

1 JAMES L. LOPES (No. 63678)
2 JEFFREY L. SCHAFFER (No. 91404)
3 JANET A. NEXON (No. 104747)
4 HOWARD, RICE, NEMEROVSKI, CANADY,
5 FALK & RABKIN
6 A Professional Corporation
7 Three Embarcadero Center, 7th Floor
8 San Francisco, California 94111-4065
9 Telephone: 415/434-1600
10 Facsimile: 415/217-5910

11 Attorneys for Debtor and Debtor in Possession
12 PACIFIC GAS AND ELECTRIC COMPANY

13 UNITED STATES BANKRUPTCY COURT
14 NORTHERN DISTRICT OF CALIFORNIA
15 SAN FRANCISCO DIVISION

16 In re
17 PACIFIC GAS AND ELECTRIC
18 COMPANY, a California corporation,
19 Debtor.
20 Federal I.D. No. 94-0742640

No. 01 30923 DM
Chapter 11 Case
Date: September 7, 2001
Time: 1:00 p.m.
Place: 235 Pine Street, 22nd Floor
San Francisco, California

HOWARD
RICE
NEMEROVSKI
CANADY
FALK
& RABKIN
A Professional Corporation

21 DEBTOR'S NOTICE OF MOTION AND MOTION
22 FOR ORDER APPROVING STIPULATION REGARDING
23 CREDIT ENHANCEMENT OF POLLUTION CONTROL REVENUE BONDS;
24 SUPPORTING MEMORANDUM OF POINTS AND AUTHORITIES

25 [SUPPORTING DECLARATIONS OF
26 MICHAEL J. DONNELLY AND STEVEN A. COHEN FILED SEPARATELY]
27
28

Acc/ Add: Kidspace Mall Center

TABLE OF CONTENTS

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Page

NOTICE OF MOTION AND MOTION 1

MEMORANDUM OF POINTS AND AUTHORITIES 2

INTRODUCTION 2

I. GENERAL BACKGROUND 2

II. THE SUBJECT BONDS AND THEIR CREDIT ENHANCEMENTS 3

A. Background and Mechanics of Subject Bond Issuances. 3

B. Letter of Credit Backed PC Bonds. 4

C. The MBIA-Enhanced 96A Bonds. 6

D. Tax-Exempt Status of Credit Enhanced PC Bonds. 7

E. Post-Chapter 11 Filing Status of Credit Enhanced PC Bonds. 8

III. SUMMARY OF TERMS OF STIPULATION 10

IV. THE COURT SHOULD APPROVE THE STIPULATION BECAUSE IT IS IN THE BEST INTEREST OF THE DEBTOR AND ITS ESTATE 14

CONCLUSION 16

HOWARD
RICE
NEMEROVSKI
CANADY
BALK
& RABKIN
A Professional Corporation

TABLE OF AUTHORITIES

Page(s)

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Statutes

11 U.S.C.	
§§1107-1108	2
§105	15, 16
§105(a)	1, 15, 16
§502(b)(2)	15
§503(b)	10
§507(a)(1)	10
Northern Dist. Local Bankr. R. 9014-1(c)(2)	1

Other Authorities

2 Lawrence P. King, <u>Collier on Bankruptcy</u> 105.01 (15th ed. rev. 2000)	16
P. Turner, <u>Letters of Credit: A Tutorial And A Look At California's New UCC Article 5</u> , <u>Business Law News</u> , at 3 (Vol. XVIII, Issue 3, Summer 1997)	15

HOWARD
RICE
NEMEROVSKI
CANADY
FALK
& RAEBURN
A Professional Corporation

1 **MEMORANDUM OF POINTS AND AUTHORITIES**

2
3 **INTRODUCTION**

4 Pacific Gas and Electric Company, the debtor and debtor in possession in the
5 above-captioned Chapter 11 case (the "Debtor" or "PG&E"), submits this Memorandum of
6 Points and Authorities In Support Of Debtor's Motion For Order Approving Stipulation
7 Regarding Credit Enhancement of Pollution Control Revenue Bonds (the "Motion"). By
8 this Motion, PG&E seeks the Court's approval of the Stipulation (a true and correct copy of
9 which is attached as Exhibit A to the Donnelly Declaration), which PG&E has entered into
10 with the various counterparties described below in order to maximize the chance that PG&E
11 can preserve for the estate and the anticipated reorganized Debtor the benefits of favorable
12 bond financing having tax-exempt status.

13
14 **I. GENERAL BACKGROUND**

15 PG&E is an investor-owned utility providing electric and gas services to millions
16 of California residents and businesses. Beginning approximately last summer, as a result of
17 the partial deregulation of the power industry, PG&E was forced to pay dramatically
18 increased wholesale prices for electricity, but has been prevented from passing these costs on
19 to retail customers, resulting in a staggering financial shortfall. In the face of the
20 deterioration in PG&E's financial condition and with little progress having been made
21 toward a resolution of the crisis, PG&E by early April 2001 determined that a Chapter 11
22 reorganization offered the best prospects for protecting the interests of its customers,
23 creditors, employees and shareholders alike. Accordingly, PG&E filed a voluntary petition
24 under Chapter 11 of the Bankruptcy Code on April 6, 2001. PG&E continues to manage and
25 operate its business and property as a debtor in possession pursuant to Sections 1107 and
26 1108 of the United States Bankruptcy Code. 11 U.S.C. §§1107-1108. No trustee has been
27 appointed.

1 **II. THE SUBJECT BONDS AND THEIR CREDIT ENHANCEMENTS¹**

2 **A. Background and Mechanics of Subject Bond Issuances.**

3 Pursuant to the terms of various separate trust indentures (each, an "Indenture")
4 each between the California Pollution Control Financing Authority, a public instrumentality
5 and political subdivision of the State of California (the "Issuer") and Bankers Trust
6 Company, as trustee (the "Bond Trustee"), and various corresponding loan agreements
7 between the Issuer and PG&E, as of the commencement of this Chapter 11 case, the Issuer
8 had issued and outstanding 15 series of its revenue bonds in aggregate principal amount of
9 approximately \$1.69 billion. As of the filing of this Motion, 11 series of such revenue bonds
10 in the aggregate principal amount of approximately \$1.24 billion remain outstanding. Of
11 this \$1.24 billion, the revenue bonds that are the subject of this Motion consist of five series
12 of credit-enhanced revenue bonds in the aggregate principal amount of approximately \$814
13 million, as set forth more specifically on Exhibit A attached to the Stipulation (collectively,
14 the "Credit Enhanced PC Bonds").²

15 The Issuer loaned the proceeds from the sale of each series of Credit Enhanced
16 PC Bonds (each a "Bond Loan" and collectively the "Bond Loans") to PG&E for the
17 purpose of financing or refinancing the acquisition and/or construction of certain pollution
18 control, sewage disposal and/or solid waste disposal facilities of PG&E located within the
19 State of California. The Bond Loans were made pursuant to the terms of various loan
20 agreements (each, a "Loan Agreement" and collectively the "Loan Agreements") between
21 the Issuer and PG&E, pursuant to which PG&E agreed, among other things, to repay the

22
23 ¹The evidentiary support for the facts set forth in this memorandum of points and
24 authorities are contained in the Donnelly Declaration filed herewith, except for certain
25 limited matters that are supported by the Cohen Declaration filed herewith. Where there is
26 no specific cite supporting a fact stated in this Motion, the evidentiary basis for such fact is
27 contained in the Donnelly Declaration. Where, on the other hand, the evidentiary support
28 for a fact is contained in the Cohen Declaration, we shall specifically cite to the Cohen
29 Declaration.

30 ²The six series of revenue bonds representing the difference between the \$1.24 billion
31 total revenue bonds outstanding and the \$814 million of Credit Enhanced PC Bonds are not
32 covered by this Motion because they are not supported by letters of credit or any
33 indemnity/insurance policies, and they therefore do not raise the issues leading to the
34 Stipulation and this Motion.

1 Bond Loans at the times and in the amounts necessary to enable the Issuer to make full and
2 timely payment of the principal of, premium, if any, and interest on, each series of Credit
3 Enhanced PC Bonds when due and to pay the purchase price of any Credit Enhanced PC
4 Bonds tendered for purchase by PG&E in accordance with the terms of the applicable
5 Indenture.

6 Pursuant to the terms of each of the Indentures, the Issuer has assigned to the
7 Bond Trustee, for the benefit of the holders of the respective series of Credit Enhanced PC
8 Bonds, certain of the Issuer's rights under the various Loan Agreements, including, but not
9 limited to, the Issuer's right under the Loan Agreements to receive payments from PG&E of
10 the principal of, premium, if any, and interest due, on the Bond Loans. In this manner, the
11 Issuer has acted solely as a conduit, loaning the proceeds from the sale of the Credit
12 Enhanced PC Bonds to PG&E and assigning its right to receive repayment of such loans to
13 the Bond Trustee as security for the Credit Enhanced PC Bonds and to provide funds for the
14 full payment of the respective Credit Enhanced PC Bonds.

15 The Credit Enhanced PC Bonds are special limited obligations of the Issuer
16 payable exclusively out of the trust estates under each of the Indentures. None of the Credit
17 Enhanced PC Bonds constitute a debt or liability, or a pledge of the faith, credit or taxing
18 power of the Issuer, the State of California or any of its instrumentalities or political
19 subdivisions. Rather, each series of Credit Enhanced PC Bonds is a limited obligation of the
20 Issuer payable solely from the revenues derived by the Issuer from PG&E pursuant to the
21 terms of the related Loan Agreement to the extent pledged by the Issuer to the Bond Trustee
22 under the terms of the applicable Indenture and from certain other funds pledged and
23 assigned as part of the trust estates under the applicable Indentures.

24 **B. Letter of Credit Backed PC Bonds.**

25 With respect to each series of Credit Enhanced PC Bonds other than the 96A
26 Bonds (collectively, the "Letter of Credit Backed PC Bonds"), PG&E entered into a
27 reimbursement agreement (each, a "Letter of Credit Reimbursement Agreement") with a
28 bank (each, a "Letter of Credit Issuing Bank") and certain banking or other financial

1 institutions (each, a "Bank"), pursuant to which the Letter of Credit Issuing Bank has issued
2 its irrevocable letter of credit (each, a "Letter of Credit") to the Bond Trustee, for the account
3 of PG&E, to provide for the payment of the principal of and interest on the related series of
4 Letter of Credit Backed PC Bonds and to support the payment of the purchase price of any
5 Letter of Credit Backed PC Bonds tendered for purchase in accordance with the terms of the
6 applicable Indenture. Under the terms of each Letter of Credit Reimbursement Agreement,
7 PG&E is obligated to reimburse the Letter of Credit Issuing Bank for all amounts drawn on
8 the related Letter of Credit.

9 Each Letter of Credit was issued in an initial stated amount (the "Stated
10 Amount") equal to the sum of (i) the aggregate outstanding principal amount of the related
11 series of Letter of Credit Backed PC Bonds (the "Principal Portion"), plus (ii) an amount
12 equal to the amount of accrued interest on the outstanding principal amount of the related
13 series of Letter of Credit Backed PC Bonds at an assumed maximum annual rate for a
14 specified period of days as set forth in the Letter of Credit (the "Interest Portion"). The
15 Stated Amount of each Letter of Credit is reduced by the amount of each drawing paid
16 thereunder, subject to the provision that (a) with respect to amounts drawn for the payment
17 of scheduled interest on the related Letter of Credit Backed PC Bonds, the Interest Portion of
18 the Stated Amount is automatically reinstated unless the Letter of Credit Issuing Bank gives
19 notice to the contrary to the Bond Trustee in accordance with the terms of the applicable the
20 Letter of Credit, and (b) with respect to amounts drawn to pay the purchase price of Letter of
21 Credit Backed PC Bonds, the amount so drawn is subject to reinstatement upon the terms set
22 forth in the applicable Letter of Credit.

23 Under the terms of each of the Indentures pursuant to which each series of Letter
24 of Credit Backed PC Bonds were issued, each regularly scheduled payment of the principal
25 of, or interest on, the Letter of Credit Backed PC Bonds is made from moneys drawn by the
26 Bond Trustee under the related Letter of Credit. The obligation of PG&E to repay the loan
27 under the Loan Agreement is deemed satisfied to the extent of any corresponding payment
28 made by the Letter of Credit Issuing Bank under the terms of the Letter of Credit. With

1 respect to each such drawing, PG&E is then obligated under the applicable Letter of Credit
2 Reimbursement Agreement to reimburse the Letter of Credit Issuing Bank for the amount of
3 such drawing. Only if the Letter of Credit Issuing Bank dishonors a drawing, or there is no
4 Letter of Credit then in effect, is the Bond Trustee authorized under the terms of the
5 Indenture to collect Bond Loan payments under the respective Loan Agreement and apply
6 such funds to the payment of the principal of, or interest on, the related Letter of Credit
7 Backed PC Bonds.

8 Accordingly, with respect to each series of Letter of Credit Backed PC Bonds for
9 which the related Letter of Credit remains outstanding, all payments of the principal of, and
10 interest on, the Letter of Credit Backed PC Bonds have been fully and timely made when
11 due from draws made by the respective Bond Trustee on the respective Letter of Credit in
12 accordance with the terms of such Letter of Credit and the related Indenture.

13 C. The MBIA-Enhanced 96A Bonds.

14 In connection with the 96A Bonds, PG&E has entered into a reimbursement and
15 indemnity agreement (the "MBIA Reimbursement Agreement" and, collectively with the
16 Letter of Credit Reimbursement Agreements, the "Reimbursement Agreements") with
17 MBIA Insurance Corporation ("MBIA") pursuant to which MBIA has issued its financial
18 guaranty insurance policy (the "PC Bond Insurance Policy") insuring the full payment of
19 regularly scheduled principal of and interest (but not premium) on the 96A Bonds.

20 The PC Bond Insurance Policy unconditionally and irrevocably guarantees (i) the
21 full and complete payment to the Bond Trustee of an amount equal to the principal of and
22 interest on the MBIA Insured PC Bonds as such payments shall become due but shall not be
23 so paid (except that in the event of any acceleration of the due date of such principal by
24 reason of redemption or acceleration or otherwise, other than any mandatory sinking fund
25 payment or mandatory redemption upon the occurrence of a determination of taxability of
26 the 96A Bonds, the payments guarantee by the PC Bond Insurance Policy shall be made in
27 such amounts and at such times as such payments of principal would have been due had
28 there not been any such acceleration); and (ii) the reimbursement of any such payment which

1 is subsequently recovered from any owner of 96A Bonds pursuant to a final judgment by a
2 court of competent jurisdiction that such payment constitutes an avoidable preference to
3 such owner within the meaning of any applicable bankruptcy law.

4 Under the terms of the MBIA Reimbursement Agreement, PG&E is obligated to
5 reimburse MBIA for all payments made by MBIA to the Bond Trustee under the PC Bond
6 Insurance Policy and to indemnify MBIA against certain liabilities, costs and expenses that it
7 may sustain in connection with the 96A Bonds.

8 **D. Tax-Exempt Status of Credit Enhanced PC Bonds.**

9 All of the Credit Enhanced PC Bonds (i.e., both the Letter of Credit Backed PC
10 Bonds and the 96A Bonds) were sold in the capital markets on the basis that, assuming
11 PG&E continues to comply with certain covenants contained in the Loan Agreements and
12 certain of the documents, instruments and agreements executed in connection therewith
13 (collectively, the "PC Bond Documents") and with certain exceptions, interest on such series
14 of Credit Enhanced PC Bonds would not be includable in the gross income of the holders
15 thereof for federal income tax purposes and that such interest is also exempt from California
16 personal income taxes.

17 The tax-exempt status of the Credit Enhanced PC Bonds has allowed such bonds
18 to be issued at favorable interest rates, thus allowing PG&E to finance certain of its capital
19 improvements and other qualified costs at rates substantially below comparable conventional
20 taxable financing alternatives available to PG&E. Based on the tax-exempt status of the
21 Credit Enhanced PC Bonds, their credit enhancement and their commensurate credit rating,
22 the Credit Enhanced PC Bonds currently accrue interest at the average blended interest rate
23 of only 3.66% per annum.³ In the event that any of the Credit Enhanced PC Bonds were to
24 be redeemed in accordance with the terms of their respective Indentures, it may not be
25 possible under current law to reissue such bonds on a tax-exempt basis. Accordingly, PG&E
26 has made the determination that the continued existence of such favorable tax-exempt

27 _____
28 ³This rate was calculated as of August 8, 2001, shortly before the filing of this Motion.

1 financing is a valuable asset of the Debtor's estate, and that it is in the best interest of the
2 Debtor's estate to keep the Credit Enhanced PC Bonds outstanding in order to preserve the
3 substantial benefits of such tax-exempt financing.

4 **E. Post-Chapter 11 Filing Status of Credit Enhanced PC Bonds.**

5 Since PG&E's Chapter 11 filing on April 6, 2001 (the "Petition Date"), all of the
6 Credit Enhanced PC Bonds have remained outstanding, and each scheduled interest payment
7 due thereon has been fully and timely made by the Bond Trustee through the use of draws
8 made on the respective Letters of Credit or payments made under the PC Bond Insurance
9 Policy. Following each such drawing, each of the Letter of Credit Issuing Banks has
10 allowed the Interest Portion of its respective Letter of Credit to automatically reinstate in
11 accordance with the terms thereof each month, which has resulted in automatic
12 reinstatements in May, June, July and August 2001. The next interest draw on the Letters of
13 Credit will be on or about September 4, 2001, and each Letter of Credit Issuing Bank
14 thereafter has until on or about September 10, 2001 to decide whether to give notice to the
15 Bond Trustee that such Letter of Credit Issuing Bank's Letter of Credit will not be reinstated
16 or to stay silent and permit an automatic reinstatement.

17 Since the Petition Date, consistent with its duties as a Chapter 11 debtor in
18 possession, PG&E has not reimbursed either the Letter of Credit Issuing Banks or MBIA for
19 any of the payments they have made pursuant to the several post-petition draws by the Bond
20 Trustee. As a result thereof, each of the Letter of Credit Issuing Banks and MBIA claim that
21 they have the right upon the passage of time, the giving of notice or both, (i) to declare a
22 default under its respective Reimbursement Agreement, (ii) to notify the Bond Trustee of
23 such default, and (iii) to direct the Bond Trustee to call an Event of Default under the terms
24 of the respective Indenture and, in accordance with the terms of the respective Indenture, to
25 cause the Bond Trustee to declare the respective series of Credit Enhanced PC Bonds
26 immediately due and payable. In such event, (i) in the case of the Letter of Credit Backed
27 PC Bonds, the Bond Trustee would, in accordance with the terms of the respective
28 Indentures and the respective Letters of Credit, draw upon the respective Letters of Credit,

1 and apply such drawn funds to the full payment and cancellation of the related outstanding
2 Letter of Credit Backed PC Bonds, with the end result that this tax-preferred financing
3 would no longer be outstanding, and (ii) in the case of the 96A Bonds, the Bond Trustee may
4 make demand upon PG&E for the full outstanding amount of the 96A Bonds and, because
5 PG&E could not honor such demand as a Chapter 11 debtor in possession, may then draw on
6 the PC Bond Insurance Policy from time to time to the extent of the regularly scheduled
7 amounts specified in the PC Bond Insurance Policy.

8 While during the first several months of this Chapter 11 case the Letter of Credit
9 Issuing Banks and MBIA (sometimes collectively referred to herein as the "Credit
10 Enhancers") refrained from taking the actions described in the preceding paragraph, they at
11 the same time indicated to PG&E that they required some type of comfort agreement with
12 PG&E that would need to be approved by the Bankruptcy Court if they were to consider any
13 further such restraint. Consistent with such position of the Credit Enhancers, PG&E during
14 the past several weeks has engaged in discussions with the Credit Enhancers, culminating in
15 the proposed Stipulation. Certain of the Credit Enhancers have indicated that unless the
16 Stipulation is presented to and approved by the Court before September 10, 2001, they may
17 proceed to take the actions described in the preceding paragraph. Similarly, some of the
18 Letter of Credit Issuing Banks have also have indicated that they in all likelihood will
19 decline to allow the automatic reinstatement of their respective Letters of Credit following
20 the September 2001 drawing, which would result in a similar acceleration of the Letter of
21 Credit Backed PC Bonds, unless the Stipulation is timely heard and approved by the Court.
22 Cohen Decl. ¶¶7-11.

23 Because such actions by the Letter of Credit Issuing Banks and/or MBIA could result
24 in the loss to PG&E and its estate of the significant benefits of the tax-exempt financing
25 afforded by the respective Credit Enhanced PC Bonds, PG&E has determined that it is in the
26 best interests of PG&E and its estate to enter into the Stipulation and to seek this Court's
27 approval of the Stipulation on or before September 7.

1 Explanation of Term No. 1: The Letter of Credit Issuing Banks and MBIA
2 believe it fair and appropriate that they have the comfort of knowing now that they will have
3 allowed claims for any post-petition payments they make to the Bond Trustee on account of
4 draws for interest, as well as for various fees and expenses incurred by them. Without this
5 comfort, certain of the Credit Enhanced PC Bonds in all likelihood would not remain
6 outstanding.

7 Term No. 2: PG&E will pay, on a current basis, the fees and reasonable out-of-
8 pocket expenses of the remarketing agents, the credit rating agencies, the tender agents and
9 the Bond Trustee associated with the maintenance of the Credit Enhanced PC Bonds as set
10 forth on Schedule 1 to the Stipulation, to the extent such fees and reasonable out-of-pocket
11 expenses are payable in accordance with the terms of the applicable underlying agreements
12 and are incurred with respect to the post-petition period. Id. ¶9.

13 Explanation of Term No. 2: The fees and expenses associated with the
14 maintenance of the Credit Enhanced PC Bonds that are set forth on Schedule 1 to the
15 Stipulation are relatively small. It is necessary to pay most or all of these fees and expenses
16 in order to further the goal of keeping the Credit-Enhanced PC Bonds outstanding and taking
17 the minimum steps necessary to maintain a market for them.

18 Term No. 3: At any time there is an “Event of Default” under the applicable
19 Reimbursement Agreements, the Letter of Credit Issuing Banks and MBIA have the
20 continuing right, pursuant to the applicable Reimbursement Agreement and Indenture, to
21 notify the Bond Trustee of the occurrence or existence of one or more “Events of Default”
22 under the applicable Reimbursement Agreements and to direct the Bond Trustee to declare
23 an “Event of Default” under such Indenture, notwithstanding their failure to exercise such
24 right at any time. In addition, so long as a Letter of Credit Issuing Bank is not reimbursed in
25 full for drawings honored by such Letter of Credit Issuing Bank under the Letter of Credit
26 issued by it, such Letter of Credit Issuing Bank shall have, among other things, the
27 continuing right (pursuant to the Letter of Credit Reimbursement Agreement pursuant to
28 which such Letter of Credit was issued, such Letter of Credit and the Indenture pursuant to

1 which the Credit Enhanced PC Bonds supported by such Letter of Credit were issued) to
2 notify the Bond Trustee of such failure to be reimbursed in full and to state that the amount
3 available to be drawn under the Letter of Credit to pay interest on such Credit Enhanced PC
4 Bonds has not been reinstated, notwithstanding the failure of the Letter of Credit Bank to
5 exercise such right at any time. Finally, the Letter of Credit Issuing Banks and the Banks
6 have the continuing right to refuse to extend the terms of the Letters of Credit upon their
7 respective maturities. At the same time, however, upon terms mutually acceptable to PG&E
8 and the respective Letter of Credit Issuing Banks and the Banks, the terms of one or more of
9 the Letters of Credit may be extended to the extent permitted under the terms of the existing
10 documents pertaining to the Credit Enhanced PC Bonds. Id. ¶¶6-8.

11 Explanation of Term No. 3: These points merely restate the existing provisions
12 of the Reimbursement Agreements and do not confer any new rights on anyone. The Letter
13 of Credit Issuing Banks and MBIA merely wanted to confirm that in entering into the
14 Stipulation, they were not intending to affect these bedrock provisions of the Reimbursement
15 Agreements.

16 Term No. 4: PG&E's previous entry into the amendments to the Reimbursement
17 Agreement with Deutsche Bank AG as the Letter of Credit Issuing Bank and with the Banks
18 parties thereto (the "DB Reimbursement Agreement"), which amendments are attached as
19 Exhibit B to the Stipulation (the "Prior Amendments"), is ratified and approved. Further,
20 PG&E consents to the form of future amendments to the DB Reimbursement Agreement,
21 substantially in the same form as the Prior Amendments, which address allocation issues
22 among Deutsche Bank AG and the Banks that are parties to the DB Reimbursement
23 Agreement; provided, however, that with the approval of PG&E and the other parties to the
24 DB Reimbursement Agreement, any one or more of such future amendments may reflect an
25 extension of time that is different than the extension contained in the Prior Amendments.
26 PG&E also consents to the form of Agreement to Extend the Letter of Credit and the related
27 form of amendment to the applicable Letters of Credit, both of which are attached as Exhibit
28 C to the Stipulation, with respect to the extension of the term of the Letters of Credit. PG&E

1 is authorized, but not required, to execute any such amendments in substantially the form of
2 Exhibits B or C to the Stipulation from time to time without further order of the Court. Id.
3 ¶¶10-12.⁴

4 Explanation of Term No. 4: With respect to the prior Amendments to
5 Reimbursement Agreement attached as Exhibit D to the Stipulation, such amendments
6 merely allocate risk among the applicable Letter of Credit Issuing Bank and the applicable
7 Banks. With respect to the prospective amendments to the Letter of Credit Reimbursement
8 Agreements and Letters of Credit in the form attached as Exhibit C to the Stipulation, the
9 requested authority merely acts to facilitate the process of keeping the Credit Enhanced PC
10 Bonds in place and outstanding by reducing the amount of time and expense necessary to do
11 so; they do not confer any new rights or obligations on any party. The Letter of Credit
12 Issuing Banks reasonably want to amend the applicable Letter of Credit Reimbursement
13 Agreements to take into account the reality that the dollar amount of the aggregate liabilities
14 of the Letter of Credit Issuing Banks and the Banks under the Letters of Credit increase each
15 month that the Letter of Credit Issuing Banks allow an automatic reinstatement to take place,
16 thus increasing the overall exposure of the Letter of Credit Issuing Banks because PG&E has
17

18 ⁴PG&E notes that the form of Agreement to Extend the Letter of Credit attached as
19 Exhibit C to the Stipulation (an "Extension Agreement") contemplates that the periodic
20 commitment fee for the applicable extension term of the applicable Letter of Credit may be
21 different than the periodic commitment fee that was applicable prior to the extension term,
22 and will only be determined by the parties at the time any such Extension Agreement is
23 entered into. PG&E further notes that any such periodic commitment fee under any such
24 Extension Agreement shall constitute an allowed claim pursuant to the provisions of
25 Paragraph 4 of the Stipulation as summarized in the text above in the paragraph entitled
26 "Term No. 1." Accordingly, PG&E, in seeking this Court's present authorization to enter
27 into any future Extension Agreement as part of the Stipulation, is also seeking authorization
28 to agree upon the applicable periodic commitment fee for the extension term at the time such
Extension Agreement is entered into. This is reasonable because commitment fees for
material extension terms of letters of credit are functionally equivalent to commitment fees
for a new letter of credit, and are typically determined based on market factors at the time
such extension is entered into. Further, there are two reasons why the Court and parties in
interest need not be concerned based on other provisions of the Stipulation: first, if the
Motion is granted, PG&E will have the authority but not the obligation to enter into any
Extension Agreement; and second, although the periodic commitment fee agreed to in any
Extension Agreement will be an allowed claim pursuant to Paragraph 4 of the Stipulation, it,
like the other claims allowed pursuant to Paragraph 4 of the Stipulation, will not be paid by
the estate on a current basis absent a further Court order.

1 not been reimbursing any of the Letter of Credit Issuing Banks for the Bond Trustee's
2 monthly interest draws since the first post-petition draw in May 2001. To the extent the
3 Letter of Credit Issuing Banks continue to allow the Letters of Credit to be reinstated, the
4 Letter of Credit Issuing Banks' unreimbursed exposure will continue to increase. PG&E has
5 every reason to want to facilitate amendments by which the Letter of Credit Issuing Banks
6 recognize the increased exposure and allocate the amount of the increase among themselves.
7 Similarly, PG&E wants the ability to facilitate the extension of the Letters of Credit so long
8 as PG&E deems an extension desirable, since extensions of the Letters of Credit will or may
9 be necessary from time to time to keep the Credit Enhanced PC Bonds in place and
10 outstanding.

11
12 **IV. THE COURT SHOULD APPROVE THE STIPULATION BECAUSE IT IS IN
13 THE BEST INTEREST OF THE DEBTOR AND ITS ESTATE.**

14 The Court should approve the Stipulation because there is little hope or prospect
15 of keeping the tax-exempt Credit Enhanced PC Bonds outstanding without approval of the
16 Stipulation. In PG&E's view, the benefits of approval of the Stipulation substantially
17 outweigh any concessions made in the Stipulation.

18 Indeed, one could argue that virtually no concession has been made in the
19 Stipulation, since (a) most of the terms of the Stipulation only seek to restate the parties'
20 existing rights under the PC Bond Documentation and do not create any new rights or
21 obligations for any party, and (b) with respect to Paragraphs 2 and 3 of the Stipulation, it
22 seems that the claims of a letter-of-credit-issuing bank against its account party under a
23 reimbursement agreement (or the similar claims of an entity like MBIA under a
24 surety/indemnity agreement) should clearly be allowable as at least general unsecured claims
25 in the account party's Chapter 11 case.

26 However, PG&E is mindful that so long as the subject Letters of Credit are
27 reinstated, the Bond Trustee's monthly drawings thereunder are used to fund interest
28 payments on the Letter of Credit Backed PC Bonds, and most of the payments made under

1 MBIA's PC Bond Insurance Policy during the term thereof are used for a similar purpose.
2 And as this Court is no doubt aware, post-petition interest is generally disallowed under
3 Section 502(b)(2) of the Bankruptcy Code, subject to limited exceptions. Thus, an argument
4 could be made that the claims of the Letter of Credit Issuing Banks under the Letter of
5 Credit Reimbursement Agreements (and MBIA under the MBIA Reimbursement
6 Agreement) in respect of draws that are utilized to fund post-petition interest payments
7 should similarly be disallowed.

8 PG&E for two reasons does not believe this argument should carry the day and
9 stand as an obstacle to approval of the Stipulation. First, by analogy to the "independence
10 principle" in letter of credit law (viz., that the obligations of the issuing bank to the
11 beneficiary and of the account party to the issuing bank are separate and independent from
12 any rights, obligations, claims or defenses of the beneficiary and account party vis-à-vis each
13 other),⁵ the issuing bank's rights and claims against the account party under the
14 reimbursement agreement should be separate and independent from the beneficiary's use of
15 the draws under the letter of credit. Thus, the fact that the Bond Trustee uses the monthly
16 draws under the Letters of Credit and the MBIA Reimbursement Agreement to pay interest
17 to the bondholders arguably should not affect the allowability of the honoring Banks' or
18 MBIA's claims under their respective reimbursement agreements.

19 Second, and in any event, here the advantage and benefit of the Credit Enhanced
20 PC Bonds are sufficiently great that the allowance issue should not become an impediment
21 to the Stipulation. This is particularly true since PG&E has repeatedly announced its intent
22 to propound a full payment plan of reorganization, which ultimately should provide for and
23 allow for the payment of all interest due on the Credit Enhanced PC Bonds to the extent not
24 previously paid in full.

25 Section 105(a) of the Bankruptcy Code authorizes this Court to "issue any order,
26 process, or judgment that is necessary or appropriate to carry out the provisions of this title."

27
28 ⁵ See generally P. Turner, Letters of Credit: A Tutorial And A Look At California's
New UCC Article 5, Business Law News, at 3 (Vol. XVIII, Issue 3, Summer 1997).

1 The purpose of Section 105 is "to assure the bankruptcy courts power to take whatever
2 action is appropriate or necessary in aid of the exercise of their jurisdiction." 2 Lawrence P.
3 King, Collier on Bankruptcy 105.01, at 105-6 (15th ed. rev. 2000). PG&E believes that the
4 principal creditors of the estate and other parties in interest noticed on this Motion will
5 support the Stipulation because it is plainly in the best interests of the estate, and that this
6 Court's approval of the Stipulation will help facilitate the efficient administration of the
7 estate and, as the ultimate goal of a successful Chapter 11 case, a confirmable plan of
8 reorganization. On the present facts, where the substantial benefits of the tax-exempt Credit
9 Enhanced PC Bonds may be lost to the estate immediately if the Stipulation is not approved,
10 approval of the Stipulation is consistent with both the letter and spirit of Section 105(a).

11 **CONCLUSION**

12 For all of the foregoing reasons, PG&E respectfully requests that this Court make
13 and enter its order granting the Motion, thereby approving the terms of the Stipulation that
14 PG&E has provisionally entered into with the Letter of Credit Issuing Banks and MBIA.

15 DATED: August 10, 2001

HOWARD
RICE
NEMEROVSKI
CANADY
FALK
& RABKIN
A Professional Corporation

16 Respectfully,

17 HOWARD, RICE, NEMEROVSKI, CANADY,
18 FALK & RABKIN
A Professional Corporation

19 By: 
20 JEFFREY L. SCHAFER

21 Attorneys for Debtor and Debtor in Possession
22 PACIFIC GAS AND ELECTRIC COMPANY

23 WD 081001/F-1419911/Y7/935348/v6

24
25
26
27
28