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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

In re
PACIFIC GAS AND ELECTRIC
COMPANY, a California corporation,

Debtor.

Federal I.D. No. 94-0742640

No. 01-30923 DM
Chapter 11 Case
Date: April 9, 2002
Time: 1:30 p.m.
Place: 235 Pine Street, 22nd Floor
San Francisco, California
Judge: Hon. Dennis Montali

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DEBTOR'S NOTICE OF MOTION AND MOTION
FOR ORDER APPROVING DEBTOR'S EXECUTION AND PERFORMANCE UNDER
THE SUMMARY OF TERMS WITH RESPECT TO FORBEARANCE AND PROPOSED
REVISED TREATMENT OF LETTER OF CREDIT BANK CLAIMS IN THE PLAN OF
REORGANIZATION;
SUPPORTING MEMORANDUM OF POINTS AND AUTHORITIES

[SUPPORTING DECLARATION OF
MICHAEL J. DONNELLY FILED SEPARATELY]

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NOTICE OF MOTION AND MOTION

PLEASE TAKE NOTICE that on April 9, 2002, at 1:30 p.m., or as soon thereafter as the matter may be heard, in the Courtroom of the Honorable Dennis Montali, located at 235 Pine Street, 22nd Floor, San Francisco, California, Pacific Gas and Electric Company, the debtor and debtor in possession in the above-captioned Chapter 11 case ("PG&E" or the "Debtor"), will and hereby does move the Court (the "Motion") for entry of an order approving PG&E's execution of, and performance under, a Summary of Terms With Respect to Forbearance and Proposed Revised Treatment of Letter of Credit Bank Claims in the Plan of Reorganization (the "Term Sheet") by and between PG&E, on the one hand, and various counterparties who have provided credit support for the outstanding bonds that are the subject of the Motion.

This Motion is made pursuant to Sections 105(a) and 363 of the United States Bankruptcy Code (11 U.S.C. §§105(a) and 363) and Rule 9019(a) of the Federal Rules of Bankruptcy Procedure, and is based on the facts and law set forth herein (including the accompanying Memorandum of Points and Authorities beginning on the next page), the Declaration of Michael J. Donnelly filed concurrently herewith (hereinafter referred to as the "Donnelly Declaration" and cited as the "Donnelly Decl."), the record of this case and any evidence presented at or prior to the hearing on this Motion.

PLEASE TAKE FURTHER NOTICE that pursuant to Rule 9014-1(c)(2) of the Bankruptcy Local Rules for the Northern District of California, any written opposition to the Motion and the relief requested therein must be filed with the Bankruptcy Court and served upon appropriate parties (including counsel for PG&E, the Office of the United States Trustee and the Official Committee of Unsecured Creditors) at least five (5) days prior to the scheduled hearing date. If there is no timely objection to the requested relief, the Court may enter an order granting such relief without further hearing.

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2 **MEMORANDUM OF POINTS AND AUTHORITIES**

3
4 **INTRODUCTION**

5 Pacific Gas and Electric Company, the debtor and debtor in possession in the
6 above-captioned Chapter 11 case (the "Debtor" or "PG&E"), submits this Memorandum of
7 Points and Authorities In Support Of Debtor's Motion For Order Approving the Debtor's
8 execution of, and performance under, a Summary of Terms With Respect to Forbearance
9 and Proposed Revised Treatment of Letter of Credit Bank Claims in the Plan of
10 Reorganization (the "Motion"). By this Motion, PG&E seeks the Court's approval of
11 PG&E's execution of, and performance under, the Summary of Terms With Respect to
12 Forbearance and Proposed Revised Treatment of Letter of Credit Bank Claims in the Plan of
13 Reorganization (the "Term Sheet," a true and correct copy of which is attached as Exhibit A
14 to the Donnelly Declaration), which PG&E has entered into with the various counterparties
15 described below, subject to Bankruptcy Court approval, in order to maximize the chance that
16 PG&E can preserve for the bankruptcy estate and the anticipated reorganized Debtor the
17 benefits of favorable tax-exempt bond financing. This Motion is related to, but distinct
18 from, the Debtor's Motion For Order Approving Stipulation Regarding Credit Enhancement
19 of Pollution Control Revenue Bonds dated August 10, 2001 (Docket No. 1822), which was
20 granted by this Court's Order dated September 7, 2001 (Docket No. 2068) (hereinafter the
21 "Prior Motion and Order").

22 **OVERVIEW**

23 As described more fully below, PG&E is currently benefiting from certain below-
24 market-rate loans made to PG&E by the California Pollution Control Financing Authority
25 with the proceeds from the sale of certain tax-exempt revenue bonds. The bonds are secured
26 by certain letters of credit, and PG&E is obligated to repay the loans by reimbursing the
27 Letter of Credit issuing banks for all draws made on the letters of credit that are used to pay
28 the bonds.

1 PG&E derives substantial benefit, in the form of reduced borrowing costs, by
2 maintaining the bonds and the resulting loans outstanding. However, pursuant to their terms,
3 the bonds cannot remain outstanding unless they continue to be secured by letters of credit
4 or certain other forms of credit enhancement.

5 Under their current terms, due to certain defaults by PG&E as debtor in
6 possession, the letter of credit issuing banks currently have the right to cause the bonds to be
7 redeemed through draws on their letters of credit. Further, unless the letter of credit issuing
8 banks elect to extend the maturity of their letters of credit, certain of the letters of credit
9 expire in accordance with their terms prior to the date that PG&E anticipates any plan of
10 reorganization could become effective.

11 Accordingly, PG&E desires to enter into a consensual arrangement with the letter
12 of credit issuing banks, as set forth in the Term Sheet, pursuant to which, among other
13 things, in exchange for an increase in the letter of credit fees payable by PG&E and the
14 current payment of certain fees and expenses of the letter of credit issuing banks, such banks
15 would agree to maintain their existing letter of credit for the benefit of PG&E, extend the
16 maturity of their letters of credit, allow the existing letters of credit to continue to be drawn
17 to pay accruing interest on outstanding tax-exempt bonds, and take certain other actions in
18 cooperation with PG&E to keep the tax-exempt bonds, and the related below-market-rate
19 loans to PG&E, outstanding.

20 For the reasons set forth above and as more fully described below, PG&E
21 believes that the agreement set forth in the Term Sheet is beneficial to the Debtor and its
22 estate and, accordingly, should be approved by the Court.

23 24 I. GENERAL BACKGROUND

25 PG&E is an investor-owned utility providing electric and gas services to millions
26 of California residents and businesses. Beginning approximately in the summer of 2000, as
27 a result of the partial deregulation of the power industry, PG&E was forced to pay
28 dramatically increased wholesale prices for electricity, but was prevented from passing these

1 costs on to retail customers, resulting in a staggering financial shortfall. In the face of the
2 deterioration in PG&E's financial condition and with little progress having been made
3 toward a resolution of the crisis, PG&E by early April 2001 determined that a Chapter 11
4 reorganization offered the best prospects for protecting the interests of its customers,
5 creditors, employees and shareholders alike. Accordingly, PG&E filed a voluntary petition
6 under Chapter 11 of the Bankruptcy Code on April 6, 2001. PG&E continues to manage and
7 operate its business and property as a debtor in possession pursuant to Sections 1107 and
8 1108 of the United States Bankruptcy Code. 11 U.S.C. §§1107-1108. On September 10,
9 2001, PG&E and its parent company, PG&E Corporation, jointly propounded and filed a
10 Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for Pacific Gas and
11 Electric Company (the "Plan"), which Plan has been amended by a Second Amended Plan of
12 Reorganization filed March 7, 2002 (the Plan, as so amended and as may be further modified
13 prior to the hearing on this Motion, being hereinafter referred to as the "Amended Plan").

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II. THE SUBJECT BONDS AND THEIR CREDIT ENHANCEMENTS¹

A. Background and Mechanics of Subject Bond Issuances.

Pursuant to the terms of various separate trust indentures (each, an "Indenture")
each between the California Pollution Control Financing Authority, a public instrumentality
and political subdivision of the State of California (the "Issuer") and Bankers Trust
Company, as trustee (the "Bond Trustee"), and various corresponding loan agreements
between the Issuer and PG&E, as of the commencement of this Chapter 11 case, the Issuer
had issued and outstanding 15 series of its revenue bonds in aggregate principal amount of
approximately \$1.69 billion. As of the filing of this Motion, 11 series of such revenue bonds
in the aggregate principal amount of approximately \$1.24 billion remain outstanding. Of
this \$1.24 billion, the revenue bonds that are the subject of this Motion consist of four series
of credit-enhanced revenue bonds in the aggregate principal amount of approximately

¹The evidentiary support for the facts set forth in this memorandum of points and authorities are contained in the Donnelly Declaration filed herewith.

1 \$613,550,000, as set forth more specifically on Schedule 1 attached to the Term Sheet
2 (collectively, the "Letter of Credit Backed PC Bonds").²

3 The Issuer loaned the proceeds from the sale of each series of Letter of Credit
4 Backed PC Bonds (each a "Bond Loan" and collectively the "Bond Loans") to PG&E for the
5 purpose of financing or refinancing the acquisition and/or construction of certain pollution
6 control, sewage disposal and/or solid waste disposal facilities of PG&E located within the
7 State of California. The Bond Loans were made pursuant to the terms of various loan
8 agreements (each, a "Loan Agreement" and collectively the "Loan Agreements") between
9 the Issuer and PG&E, pursuant to which PG&E agreed, among other things, to repay the
10 Bond Loans at the times and in the amounts necessary to enable the Issuer to make full and
11 timely payment of the principal of, premium, if any, and interest on, each series of Letter of
12 Credit Backed PC Bonds when due and to pay the purchase price of any Letter of Credit
13 Backed PC Bonds tendered for purchase by PG&E in accordance with the terms of the
14 applicable Indenture.

15 Pursuant to the terms of each of the Indentures, the Issuer has assigned to the
16 Bond Trustee, for the benefit of the holders of the respective series of Letter of Credit
17 Backed PC Bonds, certain of the Issuer's rights under the various Loan Agreements,
18 including, but not limited to, the Issuer's right under the Loan Agreements to receive
19 payments from PG&E of the principal of, and premium (if any) and interest on, the Bond
20 Loans. In this manner, the Issuer has acted solely as a conduit, loaning the proceeds from
21 the sale of the Letter of Credit Backed PC Bonds to PG&E and assigning its right to receive
22 repayment of such loans to the Bond Trustee as security for the Letter of Credit Backed PC
23 Bonds and to provide funds for the full payment of the respective Letter of Credit Backed
24 PC Bonds.

25 The Letter of Credit Backed PC Bonds are special limited obligations of the

26 _____
27 ²The seven series of revenue bonds representing the difference between the \$1.24
28 billion total revenue bonds outstanding and the \$613,550,000 of Letter of Credit Backed PC
Bonds are not covered by this Motion because they are not supported by letters of credit, and
they therefore do not raise the issues leading to the Term Sheet and this Motion.

1 Issuer payable exclusively out of the trust estates under each of the Indentures. None of the
2 Letter of Credit Backed PC Bonds constitute a debt or liability, or a pledge of the faith,
3 credit or taxing power of the Issuer, the State of California or any of its instrumentalities or
4 political subdivisions. Rather, each series of Letter of Credit Backed PC Bonds is a limited
5 obligation of the Issuer payable solely from the revenues derived by the Issuer from PG&E
6 pursuant to the terms of the related Loan Agreement to the extent pledged by the Issuer to
7 the Bond Trustee under the terms of the applicable Indenture and from certain other funds
8 pledged and assigned as part of the trust estates under the applicable Indentures.

9 **B. Letter of Credit Backed PC Bonds:**

10 With respect to each series of Letter of Credit Backed PC Bonds, PG&E entered
11 into a reimbursement agreement (each, a "Letter of Credit Reimbursement Agreement") with
12 a bank (each, a "Letter of Credit Issuing Bank") and certain banking or other financial
13 institutions (each, a "Bank"), pursuant to which the Letter of Credit Issuing Bank has issued
14 its irrevocable letter of credit (each, a "Letter of Credit") to the Bond Trustee, for the account
15 of PG&E, to provide for the payment of the principal of and interest on the related series of
16 Letter of Credit Backed PC Bonds and to support the payment of the purchase price of any
17 Letter of Credit Backed PC Bonds tendered for purchase in accordance with the terms of the
18 applicable Indenture. Under the terms of each Letter of Credit Reimbursement Agreement,
19 PG&E is obligated to reimburse the Letter of Credit Issuing Bank for all amounts drawn on
20 the related Letter of Credit.

21 Each Letter of Credit was issued in an initial stated amount (the "Stated
22 Amount") equal to the sum of (i) the aggregate outstanding principal amount of the related
23 series of Letter of Credit Backed PC Bonds (the "Principal Portion"), plus (ii) an amount
24 equal to the amount of accrued interest on the outstanding principal amount of the related
25 series of Letter of Credit Backed PC Bonds at an assumed maximum annual rate for a
26 specified period of days as set forth in the Letter of Credit (the "Interest Portion"). The
27 Stated Amount of each Letter of Credit is reduced by the amount of each drawing paid
28 thereunder, subject to the provision that (a) with respect to amounts drawn for the payment

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1 of scheduled interest on the related Letter of Credit Backed PC Bonds, the Interest Portion of
2 the Stated Amount is automatically reinstated unless the Letter of Credit Issuing Bank gives
3 notice to the contrary to the Bond Trustee in accordance with the terms of the applicable
4 Letter of Credit, and (b) with respect to amounts drawn to pay the purchase price of Letter of
5 Credit Backed PC Bonds, the amount so drawn is subject to reinstatement upon the terms set
6 forth in the applicable Letter of Credit.

7 Under the terms of each of the Indentures pursuant to which each series of Letter
8 of Credit Backed PC Bonds were issued, each regularly scheduled payment of the principal
9 of, or interest on, the Letter of Credit Backed PC Bonds is made from moneys drawn by the
10 Bond Trustee under the related Letter of Credit. The obligation of PG&E to repay the loan
11 under the Loan Agreement is deemed satisfied to the extent of any corresponding payment
12 made by the Letter of Credit Issuing Bank under the terms of the Letter of Credit. With
13 respect to each such drawing, PG&E is then obligated under the applicable Letter of Credit
14 Reimbursement Agreement to reimburse the Letter of Credit Issuing Bank for the amount of
15 such drawing. Only if the Letter of Credit Issuing Bank dishonors a drawing, or there is no
16 Letter of Credit then in effect, is the Bond Trustee authorized under the terms of the
17 Indenture to collect Bond Loan payments under the respective Loan Agreement and apply
18 such funds to the payment of the principal of, or interest on, the related Letter of Credit
19 Backed PC Bonds.

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

25 C. Tax-Exempt Status of Letter of Credit Backed PC Bonds.

26 All of the Letter of Credit Backed PC Bonds were sold in the capital markets on
27 the basis that, assuming PG&E continued to comply with certain covenants contained in the
28 Loan Agreements and certain of the documents, instruments and agreements executed in

1 connection therewith (collectively, the "PC Bond Documents") and with certain exceptions,
2 interest on such series of Letter of Credit Backed PC Bonds would not be includable in the
3 gross income of the holders thereof for federal income tax purposes and that such interest is
4 also exempt from California personal income taxes.

5 The tax-exempt status of the Letter of Credit Backed PC Bonds allowed such
6 bonds to be issued at favorable interest rates, thus allowing PG&E to finance certain of its
7 capital improvements and other qualified costs at rates substantially below comparable
8 conventional taxable financing alternatives available to PG&E. Based on the tax-exempt
9 status of the Letter of Credit Backed PC Bonds, their credit enhancement and their
10 commensurate credit rating, the Letter of Credit Backed PC Bonds currently accrue interest
11 at the average blended interest rate of only 1.26 % per annum,³ and at least some of PG&E's
12 tax-exempt bonds on a recent date (March 5, 2002) accrued interest at a rate of less than 1%
13 per annum. In the event that any of the Letter of Credit Backed PC Bonds were to be
14 redeemed in accordance with the terms of their respective Indentures, it may not be possible
15 under current law to reissue such bonds on a tax-exempt basis. Accordingly, PG&E has
16 made the determination that the continued existence of such favorable tax-exempt financing
17 is a valuable asset of PG&E's bankruptcy estate, and that it is in the best interest of PG&E's
18 estate to keep the Letter of Credit Backed PC Bonds outstanding in order to preserve the
19 substantial benefits of such tax-exempt financing.

20 **D. Post-Chapter 11 Filing Status of Letter of Credit Backed PC Bonds.**

21 Since PG&E's Chapter 11 filing on April 6, 2001 (the "Petition Date"), all of the
22 Letter of Credit Backed PC Bonds have remained outstanding, and all of the scheduled
23 interest payments on the Letter of Credit Backed PC Bonds have been fully and timely paid,
24 when due, through periodic draws by the Bond Trustee on the Letters of Credit provided by
25 the Letter of Credit Issuing Banks. To date, following each such drawing, each of the Letter
26 of Credit Issuing Banks has allowed the Interest Portion of its respective Letter of Credit to
27

28 ³This rate was calculated as of March 1, 2002, shortly before the filing of this Motion.

1 automatically reinstate in accordance with the terms thereof each month, which has resulted
2 in automatic reinstatements each month since PG&E's Chapter 11 filing in April 2001. This
3 in large part is the result of the interim stipulation negotiated between PG&E, the Letter of
4 Credit Issuing Banks and the Banks (among others) during the first few months of this case,
5 culminating in the Prior Motion and Order in September 2001.

6 Pursuant to the Prior Motion and Order and the interim stipulation approved
7 therein, the Letter of Credit Issuing Banks did not obligate themselves to allow any Letter of
8 Credit to be reinstated automatically and instead reserved the right in any month to give a
9 notice of nonreinstatement and trigger the presentment of any Letter of Credit. However, as
10 a small and fair incentive for the Letter of Credit Issuing Banks to allow automatic
11 reinstatement to take place while negotiations over a more permanent resolution of the Letter
12 of Credit issues was being negotiated, the estate agreed pursuant to the Prior Motion and
13 Order that with respect to any automatic reinstatements and draws for interest that occur
14 post-petition as a consequence of the Letter of Credit Issuing Banks allowing the automatic
15 reinstatement to take place, any post-petition interest drawings under the Letters of Credit
16 will constitute allowed claims against PG&E and its bankruptcy estate in favor of the Letter
17 of Credit Issuing Banks. Similarly, the Prior Motion and Order provides that, subject to
18 certain conditions, the fees and expenses of the Letter of Credit Issuing Banks and the Banks
19 (including the post-petition fees and expenses of unrelated third-party professionals retained
20 by the Letter of Credit Issuing Banks and the Banks), to the extent provided for under the
21 applicable Reimbursement Agreement, will constitute allowed claims against PG&E and its
22 bankruptcy estate. Pursuant to the Prior Motion and Order, PG&E also was authorized to
23 pay on a current basis certain fees and reasonable out-of-pocket expenses of the remarketing
24 agents, the credit rating agencies, the tender agents and the Bond Trustee associated with the
25 maintenance of the Letter of Credit Backed PC Bonds, to the extent such fees and expenses
26 are payable in accordance with the terms of the applicable underlying agreements and are
27 incurred with respect to the post-petition period.

28 The next interest draw on the Letters of Credit will be on or about April 1, 2002,

1 and each Letter of Credit Issuing Bank thereafter has until on or about April 8, 2002 to
2 decide whether to give notice to the Bond Trustee that such Letter of Credit Issuing Bank's
3 Letter of Credit will not be reinstated or to stay silent and permit an automatic reinstatement.

4 Since the Petition Date, consistent with its duties as a Chapter 11 debtor in
5 possession, the Debtor has not reimbursed the Letter of Credit Issuing Banks for any of the
6 payments they have made pursuant to the monthly post-petition draws by the Bond Trustee.
7 As a result thereof, during the period that one or more "Events or Defaults" under its
8 Reimbursement Agreement continue to exist, each of the Letter of Credit Issuing Banks has
9 the right upon the passage of time, the giving of notice or both, (i) to declare a default under
10 its respective Reimbursement Agreement, (ii) to notify the Bond Trustee of such default, and
11 (iii) to direct the Bond Trustee to call an Event of Default under the terms of the respective
12 Indenture and, in accordance with the terms of the respective Indenture, to cause the Bond
13 Trustee to declare the respective series of Letter of Credit Backed PC Bonds immediately
14 due and payable. In such event the Bond Trustee would, in accordance with the terms of the
15 respective Indentures and the respective Letters of Credit, draw upon the respective Letters
16 of Credit, and apply such drawn funds to the full payment and cancellation of the related
17 outstanding Letter of Credit Backed PC Bonds, with the end result that this tax-preferred
18 financing would no longer be outstanding.

19 Further, each of the Letters of Credit will expire in accordance with its terms on
20 the expiry date set forth on Schedule 1 attached to the Term Sheet. Pursuant to the terms of
21 each of the Indentures, with respect to each series of Letter of Credit Backed PC Bonds,
22 subject to certain exceptions, unless the Bond Trustee shall have received either (a) a
23 renewal or extension of the existing Letter of Credit for a period of at least one year, or (b) a
24 substitute letter of credit or other credit facility meeting the requirements of the respective
25 Loan Agreement and Indenture at least 35 days prior to the expiration date of the respective
26 Letter of Credit, the Bond Trustee is required to call the series of Letter of Credit Backed PC
27 Bonds for redemption and cancellation on the last business day which is at least five
28 calendar days preceding the expiration date of the respective Letter of Credit. In such event

1 the Bond Trustee would again, in accordance with the terms of the respective Indenture and
2 the respective Letter of Credit, draw upon the respective Letter of Credit, and apply such
3 drawn funds to the full payment and cancellation of the related series of outstanding Letter
4 of Credit Backed PC Bonds, with the end result that this tax-preferred financing would no
5 longer be outstanding.

6 As an accommodation to PG&E and relying on the modest concession made to
7 them in the Prior Motion and Order, the Letter of Credit Issuing Banks have thus far
8 refrained from taking the actions described above which would result in the redemption of
9 the Letter of Credit Backed PC Bonds. However, absent a further consensual agreement
10 between PG&E and the Letter of Credit Issuing Banks, the Letter of Credit Issuing Banks
11 have no obligation either to (i) continue to forbear from the exercise of their remedies under
12 their respective Reimbursement Agreements and the related Indentures (which could result
13 in the redemption of the related series of Letter of Credit Backed PC Bonds), or (ii) provide
14 an extension of the stated expiration of their Letters of Credit (which may be necessary to
15 avoid the redemption of the related series of Letter of Credit Backed PC Bonds).

16 PG&E, the Letter of Credit Issuing Banks and the Banks always intended that the
17 interim stipulation approved by the Prior Motion and Order would be a "bridge" to allow
18 PG&E time to try and obtain the Letter of Credit Issuing Banks' and the Banks' concurrence
19 to a long-term solution via negotiated provisions in a plan of reorganization. Accordingly,
20 once the Plan was filed in September 2002, PG&E and the Letter of Credit Issuing Banks
21 began negotiating in earnest for such a long-term solution to be incorporated into the Plan
22 via an amendment, plus whatever additional short-term provisions the parties might deem
23 appropriate.

24 The Letter of Credit Banks have indicated to PG&E that, subject to certain
25 conditions, they would agree to continue to forbear from exercising their remedies under
26 their respective Reimbursement Agreements and the related Indentures and would agree to
27 extend the terms of their Letters of Credit in order to provide PG&E with more time to
28 confirm and effectuate a plan of reorganization that would permit the reorganized Debtor to

1 retain the benefits of the tax-exempt exempt financing offered by the continued existence of
2 the Letter of Credit Backed PC Bonds. Consistent with such position of the Letter of Credit
3 Issuing Banks, during the past several months PG&E has engaged in discussions with the
4 Letter of Credit Issuing Banks, culminating in the proposed Term Sheet.

5 Because either expiration of the Letters of Credit or the exercise by the Letter of
6 Credit Issuing Banks of their remedies under their respective Reimbursement Agreements
7 and the related Indentures could result in the redemption of the Letter of Credit Backed PC
8 Bonds, which in turn could result in the permanent loss to PG&E and its bankruptcy estate
9 of the significant benefits of the tax-exempt financing afforded by the respective Letter of
10 Credit Backed PC Bonds, and because the Letter of Credit Issuing Banks have offered
11 certain financial incentives to PG&E if PG&E's execution of and performance under the
12 Term Sheet is approved by the Bankruptcy Court on or prior to May 7, 2002, PG&E has
13 determined that it is in the best interests of the estate and its creditors for PG&E to enter into
14 the Term Sheet and to seek this Court's approval of PG&E's execution of, and performance
15 under, the terms of the Term Sheet on or before May 7, 2002.

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16 17 III. SUMMARY OF TERMS OF THE TERM SHEET

18 As noted above, a true and correct copy of the Term Sheet is attached as Exhibit
19 A to the Donnelly Declaration. The principal terms of the Term Sheet are summarized and
20 explained as follows:

21 A. Agreements by the Letter of Credit Issuing Banks.

22 Forbearance: During the period commencing on the date that the "Consent to
23 Term Sheet" in the form attached to the Term Sheet has been fully executed by PG&E and
24 each of the Letter of Credit Issuing Banks (the "Term Sheet Approval Date") and ending,
25 with respect to each Letter of Credit, upon the earlier of: (i) the last interest payment date on
26 the related series of Letter of Credit Backed PC Bonds immediately preceding the expiration
27 date of such Letter of Credit, as such expiration date shall be extended in accordance with
28 the terms of the Term Sheet, and (ii) the occurrence of a "Termination Event" (as hereinafter

1 defined), each of the Letter of Credit Issuing Banks has agreed to (i) maintain its Letter of
2 Credit outstanding in its current stated amount, and (ii) not provide the Bond Trustee with
3 notice of any default under its Reimbursement Agreement or non-reinstatement of its Letter
4 of Credit or take any other action which would result in the mandatory tender or redemption
5 of any of the outstanding Letter of Credit Backed PC Bonds without the prior written
6 consent of PG&E.

7 For such purpose, a "Termination Event" shall have occurred, and the Letter of
8 Credit Issuing Banks will no longer be obligated to continue to forbear from the exercise of
9 their remedies under their respective Reimbursement Agreements and the related Indentures
10 if (a) PG&E fails to pursue this Motion in good faith and with all reasonable diligence, (b)
11 PG&E fails to timely remit to the Letter of Credit Issuing Banks any of the payments set
12 forth in the Term Sheet, (c) a plan of reorganization of PG&E which provides for the
13 treatment of Allowed Letter of Credit Bank Claims (as defined in the Plan) in the manner
14 described in the Term Sheet or for alternative treatment of Allowed Letter of Credit Bank
15 Claims which is acceptable to the Letter of Credit Issuing Banks is not confirmed on or
16 before September 30, 2002, (d) a plan of reorganization is confirmed in PG&E's Chapter 11
17 case which does not provide for the treatment of Allowed Letter of Credit Bank Claims in
18 the manner described in the Term Sheet or for alternative treatment of Allowed Letter of
19 Credit Bank Claims which is acceptable to the Letter of Credit Issuing Banks, (e) the
20 "Effective Date" as defined in the Plan (the "Effective Date") occurs, or (f) the Chapter 11
21 case of PG&E is dismissed or converted to a case under Chapter 7.

22 Explanation of Forbearance: At any time there is an "Event of Default" under
23 the terms of a Reimbursement Agreement, the applicable Letter of Credit Issuing Bank has
24 the continuing right, pursuant to the terms of its Reimbursement Agreement and related
25 Indenture, to notify the Bond Trustee of the occurrence or existence of one or more "Events
26 of Default" under its Reimbursement Agreements and to direct the Bond Trustee to declare
27 an "Event of Default" under the related Indenture, notwithstanding the Letter of Credit
28 Issuing Bank's failure to exercise such right at any time. In addition, so long as a Letter of

1 Credit Issuing Bank is not reimbursed in full for drawings properly honored by such Letter
2 of Credit Issuing Bank under the Letter of Credit issued by it, such Letter of Credit Issuing
3 Bank has, among other things, the continuing right (under both its Reimbursement
4 Agreement and its Letter of Credit) to notify the Bond Trustee of such failure to be
5 reimbursed in full and to state that the amount available to be drawn under the Letter of
6 Credit to pay interest on such Letter of Credit Backed PC Bonds has not been reinstated,
7 notwithstanding the failure of the Letter of Credit Issuing Bank to exercise such right
8 previously.

9 As a Chapter 11 debtor in possession, PG&E has not reimbursed the Letter of
10 Credit Issuing Banks for any of the payments they have made pursuant to the several post-
11 petition draws on their Letters of Credit. Accordingly, each of the Letter of Credit Issuing
12 Banks has the right upon the passage of time, the giving of notice or both, to either (i)
13 declare an "Event of Default" under their respective Reimbursement Agreements and to
14 direct the Bond Trustee to call an Event of Default under the terms of the respective
15 Indenture, and/or (ii) during certain periods following the monthly draws on each of the
16 Letters of Credit to pay interest on the Letter of Credit Backed PC Bonds, to notify the Bond
17 Trustee that the Interest Portion of the Letter of Credit will not be reinstated. In such event
18 the Bond Trustee would, in accordance with the terms of the respective Indentures and the
19 respective Letters of Credit, declare the respective series of Letter of Credit Backed PC
20 Bonds immediately due and payable, draw upon the respective Letter of Credit, and apply
21 such drawn funds to the full payment and cancellation of the related outstanding Letter of
22 Credit Backed PC Bonds, with the end result that the tax-preferred financing would no
23 longer be outstanding.

24 Under the terms of the Term Sheet, each of the Letter of Credit Issuing Banks has
25 agreed to forbear, for a limited period, from taking such action or taking any other action
26 which would result in the mandatory tender or redemption of any of the outstanding Letter
27 of Credit Backed PC Bonds without the prior written consent of PG&E. This concession by
28 the Letter of Credit Issuing Banks allows PG&E to maintain the benefits of the tax-exempt

1 financing during the forbearance period at a significant savings to the estate.

2 Extension of Letter of Credit Expiration: Provided that no Termination Event
3 shall have occurred and remain uncured, each of the Letter of Credit Issuing Banks has
4 agreed that prior to April 18, 2002, it shall extend the expiration date of its Letter of Credit
5 to the first business day subsequent to the one-year anniversary of the existing expiration
6 date of such Letter of Credit.

7 Explanation of Extension of Letter of Credit Expiration: Each of the Letters of
8 Credit will expire in accordance with its terms on the expiry date set forth on Schedule 1
9 attached to the Term Sheet. Unless each of the Letters of Credit is renewed or replaced in
10 accordance with the terms of the Indentures at least 35 days prior to its expiration date, the
11 Bond Trustee will be required to call the related series of Letter of Credit Backed PC Bonds
12 for redemption and cancellation. The Letter of Credit Issuing Banks have the right to refuse
13 to extend the terms of their Letters of Credit beyond their respective maturities.

14 The agreement by the Letter of Credit Banks in the Term Sheet to extend the
15 terms of their Letters of Credit allows PG&E to maintain the benefits of the tax-exempt
16 financing for up to one additional year, at a significant savings to the estate. Moreover,
17 given that certain of the Letters of Credit will expire in the near future, the Letter of Credit
18 Issuing Banks' agreement to extend the maturities of the Letters of Credit provides PG&E
19 with necessary additional time in which to gain approval of the Amended Plan while still
20 preserving the Letter of Credit Backed PC Bonds.

21 **B. Agreements by the Debtor.**

22 Additional Fees: The Term Sheet provides that if this Motion is approved by the
23 Bankruptcy Court on or before May 7, 2002, then PG&E will be required to pay to each of
24 the Letter of Credit Banks, during the period from and after December 1, 2001 and
25 continuing until the Confirmation Date (as defined in the Amended Plan), quarterly, in
26 arrears, the Letter of Credit fee as set forth in the respective Reimbursement Agreement (the
27 "Original Letter of Credit Fee"), together with an amount equal to the positive difference, if
28 any, of an amount per annum equal to two (2%) percent of the Stated Amount of the Letter

1 of Credit, less the Original Letter of Credit Fee (together, the "Initial Letter of Credit Fee"),
2 which total fee shall accrue from and after December 1, 2001 and until the Confirmation
3 Date, and shall be payable on the same dates as are set forth for payment of Letter of Credit
4 Fees in the applicable Reimbursement Agreement, and during the period from and after the
5 Confirmation Date and continuing until the Effective Date (as defined in the Amended Plan),
6 quarterly, in arrears, the Original Letter of Credit Fee, together with an amount equal to the
7 positive difference, if any, of an amount per annum equal to three (3%) percent of the Stated
8 Amount of the Letter of Credit, less the Original Letter of Credit Fee, which total fee shall
9 accrue from and after the Confirmation Date until the Effective Date, and shall be payable
10 on the same dates as are set forth for payment of Letter of Credit fees in the applicable
11 Reimbursement Agreement; provided however, that the first such payment, for Initial Letter
12 of Credit Fees accruing from and after December 1, 2001 until and including March 31,
13 2002, shall be paid not later than ten (10) days after the Court issues an order approving the
14 Motion.

15 The Term Sheet also provides that if this Motion is not approved by the
16 Bankruptcy Court on or before May 7, 2002, then PG&E will be required to pay to each of
17 the Letter of Credit Issuing Banks with respect to its Letter of Credit to the extent permitted
18 by order of the Bankruptcy Court, during the period from and after the Confirmation Date
19 and continuing until the Effective Date, quarterly, in arrears, the Original Letter of Credit
20 Fee, together with an amount equal to the positive difference, if any, of an amount per
21 annum equal to three (3%) percent of the Stated Amount of the Letter of Credit, less the
22 Original Letter of Credit Fee, which total fee shall accrue from and after December 1, 2001
23 until the Effective Date, and shall be payable on the same dates as are set forth for payment
24 of Letter of Credit fees in the applicable Reimbursement Agreement.

25 The Term Sheet also provides that on the Confirmation Date, PG&E is required
26 to pay to Deutsche Bank AG New York Branch an agency fee in the amount of \$250,000 as
27 additional compensation for acting as the administrative agent under the terms of its
28 Reimbursement Agreement during the period from and after December 1, 2001 through the

1 Effective Date; provided that if no Termination Event shall have occurred prior to June 30,
2 2002 and Deutsche Bank AG shall not be in default hereunder, such agency fee shall be
3 deemed fully earned on the earlier of the Confirmation Date or June 30, 2002.

4 Explanation of Additional Fees: As set forth in the Amended Plan and the Term
5 Sheet, the Letter of Credit Issuing Banks and the Banks will be paid their outstanding
6 Allowed Letter of Credit Bank Claims, together with pre- and post-petition interest thereon,
7 in full on the terms set forth therein. The Term Sheet, however, also provides for the
8 payment of certain increased fees to the Letter of Credit Issuing Banks as consideration for
9 their agreements to forbear and extend the maturities of the Letters of Credit.

10 If this Motion is approved by the Bankruptcy Court on or before May 7, 2002,
11 then PG&E will make current payments of the letter of credit fees due under the terms of the
12 respective Reimbursement Agreements, plus pay an additional fee in the amount necessary
13 to bring the total annual fee payable to each Letter of Credit Bank up to an aggregate amount
14 per annum equal to two (2%) percent of the Stated Amount of each Letter of Credit for the
15 period that the respective Letter of Credit remains outstanding in the Stated Amount, which
16 letter of credit fees will be payable with respect to the period from and after December 1,
17 2001 through the Confirmation Date. Thereafter, during the period from and after the
18 Confirmation Date through the Effective Date, PG&E will make current payments of the
19 letter of credit fees due under the terms of the respective Reimbursement Agreements, plus
20 pay an additional fee in the amount necessary to bring the total annual fee payable to each
21 Letter of Credit Bank up to an aggregate amount per annum equal to three (3%) percent of
22 the Stated Amount of each Letter of Credit for the period that the respective Letter of Credit
23 remains outstanding in the Stated Amount from the Confirmation Date through the Effective
24 Date.

25 Alternatively if this Motion is not approved by the Bankruptcy Court on or before
26 May 7, 2002, then PG&E will not make current payments of the either the letter of credit
27 fees due under the terms of the respective Reimbursement Agreements or the additional
28 amounts, but will, to the extent permitted by order of the Bankruptcy Court, pay a higher

1 total fee, in an aggregate amount per annum equal to three (3%) percent of the Stated
2 Amount of each Letter of Credit for the period that the respective Letter of Credit remains
3 outstanding in the Stated Amount from the Confirmation Date through the Effective Date.
4 In such event, the higher total fee will accrue during the period that the respective Letter of
5 Credit remains outstanding from and after December 1, 2001 through the Effective Date.

6 In either event, the increased total letter of credit fees will be calculated, and will
7 either accrue or be payable, in the same manner as letter of credit fees are currently provided
8 for in each of the existing Reimbursement Agreements.

9 In addition, the Term Sheet provides that PG&E will pay to Deutsche Bank AG
10 New York Branch an agency fee in the amount of \$250,000 as additional compensation for
11 acting as the administrative agent under the terms of its Reimbursement Agreement during
12 the period from and after December 1, 2001 through the Effective Date, and that such fee
13 will be deemed fully earned on the earlier of the Confirmation Date or June 30, 2002 and
14 paid on the Confirmation Date.

15 The fees payable by PG&E under the terms of the Term Sheet and the timing of
16 the payment of such fees are, in the opinion of PG&E, fair compensation to the Letter of
17 Credit Issuing Banks for their agreements under the provisions of the Term Sheet to, among
18 other things, forbear from the exercise of remedies under their respective Reimbursement
19 Agreements and for their agreement to extend the maturities of their respective Letters of
20 Credit as described above. Even after the payment of the increased fees set forth in the Term
21 Sheet, PG&E will continue to realize substantial interest cost savings by maintaining the
22 benefits of the outstanding tax-exempt financing provided by the Letter of Credit Backed PC
23 Bonds, which cost savings more than offset the cost of the fees. Furthermore, it is
24 customary in connection with the extension of the term of a letter of credit for the borrower
25 or account party and the issuing bank to renegotiate the terms under which the letter of credit
26 would be extended given the prevailing market conditions and the creditworthiness of the
27 borrower. Under the current circumstances, the Debtor believes that the increased total letter
28 of credit fees are a reasonable and necessary component of any agreement to extend the

1 maturities of the Letters of Credit.

2 Finally, the Debtor believes that, given the additional administrative
3 responsibilities that Deutsche Bank will have to perform as agent for its bank group in order
4 to maintain its Letter of Credit, it is reasonable and necessary for the Debtor to pay Deutsche
5 Bank the additional agency fee set forth in the Term Sheet.

6 Professional Fees: The Term Sheet provides that commencing on a date not more
7 than 10 days after the Bankruptcy Court approves the Motion, PG&E will pay the reasonable
8 fees and expenses of unrelated third party professionals retained by the Letter of Credit
9 Issuing Banks ("Professional Fees"), to the extent incurred subsequent to April 6, 2001 in
10 connection with the Chapter 11 case of PG&E, and shall thereafter pay such additional
11 Professional Fees as may be incurred by the Letter of Credit Issuing Banks no later than 30
12 days subsequent to each date reimbursement requests therefor (with appropriate backup) are
13 made in writing by the Letter of Credit Issuing Bank to PG&E.

14 Explanation of Professional Fees: PG&E is obligated under the terms of the
15 respective Reimbursement Agreements to reimburse the Letter of Credit Issuing Banks for
16 the reasonable fees and expenses of unrelated third party professionals retained by the Letter
17 of Credit Issuing Banks.⁴ Moreover, under the stipulation approved by the Prior Motion and
18 Order, subject to certain conditions, such attorneys' fees constitute allowed claims against
19 PG&E and its estate. Thus, this provision of the Term Sheet does not expand PG&E's
20 obligations, but, in light of the full payment of creditors proposed in the Amended Plan, only
21 serves to accelerate the timing of the Letter of Credit Issuing Banks' reimbursement for such
22 costs. Again, given the substantial benefits to PG&E from this deal, such a concession by
23 PG&E is minor and well justified.

24 Purchase in Lieu of Redemption: The Term Sheet provides that, if no
25

26 ⁴These fees include the fees of outside counsel retained by Bank of America, N.A.
27 ("BofA") in connection with BofA's capacity as a Letter of Credit Issuing Bank, including a
28 reasonable allocable portion of the fees of outside counsel retained by BofA for services
related to Creditors Committee matters that at the same time are reasonably attributable to
protecting BofA's interests in its capacity as a Letter of Credit Issuing Bank.

1 Termination Event shall have occurred and remain uncured prior to the Effective Date, then
2 upon written request of PG&E, each Letter of Credit Issuing Bank shall cause the related
3 series of Letter of Credit Backed PC Bonds to be tendered for purchase through a draw upon
4 the respective Letter of Credit and instruct the respective Bond Trustee to either register the
5 purchased Letter of Credit Backed PC Bonds in the name of the Letter of Credit Issuing
6 Bank or in the name of PG&E subject to a first lien security interest in favor of the
7 respective Letter of Credit Issuing Bank to additionally secure the obligations of PG&E
8 under the related Reimbursement Agreement.

9 The Term Sheet further provides that upon written request of PG&E or the Letter
10 of Credit Issuing Banks delivered by either party to the other on or after the date the
11 Bankruptcy Court approves this Motion, PG&E and each of the Letter of Credit Issuing
12 Banks shall take any action as shall be reasonably necessary to amend the Loan Agreement
13 and/or Indenture pursuant to which each series of Letter of Credit Backed PC Bonds were
14 issued to add the right of the Letter of Credit Issuing Bank or PG&E to purchase any Letter
15 of Credit Backed PC Bonds in lieu of redemption and to cause such purchased Letter of
16 Credit Backed PC Bonds to be registered in the name of the respective Letter of Credit
17 Issuing Bank or in the name of PG&E subject to a first lien security interest in favor of the
18 respective Letter of Credit Issuing Bank to secure the related reimbursement obligation of
19 PG&E; provided that, if certain Termination Events occur, PG&E will not, without the prior
20 written consent of the respective Letter of Credit Issuing Bank, have the right to convert a
21 mandatory redemption of Letter of Credit Backed PC Bonds into a purchase in lieu of
22 redemption in accordance with the proposed amended Loan Agreement or Indenture.

23 Finally, in the event that a plan of reorganization which provides for the treatment
24 of Allowed Letter of Credit Bank Claims in the manner described in the Term Sheet or for
25 alternative treatment of Allowed Letter of Credit Bank Claims which is acceptable to the
26 Letter of Credit Issuing Banks is not confirmed on or before June 30, 2002, then each Letter
27 of Credit Issuing Bank shall have the right, but not the obligation, to cause the related series
28 of Letter of Credit Backed PC Bonds to be tendered for purchase through a draw upon the

1 respective Letter of Credit and to instruct the respective Bond Trustee to either register the
2 purchased Letter of Credit Backed PC Bonds in the name of the Letter of Credit Issuing
3 Bank or, at the direction of the Letter of Credit Issuing Bank, in the name of PG&E subject
4 to a first lien security interest in favor of the respective Letter of Credit Issuing Bank to
5 additionally secure the obligations of PG&E under the related Reimbursement Agreement,
6 and shall not thereafter take any action which would cause the related series of Letter of
7 Credit Backed PC Bonds to be called for redemption unless certain Termination Events
8 occur.

9 Explanation of Purchase in Lieu of Redemption: For United States federal
10 income tax purposes, Letter of Credit Backed PC Bonds which have been purchased, rather
11 than redeemed or cancelled, remain outstanding. However, the cooperation of the Letter of
12 Credit Issuing Banks and the Banks is necessary in order to provide a mechanism by which
13 the Letter of Credit Backed PC Bonds can be purchased. Thus, pursuant to the terms of the
14 Term Sheet, PG&E and the Letter of Credit Issuing Banks have agreed to cooperate in a
15 mutual attempt to amend the related bond documents to permit the Letter of Credit Issuing
16 Banks to purchase the Letter of Credit Backed PC Bonds under certain circumstances in
17 which the Letter of Credit Backed PC Bonds would otherwise be subject to redemption and
18 cancellation. Such amendments to the respective Loan Agreements and Indentures would
19 not be adverse to the interests of the holders of Letter of Credit Backed PC Bonds and would
20 enhance PG&E's ability to maintain the benefits of the tax-exempt financing provided by the
21 Letter of Credit Backed PC Bonds by facilitating the orderly purchase of outstanding Letter
22 of Credit Backed PC Bonds in certain circumstances.

23 The amendments to the bond documents proposed in the Term Sheet would also
24 grant the Letter of Credit Issuing Banks the right, but not the obligation, to cause a purchase
25 of Letter of Credit Backed PC Bonds on or after June 30, 2002 if a plan of reorganization
26 which provides for the treatment of Allowed Letter of Credit Bank Claims in the manner
27 described in the Term Sheet or for alternative treatment of Allowed Letter of Credit Bank
28 Claims which is acceptable to the Letter of Credit Issuing Banks is not confirmed on or

1 before such date. This would allow the Letter of Credit Issuing Banks to limit their ever
2 increasing credit exposure to PG&E which results from the currently unreimbursed monthly
3 draws on their respective Letters of Credit for the payment of interest on the Letter of Credit
4 Backed PC Bonds, while keeping the Letter of Credit Backed PC Bonds outstanding and,
5 accordingly, preserving PG&E's ability to subsequently remarket the Letter of Credit
6 Backed PC Bonds on a tax-exempt basis, which may otherwise be lost if the Letter of Credit
7 Backed PC Bonds were redeemed and cancelled.

8 **C. Treatment of Allowed Letter of Credit Bank Claims.**

9 Proposed Plan Treatment: The Term Sheet provides that the plan of
10 reorganization propounded by PG&E will provide for the treatment of Allowed Letter of
11 Credit Bank Claims in substantially the manner provided in PG&E's Amended Plan, or in an
12 alternative manner acceptable to the Letter of Credit Issuing Banks.

13 The Term Sheet further provides that with respect to each Letter of Credit Issuing
14 Bank and the related Banks, if any, in the event that neither the two treatment options set
15 forth in the Amended Plan can be consummated or the respective series of Letter of Credit
16 Backed PC Bonds are redeemed on or prior to the Effective Date as the result of the
17 expiration of the respective Letter of Credit or otherwise, then either: (a) the Class 4e Claim
18 of such Letter of Credit Issuing Bank and the applicable Banks, if any, would be converted
19 to a Class 4f Claim in an amount equal to the amount due by PG&E under the terms of the
20 respective Reimbursement Agreement as reimbursement for amounts paid by such Letter of
21 Credit Issuing Bank under its respective Letter of Credit to the Bond Trustee for the payment
22 of the principal portion of the redemption price of the related series of Letter of Credit
23 Backed PC Bonds; or (b) if (i) the Letter of Credit Issuing Bank maintains its Letter of
24 Credit outstanding in the stated amount set forth on Schedule 1 to the Term Sheet through
25 the Effective Date and does not provide the Trustee with notice of default under its
26 Reimbursement Agreement or non-reinstatement of its Letter of Credit or take any other
27 action which would result in the redemption, either in whole or in part, of the outstanding
28 Letter of Credit Backed PC Bonds without the prior written consent of PG&E, and (ii) the

1 Letter of Credit Issuing Bank and each of the related Banks, if any, take all action reasonably
2 required by PG&E to keep the Letter of Credit Backed PC Bonds outstanding and to
3 facilitate either the treatment options set for the Plan (including, without limitation, giving
4 direction to the Trustee, providing commercially reasonable indemnification to the Issuer
5 and Trustee, and using their best efforts to consummate the proposed amendments to the
6 terms of the Letter of Credit Backed PC Bonds and to consummate either the treatment
7 options set forth in the Plan, so as to maintain for PG&E the benefits of the tax-exempt
8 financing provided by the related series of Letter of Credit Backed PC Bonds), then in the
9 event that the Letter of Credit Backed PC Bonds are redeemed on or prior to the Effective
10 Date for reasons beyond the control of the Letter of Credit Issuing Bank, either (1) the Letter
11 of Credit Issuing Bank will receive (i) cash in an amount equal to sixty percent (60%) of the
12 principal portion of the redemption price of the redeemed Letter of Credit Backed PC Bonds
13 paid out of a draw on the respective Letter of Credit, and (ii) Long Term Notes (as defined in
14 the Amended Plan) having an aggregate face value equal to forty percent (40%) of the
15 principal portion of the redemption price of the redeemed Letter of Credit Backed PC
16 Bonds paid out of a draw on the respective Letter of Credit, plus a placement fee in an
17 amount equal to 1.5% of the aggregate principal amount of such long-term notes, or (2) at
18 the option of the Letter of Credit Issuing Bank, the reimbursement for the principal portion
19 of the redemption price of the redeemed Letter of Credit Backed PC Bonds paid out of a
20 draw on the respective Letter of Credit shall be paid on the Effective Date through a
21 combination of Cash and long term notes upon terms equivalent to the cash, Long Term
22 Notes and other consideration provided for treatment of unsecured creditors generally in the
23 confirmed plan of reorganization in this case.

24 Explanation of Proposed Plan Treatment: The proposed treatment of the Allowed
25 Letter of Credit Bank Claims as set forth in the Amended Plan with the refinements set forth
26 in the Term Sheet are intended to, among other things, allow PG&E and the Reorganized
27 Debtor the ability to maintain the benefits of the tax-exempt financing provided by the Letter
28 of Credit Backed PC Bonds through and after the Effective Date.

1 Under the terms of the Term Sheet, if a plan of reorganization were to be
2 confirmed in this case which did not provide for either (i) the treatment of Allowed Letter of
3 Credit Bank Claims in the manner set forth in the Amended Plan with the refinements set
4 forth in the Term Sheet, or (ii) alternative treatment of Allowed Letter of Credit Bank
5 Claims which was acceptable to the Letter of Credit Issuing Banks, then a Termination
6 Event would be deemed to have occurred and the Letter of Credit Issuing Banks would no
7 longer be required to forbear from the exercise of remedies under their Reimbursement
8 Agreements that could result in the redemption and cancellation of the Letter of Credit
9 Backed PC Bonds and the concomitant loss to PG&E of the valuable tax-free financing
10 provided by such bonds.

11
12 **IV. THE COURT SHOULD APPROVE THE DEBTOR'S EXECUTION OF AND
13 PERFORMANCE UNDER THE TERM SHEET BECAUSE IT IS IN THE BEST
14 INTEREST OF THE DEBTOR AND ITS ESTATE.**

15 The Court should approve PG&E's execution of and performance under the Term
16 Sheet because there is little hope or prospect of keeping the tax-exempt Letter of Credit
17 Backed PC Bonds outstanding without such approval. The tax-exempt financing provided
18 by the Letter of Credit Backed PC Bonds provide a substantial interest cost savings to PG&E
19 (and will provide such savings to the Reorganized Debtor) over the cost of alternative
20 conventional taxable financing. As such, the tax-exempt bond financing is an asset of the
21 bankruptcy estate that, in the opinion of PG&E, is best preserved through the transactions
22 contemplated in the Term Sheet.

23 PG&E believes that the benefits of the forbearance offered by the Letter of Credit
24 Issuing Banks, the extension of the terms of the Letters of Credit, and the other agreements
25 by the Letter of Credit Issuing Banks set forth in the Term Sheet outweigh any concessions
26 made by PG&E in the Term Sheet.

27 Section 363(b) of the Bankruptcy Code authorizes a debtor in possession, after
28 notice and a hearing, to use, sell or lease property of the estate other than in the ordinary
course of business. To the extent the proposed Term Sheet encompasses the use of estate

1 property to resolve outstanding issues with the Letter of Credit Issuing Banks and the Banks
2 for the benefit of the estate, it is within the ambit of Section 363(b). Further, Rule 9019(a)
3 of the Bankruptcy Rules more specifically sets forth the procedure for a settlement or a
4 compromise of controversy. Pursuant to Rule 9019(a), a bankruptcy court may approve,
5 after notice and a hearing, a compromise or settlement agreement entered into by a
6 representative of a debtor's estate and a party in interest. The standard for approval of a
7 compromise is whether the proposed settlement is "fair and equitable" and "in the best
8 interests of the estate". See Protective Comm. for Indep. Stockholders of TNT Trailer Ferry
9 Inc. v. Anderson, 390 U.S. 414, 424, reh'g denied, 391 U.S. 909 (1968); Official Comm. of
10 Unsecured Creditors v. Cajun Elec. Power Coop., Inc. (In re Cajun Elec. Power Coop., Inc.),
11 119 F. 3d 349, 355 (5th Cir. 1997.)

12 In making such a determination, the court "need not conduct its own investigation
13 concerning the reasonableness of the settlement" and may consider the informed judgment
14 of the estate's representative that the settlement is fair and equitable. In re Purofied Down
15 Prods. Corp., 150 B.R. 519, 522 (S.D.N.Y. 1993). Furthermore, the court does not "have to
16 be convinced that the settlement is the best possible compromise or that the parties have
17 maximized their recovery." Nellis v. Shugrue, 165 B.R. 115, 123 (S.D.N.Y. 1994). Instead,
18 the court need only "canvass the issues and see whether the settlement 'falls below the
19 lowest point in the range of reasonableness.'" In re Drexel Burnham Lambert Group, Inc.,
20 134 B.R. 493, 497 (Bankr. S.D.N.Y. 1991) (citation omitted).

21 For the reasons set forth above, PG&E believes the compromise reached with the
22 Letter of Credit Issuing Bank and the Banks, as set forth in the Term Sheet, is fair and
23 reasonable and is in the best interests of PG&E's estate. As such, PG&E believes approval
24 of the Term Sheet is appropriate under Rule 9019.

25 Finally, as yet another basis for the relief requested by this Motion, Section
26 105(a) of the Bankruptcy Code authorizes this Court to "issue any order, process, or
27 judgment that is necessary or appropriate to carry out the provisions of this title." The
28 purpose of Section 105 is "to assure the bankruptcy courts power to take whatever action is

1 appropriate or necessary in aid of the exercise of their jurisdiction.” 2 Lawrence P. King,
2 Collier on Bankruptcy 105.01, at 105-6 (15th ed. rev. 2000). PG&E believes that the
3 principal creditors of the estate and other parties in interest noticed on this Motion will
4 support the Motion because it is plainly in the best interests of the estate, and that this
5 Court’s entry of an order granting the Motion will help facilitate the efficient administration
6 of the estate and, as the ultimate goal of a successful Chapter 11 case, a confirmable plan of
7 reorganization. On the present facts, where the substantial benefits of the tax-exempt Letter
8 of Credit Backed PC Bonds may be lost to the estate if the Motion is not granted, the Court’s
9 approval of the Motion is consistent with both the letter and spirit of the Bankruptcy Code,
10 in general, and Section 105(a), in particular.

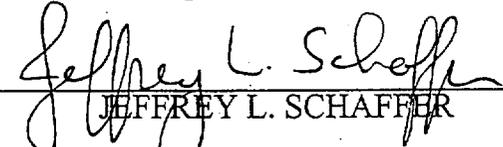
11
12 **CONCLUSION**

13 For all of the foregoing reasons, PG&E respectfully requests that this Court make
14 and enter its order granting the Motion, thereby approving PG&E’s execution of and
15 performance under the terms of the Term Sheet that PG&E has provisionally entered into
16 with the Letter of Credit Issuing Banks.

17 DATED: March 20, 2002

18 Respectfully,

19 HOWARD, RICE, NEMEROVSKI, CANADY,
20 FALK & RABKIN
21 A Professional Corporation

22 By: 
23 JEFFREY L. SCHAEFFER

24 Attorneys for Debtor and Debtor in Possession
25 PACIFIC GAS AND ELECTRIC COMPANY
26
27
28