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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 Case No. 01-30923 DM
21 Chapter 11 Case
22 Date: March 25, 2002
23 Time: 9:30 a.m.
24 Place: 235 Pine Street, 22nd Floor
25 San Francisco, California

26 Federal I.D. No. 94-0742640

27 HOWARD
28 RICE
NEMEROVSKI
CANADY
FALK
& RABKIN
A Professional Corporation

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DECLARATION OF KENT M. HARVEY IN SUPPORT OF MOTION
BY PACIFIC GAS AND ELECTRIC COMPANY FOR ORDER
(A) APPROVING SETTLEMENT AND SUPPORT AGREEMENT
BY AND AMONG PLAN PROPONENTS AND SENIOR DEBTHOLDERS,
(B) AUTHORIZING PAYMENT OF PRE- AND POST-PETITION INTEREST
TO HOLDERS OF UNDISPUTED CLAIMS IN CERTAIN CLASSES,
(C) AUTHORIZING PAYMENT OF FEES AND EXPENSES OF
INDENTURE TRUSTEES AND PAYING AGENTS AND
(D) AUTHORIZING DEBTOR TO ENTER INTO SIMILAR SETTLEMENTS

DECLARATION OF KENT HARVEY ISO SETTLEMENT

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ADD

1 I, Kent M. Harvey, declare as follows:

2 1. I am the chief financial officer of Pacific Gas and Electric Company
3 ("PG&E" or the "Debtor"), the debtor and debtor-in-possession in this Chapter 11 Case.
4 This Declaration is based on my personal knowledge of PG&E's operations and financial
5 position. If called as a witness, I could and would testify competently to the facts stated
6 herein.

7 2. I make this declaration in support of PG&E's motion (the "Motion") for
8 entry of an order (a) approving that certain Settlement and Support Agreement, dated
9 February 12, 2002, by and among PG&E, PG&E Corporation and the Senior Debtholders¹
10 (the "Settlement Agreement"), (b) authorizing the Debtor to make payments of Pre-Petition
11 Interest and Post-Petition Interest to the holders of undisputed Claims in certain Classes
12 during the Chapter 11 Case, (c) authorizing the Debtor to pay, on an on-going basis, the fees
13 and expenses of any applicable indenture trustees and administrative bank or other paying
14 agents responsible for making distributions to beneficial holders of financial debt, and
15 (d) authorizing the Debtor to enter into additional settlement agreements with other holders
16 of Class 5 Claims on substantially similar terms, without the need for further Court
17 approvals.

18 3. A true and correct copy of the Settlement Agreement is annexed as
19 Exhibit "A" hereto.

20 4. The Settlement Agreement reflects the Debtor's business judgment that it is
21 economically prudent and in the best interest of the estate to compromise the disputes
22 between the Debtor and the Senior Debtholders rather than engage in costly and distracting
23 litigation that could delay the administration of the estate.

24 5. PG&E also believes that sound business reasons exist for PG&E to make
25 early payments of interest during the Chapter 11 Case to the Senior Debtholders and other
26

27 ¹Capitalized terms not defined herein have the meanings ascribed to them in the Settlement
28 Agreement or in the First Amended Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for
Pacific Gas and Electric Company, dated January 10, 2002.

1 holders of undisputed Claims in certain Classes. It is my understanding that, as a solvent
2 debtor, PG&E will be required to pay interest to the holders of certain Claims² under a plan
3 of reorganization. Thus, PG&E's payment of Pre-Petition Interest and Post-Petition Interest
4 to these creditors is inevitable. Because PG&E has not been able to make interest payments
5 during the Chapter 11 Case, however, it is forced to compound accrued interest on Claims at
6 rates that are significantly higher than the rates its cash investments earn in today's financial
7 markets—thus creating a negative arbitrage to PG&E.

8 6. The Debtor's inability to make current interest payments has resulted (and
9 will continue to result) in the estate incurring unnecessary interest expenses. The average
10 interest rate earned on PG&E's unpaid financial debt (the "Financial Debt") is
11 approximately 7.9%, and the average interest rate on PG&E's unpaid non-financial debt (the
12 "Non-Financial Debt") is 5.5%. This interest is compounded, in most cases, on a quarterly
13 or semi-annual basis. At the same time, the returns earned on PG&E's existing cash are
14 suffering from the current low interest rate environment. PG&E's cash (\$4.22 billion as of
15 December 31, 2001) is primarily invested in money market funds, which experienced an
16 average annual return of 2.15% during the month of December, 2001 and an average annual
17 return of 2.00% during the month of January, 2002.

18 7. As of March 31, 2002, PG&E estimates that it will have accrued
19 approximately \$477 million in interest on Financial Debt alone. Because of the
20 compounding of interest, a nine month delay in the payment of interest (i.e., to
21 December 31, 2002) on the Financial Debt will increase PG&E's interest payments by
22 approximately \$35 million. At the same time, the interest PG&E will likely earn on its
23 investment of the cash that would be used to pay accrued interest, during the period from
24 March 31, 2002 through December 31, 2002, would offset these increased interest expenses
25 by only an estimated \$6 million. Thus, PG&E will enjoy a net savings of \$29 million if it is
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27 ²Under the Plan, certain Claims—Administrative Expense Claims, Environmental, Fire Suppression
28 and Tort Claims and Chromium Litigation Claims—do not earn interest. Accordingly, these Claims are not
included in the Classes of Claims for which PG&E seeks authorization to pay interest.

1 allowed to make interest payments on its Financial Debt during the period from March 31,
2 2002 through December 31, 2002. In addition, PG&E will similarly save approximately \$2
3 million by making interest payments to the holders of Non-Financial Debt during the six
4 month period from July 1, 2002 through December 31, 2002.³ Accordingly, if PG&E is
5 permitted to make interest payments as contemplated by the Motion, PG&E will save
6 approximately \$31 million during the nine-month period ending December 31, 2002.

7 8. PG&E has sufficient cash stores on hand to make these interest payments.
8 The initial interest payments on Financial Debt are estimated to aggregate approximately
9 \$477 million and projected subsequent quarterly interest payments on such Financial Debt
10 through December 31, 2002 are estimated to aggregate approximately \$313 million. The
11 initial interest payments on Non-Financial Debt are estimated to aggregate approximately
12 \$157 million and projected subsequent quarterly interest payments on such Non-Financial
13 Debt through December 31, 2002 are estimated to aggregate approximately \$57 million.

14 I declare under penalty of perjury under the laws of the United States of America
15 and the State of California that the foregoing is true and correct. Executed this 5th day of
16 March, 2002 at San Francisco, California.

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18 DATED: March 5, 2002.

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KENT M. HARVEY

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27 ³As set forth in more detail in the Motion, PG&E proposes to commence interest payments on Non-
28 Financial Debt no later than July 30, 2002. PG&E requires this additional time to reconcile and determine
which Claims based on Non-Financial Debt are disputed before commencing interest payments on these
Claims. Interest would continue to accrue on these Claims until paid.

Exhibits are not attached to the service copies of this document. You may obtain copies of the Exhibits in one of the following ways: through the "Pacific Gas & Electric Company Chapter 11 Case" link accessible through the Bankruptcy Court's website (www.canb.uscourts.gov), or by written request to Howard, Rice, Nemerovski, Canady, Falk & Rabkin, Attn: Racquel Lopez, Three Embarcadero Center, 7th Floor, San Francisco, California 94111-4065