

50-275/323

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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 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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21 DECLARATION OF MICHAEL J. DONNELLY IN SUPPORT OF DEBTOR'S MOTION  
22 FOR ORDER APPROVING DEBTOR'S EXECUTION AND PERFORMANCE UNDER  
23 THE SUMMARY OF TERMS WITH RESPECT TO FORBEARANCE AND PROPOSED  
24 REVISED TREATMENT OF LETTER OF CREDIT BANK  
25 CLAIMS IN THE PLAN OF REORGANIZATION

26 A001 Add: Rick Oye Mal B...

A001

1 I, Michael J. Donnelly, declare:

2 1. I am the Assistant Treasurer of Pacific Gas and Electric Company, the  
3 debtor and debtor in possession in the above-captioned Chapter 11 case (the "Debtor" or  
4 "PG&E"). I make this Declaration in support of the Debtor's Motion For Order Approving  
5 Debtor's Execution And Performance Under The Summary Of Terms With Respect To  
6 Forbearance And Proposed Revised Treatment Of Letter of Credit Bank Claims In The Plan  
7 Of Reorganization (the "Motion"). Except as otherwise stated herein, all capitalized words  
8 and terms used herein have the same meanings ascribed to them in the Motion. I know the  
9 following of my own knowledge (except as to any matters stated on information and belief,  
10 and as to such matters, I am informed and believe they are true) and, if called upon as a  
11 witness, could and would testify competently thereto.

12 In General:

13 2. By the Motion, PG&E seeks the Bankruptcy Court's approval of PG&E's  
14 execution of, and performance under, the Summary of Terms With Respect to Forbearance  
15 and Proposed Revised Treatment of Letter of Credit Bank Claims in the Plan of  
16 Reorganization (the "Term Sheet," a true and correct copy of which is attached as Exhibit A  
17 hereto), which PG&E has entered into with the various counterparties described below,  
18 subject to Bankruptcy Court approval, in order to maximize the chance that PG&E can  
19 preserve for the bankruptcy estate and the anticipated reorganized Debtor the benefits of  
20 favorable tax-exempt bond financing. The Motion is related to, but distinct from, the  
21 Debtor's Motion For Order Approving Stipulation Regarding Credit Enhancement of  
22 Pollution Control Revenue Bonds dated August 10, 2001, which was granted by this Court's  
23 Order dated September 7, 2001 (hereinafter the "Prior Motion and Order").

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

1 are used to pay the bonds.

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

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

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

21 7. For the reasons set forth above and as more fully described below, PG&E  
22 believes that the agreement set forth in the Term Sheet is beneficial to the Debtor and its  
23 estate.

24 8. On September 10, 2001, PG&E and its parent company, PG&E  
25 Corporation, jointly propounded and filed a Plan of Reorganization Under Chapter 11 of the  
26 Bankruptcy Code for Pacific Gas and Electric Company (the "Plan"), which Plan has been  
27 amended by a Second Amended Plan of Reorganization filed March 7, 2002 (the Plan, as so  
28 amended and as may be further modified prior to the hearing on the Motion, being

1 hereinafter referred to as the "Amended Plan").

2 Background and Mechanics of Subject Bond Issuances:

3 9. Pursuant to the terms of various separate trust indentures (each, an  
4 "Indenture") each between the California Pollution Control Financing Authority, a public  
5 instrumentality and political subdivision of the State of California (the "Issuer") and Bankers  
6 Trust 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 the 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 the Motion consist of four series  
12 of credit-enhanced revenue bonds in the aggregate principal amount of approximately  
13 \$613,550,000, as set forth more specifically on Schedule 1 attached to the Term Sheet  
14 (collectively, the "Letter of Credit Backed PC Bonds").<sup>1</sup>

15 10. The Issuer loaned the proceeds from the sale of each series of Letter of  
16 Credit Backed PC Bonds (each a "Bond Loan" and collectively the "Bond Loans") to PG&E  
17 for the purpose of financing or refinancing the acquisition and/or construction of certain  
18 pollution control, sewage disposal and/or solid waste disposal facilities of PG&E located  
19 within the State of California. The Bond Loans were made pursuant to the terms of various  
20 loan agreements (each, a "Loan Agreement" and collectively the "Loan Agreements")  
21 between the Issuer and PG&E, pursuant to which PG&E agreed, among other things, to  
22 repay the Bond Loans at the times and in the amounts necessary to enable the Issuer to make  
23 full and timely payment of the principal of, premium, if any, and interest on, each series of  
24 Letter of Credit Backed PC Bonds when due and to pay the purchase price of any Letter of  
25 Credit Backed PC Bonds tendered for purchase by PG&E in accordance with the terms of

26  
27 <sup>1</sup>The 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 the Motion because they are not supported by letters of credit, and  
they therefore do not raise the issues leading to the Term Sheet and the Motion.

1 the applicable Indenture.

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

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

21 Letter of Credit Backed PC Bonds.

22 13. With respect to each series of Letter of Credit Backed PC Bonds, PG&E  
23 entered into a reimbursement agreement (each, a "Letter of Credit Reimbursement  
24 Agreement") with a bank (each, a "Letter of Credit Issuing Bank") and certain banking or  
25 other financial institutions (each, a "Bank"), pursuant to which the Letter of Credit Issuing  
26 Bank has issued its irrevocable letter of credit (each, a "Letter of Credit") to the Bond  
27 Trustee, for the account of PG&E, to provide for the payment of the principal of and interest  
28 on the related series of Letter of Credit Backed PC Bonds and to support the payment of the

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1 purchase price of any Letter of Credit Backed PC Bonds tendered for purchase in accordance  
2 with the terms of the applicable Indenture. Under the terms of each Letter of Credit  
3 Reimbursement Agreement, PG&E is obligated to reimburse the Letter of Credit Issuing  
4 Bank for all amounts drawn on the related Letter of Credit.

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

19 15. Under the terms of each of the Indentures pursuant to which each series of  
20 Letter of Credit Backed PC Bonds were issued, each regularly scheduled payment of the  
21 principal of, or interest on, the Letter of Credit Backed PC Bonds is made from moneys  
22 drawn by the Bond Trustee under the related Letter of Credit. The obligation of PG&E to  
23 repay the loan under the Loan Agreement is deemed satisfied to the extent of any  
24 corresponding payment made by the Letter of Credit Issuing Bank under the terms of the  
25 Letter of Credit. With respect to each such drawing, PG&E is then obligated under the  
26 applicable Letter of Credit Reimbursement Agreement to reimburse the Letter of Credit  
27 Issuing Bank for the amount of such drawing. Only if the Letter of Credit Issuing Bank  
28 dishonors a drawing, or there is no Letter of Credit then in effect, is the Bond Trustee

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1 authorized under the terms of the Indenture to collect Bond Loan payments under the  
2 respective Loan Agreement and apply such funds to the payment of the principal of, or  
3 interest on, the related Letter of Credit Backed PC Bonds.

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

10 Tax-Exempt Status of Letter of Credit Backed PC Bonds:

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

18 18. The tax-exempt status of the Letter of Credit Backed PC Bonds allowed such  
19 bonds to be issued at favorable interest rates, thus allowing PG&E to finance certain of its  
20 capital improvements and other qualified costs at rates substantially below comparable  
21 conventional taxable financing alternatives available to PG&E. Based on the tax-exempt  
22 status of the Letter of Credit Backed PC Bonds, their credit enhancement and their  
23 commensurate credit rating, the Letter of Credit Backed PC Bonds currently accrue interest  
24 at the average blended interest rate of only 1.26 % per annum,<sup>2</sup> and at least some of PG&E's  
25 tax-exempt bonds on a recent date (March 5, 2002) accrued interest at a rate of less than 1%  
26 per annum. In the event that any of the Letter of Credit Backed PC Bonds were to be  
27

28 <sup>2</sup>This rate was calculated as of March 1, 2002, shortly before the filing of the Motion.

1 redeemed in accordance with the terms of their respective Indentures, it may not be possible  
2 under current law to reissue such bonds on a tax-exempt basis. Accordingly, PG&E has  
3 made the determination that the continued existence of such favorable tax-exempt financing  
4 is a valuable asset of PG&E's bankruptcy estate, and that it is in the best interest of PG&E's  
5 estate to keep the Letter of Credit Backed PC Bonds outstanding in order to preserve the  
6 substantial benefits of such tax-exempt financing.

7 Post-Chapter 11 Filing Developments Re Letter of Credit Backed PC Bonds:

8 19. Since PG&E's Chapter 11 filing on April 6, 2001 (the "Petition Date"), all of  
9 the Letter of Credit Backed PC Bonds have remained outstanding, and all of the scheduled  
10 interest payments on the Letter of Credit Backed PC Bonds have been fully and timely paid,  
11 when due, through periodic draws by the Bond Trustee on the Letters of Credit provided by  
12 the Letter of Credit Issuing Banks. To date, following each such drawing, each of the Letter  
13 of Credit Issuing Banks has allowed the Interest Portion of its respective Letter of Credit to  
14 automatically reinstate in accordance with the terms thereof each month, which has resulted  
15 in automatic reinstatements each month since PG&E's Chapter 11 filing in April 2001. This  
16 in large part is the result of the interim stipulation negotiated between PG&E, the Letter of  
17 Credit Issuing Banks and the Banks (among others) during the first few months of this case,  
18 culminating in the Prior Motion and Order in September 2001.

19 20. Pursuant to the Prior Motion and Order and the interim stipulation approved  
20 therein, the Letter of Credit Issuing Banks did not obligate themselves to allow any Letter of  
21 Credit to be reinstated automatically and instead reserved the right in any month to give a  
22 notice of nonreinstatement and trigger the presentment of any Letter of Credit. However, as  
23 a small and fair incentive for the Letter of Credit Issuing Banks to allow automatic  
24 reinstatement to take place while negotiations over a more permanent resolution of the Letter  
25 of Credit issues was being negotiated, the estate agreed pursuant to the Prior Motion and  
26 Order that with respect to any automatic reinstatements and draws for interest that occur  
27 post-petition as a consequence of the Letter of Credit Issuing Banks allowing the automatic  
28 reinstatement to take place, any post-petition interest drawings under the Letters of Credit

1 will constitute allowed claims against PG&E and its bankruptcy estate in favor of the Letter  
2 of Credit Issuing Banks. Similarly, the Prior Motion and Order provides that, subject to  
3 certain conditions, the fees and expenses of the Letter of Credit Issuing Banks and the Banks  
4 (including the post-petition fees and expenses of unrelated third-party professionals retained  
5 by the Letter of Credit Issuing Banks and the Banks), to the extent provided for under the  
6 applicable Reimbursement Agreement, will constitute allowed claims against PG&E and its  
7 bankruptcy estate. Pursuant to the Prior Motion and Order, PG&E also was authorized to  
8 pay on a current basis certain fees and reasonable out-of-pocket expenses of the remarketing  
9 agents, the credit rating agencies, the tender agents and the Bond Trustee associated with the  
10 maintenance of the Letter of Credit Backed PC Bonds, to the extent such fees and expenses  
11 are payable in accordance with the terms of the applicable underlying agreements and are  
12 incurred with respect to the post-petition period.

13           21. The next interest draw on the Letters of Credit will be on or about April 1,  
14 2002, and each Letter of Credit Issuing Bank thereafter has until on or about April 8, 2002 to  
15 decide whether to give notice to the Bond Trustee that such Letter of Credit Issuing Bank's  
16 Letter of Credit will not be reinstated or to stay silent and permit an automatic reinstatement.

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

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1 of Credit, and apply such drawn funds to the full payment and cancellation of the related  
2 outstanding Letter of Credit Backed PC Bonds, with the end result that this tax-preferred  
3 financing would no longer be outstanding.

4 23. Further, each of the Letters of Credit will expire in accordance with its terms  
5 on the expiry date set forth on Schedule 1 attached to the Term Sheet. Pursuant to the terms  
6 of each of the Indentures, with respect to each series of Letter of Credit Backed PC Bonds,  
7 subject to certain exceptions, unless the Bond Trustee shall have received either (a) a  
8 renewal or extension of the existing Letter of Credit for a period of at least one year, or (b) a  
9 substitute letter of credit or other credit facility meeting the requirements of the respective  
10 Loan Agreement and Indenture at least 35 days prior to the expiration date of the respective  
11 Letter of Credit, the Bond Trustee is required to call the series of Letter of Credit Backed PC  
12 Bonds for redemption and cancellation on the last business day which is at least five  
13 calendar days preceding the expiration date of the respective Letter of Credit. In such event  
14 the Bond Trustee would again, in accordance with the terms of the respective Indenture and  
15 the respective Letter of Credit, draw upon the respective Letter of Credit, and apply such  
16 drawn funds to the full payment and cancellation of the related series of outstanding Letter  
17 of Credit Backed PC Bonds, with the end result that this tax-preferred financing would no  
18 longer be outstanding.

19 24. As an accommodation to PG&E and relying on the modest concession made  
20 to them in the Prior Motion and Order, the Letter of Credit Issuing Banks have thus far  
21 refrained from taking the actions described above which would result in the redemption of  
22 the Letter of Credit Backed PC Bonds. However, absent a further consensual agreement  
23 between PG&E and the Letter of Credit Issuing Banks, the Letter of Credit Issuing Banks  
24 have no obligation either to (i) continue to forbear from the exercise of their remedies under  
25 their respective Reimbursement Agreements and the related Indentures (which could result  
26 in the redemption of the related series of Letter of Credit Backed PC Bonds), or (ii) provide  
27 an extension of the stated expiration of their Letters of Credit (which may be necessary to  
28 avoid the redemption of the related series of Letter of Credit Backed PC Bonds).

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1           25. PG&E (and, I believe, the Letter of Credit Issuing Banks and the Banks)  
2 always intended that the interim stipulation approved by the Prior Motion and Order would  
3 be a "bridge" to allow PG&E time to try and obtain the Letter of Credit Issuing Banks' and  
4 the Banks' concurrence to a long-term solution via negotiated provisions in a plan of  
5 reorganization. Accordingly, once the Plan was filed in September 2001, PG&E and the  
6 Letter of Credit Issuing Banks began negotiating in earnest for such a long-term solution to  
7 be incorporated into the Plan via an amendment, plus whatever additional short-term  
8 provisions the parties might deem appropriate.

9           26. The Letter of Credit Banks have indicated to PG&E that, subject to certain  
10 conditions, they would agree to continue to forbear from exercising their remedies under  
11 their respective Reimbursement Agreements and the related Indentures and would agree to  
12 extend the terms of their Letters of Credit in order to provide PG&E with more time to  
13 confirm and effectuate a plan of reorganization that would permit the reorganized Debtor to  
14 retain the benefits of the tax-exempt exempt financing offered by the continued existence of  
15 the Letter of Credit Backed PC Bonds. Consistent with such position of the Letter of Credit  
16 Issuing Banks, during the past several months PG&E has engaged in discussions with the  
17 Letter of Credit Issuing Banks, culminating in the proposed Term Sheet.

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

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1           28. At any time there is an "Event of Default" under the terms of a  
2 Reimbursement Agreement, the applicable Letter of Credit Issuing Bank has the  
3 continuing right, pursuant to the terms of its Reimbursement Agreement and related  
4 Indenture, to notify the Bond Trustee of the occurrence or existence of one or more "Events  
5 of Default" under its Reimbursement Agreements and to direct the Bond Trustee to declare  
6 an "Event of Default" under the related Indenture, notwithstanding the Letter of Credit  
7 Issuing Bank's failure to exercise such right at any time. In addition, so long as a Letter of  
8 Credit Issuing Bank is not reimbursed in full for drawings properly honored by such Letter  
9 of Credit Issuing Bank under the Letter of Credit issued by it, such Letter of Credit Issuing  
10 Bank has, among other things, the continuing right (under both its Reimbursement  
11 Agreement and its Letter of Credit) to notify the Bond Trustee of such failure to be  
12 reimbursed in full and to state that the amount available to be drawn under the Letter of  
13 Credit to pay interest on such Letter of Credit Backed PC Bonds has not been reinstated,  
14 notwithstanding the failure of the Letter of Credit Issuing Bank to exercise such right  
15 previously.

16           29. As a Chapter 11 debtor in possession, PG&E has not reimbursed the Letter  
17 of Credit Issuing Banks for any of the payments they have made pursuant to the several  
18 post-petition draws on their Letters of Credit. Accordingly, each of the Letter of Credit  
19 Issuing Banks has the right upon the passage of time, the giving of notice or both, to either  
20 (i) declare an "Event of Default" under their respective Reimbursement Agreements and to  
21 direct the Bond Trustee to call an Event of Default under the terms of the respective  
22 Indenture, and/or (ii) during certain periods following the monthly draws on each of the  
23 Letters of Credit to pay interest on the Letter of Credit Backed PC Bonds, to notify the  
24 Bond Trustee that the Interest Portion of the Letter of Credit will not be reinstated. In such  
25 event the Bond Trustee would, in accordance with the terms of the respective Indentures  
26 and the respective Letters of Credit, declare the respective series of Letter of Credit Backed  
27 PC Bonds immediately due and payable, draw upon the respective Letter of Credit, and  
28 apply such drawn funds to the full payment and cancellation of the related outstanding

1 Letter of Credit Backed PC Bonds, with the end result that the tax-preferred financing  
2 would no longer be outstanding.

3 30. Under the terms of the Term Sheet, each of the Letter of Credit Issuing  
4 Banks has agreed to forbear, for a limited period, from taking such action or taking any  
5 other action which would result in the mandatory tender or redemption of any of the  
6 outstanding Letter of Credit Backed PC Bonds without the prior written consent of PG&E.  
7 This concession by the Letter of Credit Issuing Banks allows PG&E to maintain the  
8 benefits of the tax-exempt financing during the forbearance period at a significant savings  
9 to the estate.

10 31. Further, pursuant to the Term Sheet, provided that no Termination Event  
11 shall have occurred and remain uncured, each of the Letter of Credit Issuing Banks has  
12 agreed that prior to April 18, 2002, it shall extend the expiration date of its Letter of Credit  
13 to the first business day subsequent to the one-year anniversary of the existing expiration  
14 date of such Letter of Credit. This is desirable to the Debtor because each of the Letters of  
15 Credit will expire in accordance with its terms on the expiry date set forth on Schedule 1  
16 attached to the Term Sheet. Unless each of the Letters of Credit is renewed or replaced in  
17 accordance with the terms of the Indentures at least 35 days prior to its expiration date, the  
18 Bond Trustee will be required to call the related series of Letter of Credit Backed PC  
19 Bonds for redemption and cancellation. The Letter of Credit Issuing Banks have the right  
20 to refuse to extend the terms of their Letters of Credit beyond their respective maturities.

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

28 33. The fees payable by PG&E under the terms of the Term Sheet and the timing

1 of the payment of such fees are, in the opinion of PG&E, fair compensation to the Letter of  
2 Credit Issuing Banks for their agreements under the provisions of the Term Sheet to, among  
3 other things, forbear from the exercise of remedies under their respective Reimbursement  
4 Agreements and for their agreement to extend the maturities of their respective Letters of  
5 Credit as described above. Even after the payment of the increased fees set forth in the Term  
6 Sheet, PG&E will continue to realize substantial interest cost savings by maintaining the  
7 benefits of the outstanding tax-exempt financing provided by the Letter of Credit Backed PC  
8 Bonds, which cost savings more than offset the cost of the fees. Furthermore, it is  
9 customary in connection with the extension of the term of a letter of credit for the borrower  
10 or account party and the issuing bank to renegotiate the terms under which the letter of credit  
11 would be extended given the prevailing market conditions and the creditworthiness of the  
12 borrower. Under the current circumstances, the Debtor believes that the increased total letter  
13 of credit fees are a reasonable and necessary component of any agreement to extend the  
14 maturities of the Letters of Credit.

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15 34. The Debtor believes that, given the additional administrative responsibilities  
16 that Deutsche Bank will have to perform as agent for its bank group in order to maintain its  
17 Letter of Credit, it is reasonable and necessary for the Debtor to pay Deutsche Bank the  
18 additional agency fee set forth in the Term Sheet.

19 35. The Term Sheet provides that commencing on a date not more than 10 days  
20 after the Bankruptcy Court approves the Motion, PG&E will pay the reasonable fees and  
21 expenses of unrelated third party professionals retained by the Letter of Credit Issuing Banks  
22 ("Professional Fees"), to the extent incurred subsequent to April 6, 2001 in connection with  
23 the Chapter 11 case of PG&E, and shall thereafter pay such additional Professional Fees as  
24 may be incurred by the Letter of Credit Issuing Banks no later than 30 days subsequent to  
25 each date reimbursement requests therefor (with appropriate backup) are made in writing by  
26 the Letter of Credit Issuing Bank to PG&E. PG&E is obligated under the terms of the  
27 respective Reimbursement Agreements to reimburse the Letter of Credit Issuing Banks for  
28 the reasonable fees and expenses of unrelated third party professionals retained by the Letter

DECLARATION OF MICHAEL J. DONNELLY

1 of Credit Issuing Banks. Moreover, under the stipulation approved by the Prior Motion and  
2 Order, subject to certain conditions, such attorneys' fees constitute allowed claims against  
3 PG&E and its estate. Thus, this provision of the Term Sheet does not expand PG&E's  
4 obligations, but, in light of the full payment of creditors proposed in the Amended Plan, only  
5 serves to accelerate the timing of the Letter of Credit Issuing Banks' reimbursement for such  
6 costs. Again, given the substantial benefits to PG&E from this deal, PG&E believes that  
7 such a concession is minor and well justified.

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

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

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

7 38. The proposed treatment of the Allowed Letter of Credit Bank Claims as set  
8 forth in the Amended Plan with the refinements set forth in the Term Sheet are intended to,  
9 among other things, allow PG&E and the Reorganized Debtor the ability to maintain the  
10 benefits of the tax-exempt financing provided by the Letter of Credit Backed PC Bonds  
11 through and after the Effective Date of the Amended Plan.

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

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

1 transactions contemplated in the Term Sheet.

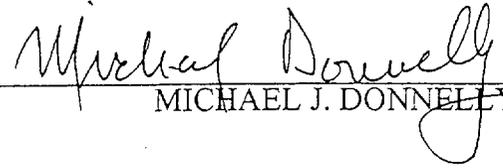
2 41. PG&E believes that the benefits of the forbearance offered by the Letter of  
3 Credit Issuing Banks, the extension of the terms of the Letters of Credit, and the other  
4 agreements by the Letter of Credit Issuing Banks set forth in the Term Sheet outweigh any  
5 concessions made by PG&E in the Term Sheet.

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I declare under penalty of perjury under the Federal laws of the United States of America that the foregoing is true and correct, and that this declaration was executed on March 20, 2002 at San Francisco, California.

  
MICHAEL J. DONNELLY

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**SUMMARY OF TERMS  
WITH RESPECT TO FORBEARANCE AND PROPOSED REVISED  
TREATMENT OF LETTER OF CREDIT BANK CLAIMS  
IN THE PLAN OF REORGANIZATION**

In connection with the overall restructuring of the debt of Pacific Gas and Electric Company (the "Debtor"), the treatment of the Debtor's obligations with respect to the outstanding Letter of Credit Backed Pollution Control Bonds set forth on Schedule 1 attached hereto and the credit enhancement facilities issued with respect thereto, will be revised as follows.

All initially capitalized terms, unless otherwise defined herein, shall have the meanings assigned to such terms in the Proposed Plan of Reorganization Under Chapter 11 of the Bankruptcy Code For Pacific Gas and Electric Company, dated September 20, 2001 (the "Plan"), filed by the Debtor together with the Debtor's parent company, PG&E Corporation, with the United States Bankruptcy Court for the Northern District of California (the "Bankruptcy Court").

**Letter of Credit Backed PC  
Bonds:**

The Pollution Control Bonds identified on Schedule 1 attached hereto (collectively, the "Letter of Credit Backed PC Bonds") remain outstanding as of the date hereof. No modifications will be made to the Letter of Credit Backed PC Bonds or to any of the documents executed in connection therewith except as described herein.

**Letters of Credit**

The Letters of Credit identified on Schedule 1 attached hereto (each a "Letter of Credit" and collectively, the "Letters of Credit") securing the payment of the principal of and interest on the related series of Letter of Credit Backed PC Bonds remain outstanding on the date hereof in the stated amount set forth on Schedule 1 attached hereto.

**Forbearance by Letter of Credit Issuing Banks:**

During the "Forbearance Period" (as hereinafter defined), unless a "Termination Event" (as hereinafter defined) occurs, the Letter of Credit Issuing Banks shall (i) maintain each of the Letters of Credit outstanding in the stated amounts set forth on Schedule 1 attached hereto, and (ii) not provide the Trustee with notice of any default under any of the Reimbursement Agreements or non-reinstatement of any of the Letters of Credit or take any other action which would result in the mandatory tender or redemption, either in whole or in part, of any of the outstanding Letter of Credit Backed PC Bonds without the prior written consent of the Debtor.

**Forbearance Period**

The "Forbearance Period" shall mean the time period commencing upon the "Term Sheet Approval Date" (as hereinafter defined) and ending, with respect to each Letter of Credit, upon the earlier of: (i) the last interest payment date on the related series of Letter of Credit Backed PC Bonds immediately preceding the expiration date of such Letter of Credit, as such expiration date shall be extended in accordance with the terms hereof; and (ii) the occurrence of a "Termination Event" (as hereinafter defined).

**Termination Event**

Each and any of the following constitutes a "Termination Event":

- The Debtor shall fail to file a motion (the "Motion") with the Bankruptcy Court on or before the tenth day following the Term Sheet Approval Date, in form and substance reasonably acceptable to the Debtor and the Letter of Credit Issuing Banks, implementing the terms of the forbearance by the Letter of Credit Issuing Banks as described herein with only such modifications as shall be reasonably acceptable to the Debtor and each of the Letter of Credit Issuing Banks, or the Debtor shall fail to pursue such Motion in good faith and with all reasonable

diligence (a "Motion Termination Event");

- The Debtor shall fail to timely remit any of the "Pre-Confirmation Date Payments" (as hereinafter defined), the "Confirmation Date Payments" (as hereinafter defined), and the "Post-Confirmation Date Payments" (as hereinafter defined) to the Letter of Credit Issuing Banks (a "Payment Termination Event");
- A Plan which provides for the treatment of Allowed Letter of Credit Bank Claims in the manner described herein or for alternative treatment of Allowed Letter of Credit Bank Claims which is acceptable to the Letter of Credit Issuing Banks is not confirmed on or before September 30, 2002 (a "Confirmation Deadline Event");
- A Plan is confirmed in the Debtor's chapter 11 case which does not provide for the treatment of Allowed Letter of Credit Bank Claims in the manner described herein or for alternative treatment of Allowed Letter of Credit Bank Claims which is acceptable to the Letter of Credit Issuing Banks (a "Plan Treatment Termination Event");
- The "Effective Date" as defined in the Plan (the "Effective Date") occurs; or

The chapter 11 case of the Debtor is dismissed or converted to chapter 7 (a "Conversion Termination Event").

**Expiration Date:**

On or before the date thirty (30) days subsequent to the date the Debtor and each of the Letter of Credit Issuing Banks execute the Consent to Term Sheet attached hereto (the "Term Sheet Approval Date"), provided that no Termination Event has occurred and remains uncured, each of the Letter of Credit Issuing Banks shall extend the expiration date of its Letter of Credit to the first

business day subsequent to the one-year anniversary of the existing expiration date of such Letter of Credit.

**Purchase in Lieu of Redemption:** Provided that no Termination Event shall have occurred and remain uncured, prior to the Effective Date upon written request of the Debtor, each Letter of Credit Issuing Bank shall cause the related series of Letter of Credit Backed PC Bonds to be tendered for purchase through a draw upon the respective Letter of Credit and instruct the respective Bond Trustee to either register the purchased Letter of Credit Backed PC Bonds in the name of the Letter of Credit Issuing Bank or in the name of the Debtor subject to a first lien security interest in favor of the respective Letter of Credit Issuing Bank to additionally secure the obligations of the Debtor under the related Reimbursement Agreement.

Upon written request of the Debtor or the Letter of Credit Issuing Banks delivered by either party to the other on or after the date the Bankruptcy Court approves the Motion, the Debtor and each of the Letter of Credit Issuing Banks shall take any action as shall be reasonably necessary to amend the Loan Agreement and/or Indenture pursuant to which each series of Letter of Credit Backed PC Bonds were issued to add the right of the Letter of Credit Issuing Bank or the Debtor to purchase any Letter of Credit Backed PC Bonds in lieu of redemption and to cause such purchased Letter of Credit Backed PC Bonds to be registered in the name of the respective Letter of Credit Issuing Bank or in the name of the Debtor subject to a first lien security interest in favor of the respective Letter of Credit Issuing Bank to secure the related reimbursement obligation of the Debtor; provided that, in the event that a Motion Termination Event, a Payment Termination Event, a Plan Treatment Termination Event or a Conversion Termination Event occurs, the Debtor shall not, without the prior written consent of the respective Letter of Credit Issuing Bank, have the

right to convert a mandatory redemption of Letter of Credit Backed PC Bonds into a purchase in lieu of redemption in accordance with the proposed amended Loan Agreement or Indenture. Such amendments to be in form and content satisfactory to the Debtor and the Letter of Credit Issuing Banks.

Notwithstanding anything contained herein to the contrary, in the event that a Plan which provides for the treatment of Allowed Letter of Credit Bank Claims in the manner described herein or for alternative treatment of Allowed Letter of Credit Bank Claims which is acceptable to the Letter of Credit Issuing Banks is not confirmed on or before June 30, 2002 then each Letter of Credit Issuing Bank shall have the right, but not the obligation to cause the related series of Letter of Credit Backed PC Bonds to be tendered for purchase through a draw upon the respective Letter of Credit and to instruct the respective Bond Trustee to either register the purchased Letter of Credit Backed PC Bonds in the name of the Letter of Credit Issuing Bank or, at the direction of the Letter of Credit Issuing Bank, in the name of the Debtor subject to a first lien security interest in favor of the respective Letter of Credit Issuing Bank to additionally secure the obligations of the Debtor under the related Reimbursement Agreement, and shall not thereafter take any action which would cause the related series of Letter of Credit Backed PC Bonds to be called for redemption unless a Confirmation Deadline Event, a Motion Termination Event, a Payment Termination Event, a Plan Treatment Termination Event or a Conversion Termination Event occurs.

**Required Payments:**

The Debtor shall remit the following payments to each of the Letter of Credit Issuing Banks with respect to its Letter of Credit to the extent permitted by order of the Bankruptcy Court (together, the "Required Payments"):

Pre-Confirmation Date: If the Bankruptcy Court approves the Motion, then

commencing upon, or within ten (10) days after, the date an order is entered by the Bankruptcy Court approving the Motion (the "Motion Approval Date"), and continuing until the Confirmation Date, the following amounts (the "Pre-Confirmation Date Payments"):

- The Approved Forbearance, Extension and Letter of Credit Fees (as hereinafter defined); and
- The reasonable fees and expenses of unrelated third party professionals retained by the Letter of Credit Issuing Banks ("Professional Fees"), to the extent incurred subsequent to April 6, 2001 in connection with the Chapter 11 case of the Debtor, which with respect to each Letter of Credit Issuing Bank for the period prior to the Term Sheet Approval Date shall be in an aggregate amount not to exceed the amount mutually agreed to by the Debtor and each Letter of Credit Issuing Bank on or prior to the Term Sheet Approval Date. Such Professional Fees shall be payable no later than thirty (30) days subsequent to each date such reimbursement requests (with appropriate backup) are made in writing by the Letter of Credit Issuing Bank to the Debtor.

Confirmation Date: On, or within ten (10) days after, the date an order is entered confirming a Plan (the "Confirmation Date"), and irrespective of the existence of conditions which must be satisfied prior to the occurrence of the Effective Date of the Plan, the Debtor shall pay to the Letter of Credit Issuing Banks the following amounts (the "Confirmation Date Payments"):

- All outstanding reimbursement claims under the applicable Reimbursement Agreements with respect to Letter of Credit draws for payment of interest on the related series of Letter of Credit Backed PC Bonds (“Interest Reimbursement Claims”);
- All accrued and unpaid interest at the non-default rate due on the Interest Reimbursement Claims to the extent provided in the applicable Reimbursement Agreement (“Reimbursement Interest”);
- If the Motion Approval Date does not occur within 49 days after the date the Motion is filed, all accrued and unpaid Unapproved Forbearance, Extension and Letter of Credit Fees, if any; and
- All other amounts (other than reimbursement for principal drawings on the respective Letter of Credit, if any, or the principal portion of purchase drawings on the respective Letter of Credit, if any) then due and owing to the respective Letter of Credit Issuing Bank under the terms of the respective Reimbursement Agreement through the Confirmation Date;

Post-Confirmation Date: During the time period subsequent to the Confirmation Date and prior to the Effective Date, the Debtor shall pay to each Letter of Credit Issuing Bank the following amounts (the “Post-Confirmation Payments”):

- The accrued and unpaid Approved

Forbearance, Extension and Letter of Credit Fees or the accrued and unpaid Unapproved Forbearance, Extension and Letter of Credit Fees, as applicable;

- All accrued and unpaid reasonable Professional Fees to the extent incurred in connection with the Chapter 11 case of the Debtor, which shall be payable no later than thirty (30) days subsequent to each date such reimbursement requests (with appropriate backup) are made in writing by the Letter of Credit Issuing Bank to the Debtor; and
- All Interest Reimbursement Claims and Reimbursement Interest, which shall be payable when due pursuant to the terms of the applicable Reimbursement Agreement.

### Letter of Credit Fees

If the Motion Approval Date occurs within forty-nine (49) days after the date the Motion is filed, then the Debtor shall remit the following payments to each of the Letter of Credit Issuing Banks with respect to its Letter of Credit to the extent permitted by order of the Bankruptcy Court (together, the "Approved Forbearance, Extension and Letter of Credit Fees"):

- During the period after the Motion Approval Date and continuing until the Confirmation Date, quarterly, in arrears, the Letter of Credit fee as set forth in the respective Reimbursement Agreement (the "Original Letter of Credit Fee"), together with an amount equal to the positive difference, if any, of an amount per annum equal to two (2%)

percent of the Stated Amount of the Letter of Credit, less the Original Letter of Credit Fee (together, the "Initial Letter of Credit Fee"), which total fee shall accrue from and after December 1, 2001 and until the Confirmation Date, and shall be payable on the same dates as are set forth for payment of Letter of Credit Fees in the applicable Reimbursement Agreement.

- During the period from and after the Confirmation Date and continuing until the Effective Date, quarterly, in arrears, the Original Letter of Credit Fee, together with an amount equal to the positive difference, if any, of an amount per annum equal to three (3%) percent of the Stated Amount of the Letter of Credit, less the Original Letter of Credit Fee, which total fee shall accrue from and after the Confirmation Date until the Effective Date, and shall be payable on the same dates as are set forth for payment of Letter of Credit fees in the applicable Reimbursement Agreement.

If the Motion Approval Date does not occur within forty-nine (49) days after the Motion is filed, then the Debtor shall remit the following payments to each of the Letter of Credit Issuing Banks with respect to its Letter of Credit to the extent permitted by order of the Bankruptcy Court (together, the "Unapproved Forbearance, Extension and Letter of Credit Fees"):

- During the period from and after the Confirmation Date and continuing until the Effective Date, quarterly, in arrears, the Original Letter of Credit Fee, together with

an amount equal to the positive difference, if any, of an amount per annum equal to three (3%) percent of the Stated Amount of the Letter of Credit, less the Original Letter of Credit Fee, which total fee shall accrue from and after December 1, 2001 until the Effective Date, and shall be payable on the same dates as are set forth for payment of Letter of Credit fees in the applicable Reimbursement Agreement.

**Agency Fee**

On the Confirmation Date, the Debtor shall pay to Deutsche Bank AG New York Branch, an agency fee in the amount of \$250,000 as additional compensation for acting as the administrative agent under the terms of its Reimbursement Agreement during the period from and after December 1, 2001 through the Effective Date; provided that no Termination Event shall have occurred prior to June 30, 2002 and Deutsche Bank AG shall not be in default hereunder, such agency fee shall be deemed fully earned on the earlier of the Confirmation Date or June 30, 2002.

**Treatment of Allowed Letter of Credit Bank Claims**

The revised Plan shall provide that, on the Effective Date one of the following shall occur with respect to each series of Letter of Credit Backed PC Bonds and its respective Letter of Credit, at the option of the Debtor separately for each series of Letter of Credit Backed PC Bonds:

Purchase Option: The respective series of Letter of Credit Backed PC Bonds shall be called for mandatory tender in accordance with the terms of the respective Indenture and shall be purchased by the respective Bond Trustee through a draw on the related Letter of Credit and, at the option of the respective Letter of Credit Issuing Bank, shall either be registered in the name of the respective Letter of Credit Issuing Bank or in the name of the Debtor subject to a first lien security interest in

favor of the respective Letter of Credit Issuing Bank to additionally secure the obligations of the Debtor under the related Reimbursement Agreement.

On the Effective Date, the Letter of Credit Issuing Bank will receive Cash in an amount equal to the sum of (i) the interest portion of the purchase price of the tendered Letter of Credit Backed PC Bonds paid out of a draw on the respective Letter of Credit, and (ii) the aggregate amount paid by the respective Letter of Credit Issuing Bank to the respective Bond Trustee under the terms of the applicable Letter of Credit with respect to the payment of the interest on the respective Letter of Credit Backed PC Bonds during the period from the Confirmation Date to and including the last scheduled interest payment date on such Letter of Credit Backed PC Bonds preceding the Effective Date, together with interest at the non-default rate due on such amounts to the extent provided in the respective Reimbursement Agreement.

On the Effective Date, the Letter of Credit Issuing Bank shall transfer the related Letter of Credit Backed PC Bonds in the aggregate principal amount as set forth on Schedule 1 attached hereto to the Debtor free and clear of all liens.

The Letter of Credit Issuing Bank will receive (i) Cash in an amount equal to sixty percent (60%) of the principal portion of the purchase price of the tendered Letter of Credit Backed PC Bonds paid out of a draw on the respective Letter of Credit, and (ii) Long Term Notes (as defined in the Plan) having an aggregate face value equal to forty percent (40%) of the principal portion of the purchase price of the tendered Letter of Credit Backed PC Bonds paid out of a

draw on the respective Letter of Credit, plus a placement fee in an amount equal to 1.5% of the aggregate principal amount of such long-term notes. Alternatively, at the option of the Letter of Credit Issuing Bank, the reimbursement for the principal portion of the purchase price of the tendered Letter of Credit Backed PC Bonds paid out of a draw on the respective Letter of Credit shall be paid on the Effective Date through a combination of Cash and long term notes upon terms equivalent to the Cash, long term notes and other consideration provided for treatment of unsecured creditors generally in the confirmed Plan.

- or -

Remarketing Option: The respective series of Letter of Credit Backed PC Bonds shall be called for mandatory tender in accordance with the terms of the respective Indenture and shall be purchased by the respective Bond Trustee through a draw on the related Letter of Credit. The Debtor will then either (i) provide or cause to be provided to the respective Bond Trustee an alternative "Credit Facility" pursuant to the terms of the respective Indenture in lieu of the existing Letter of Credit, or (ii) shall obtain the consent of the Issuer to remarket the respective series of Letter of Credit Backed PC Bonds without credit enhancement in accordance with the terms of the applicable Indenture. In either event the respective series of Letter of Credit Backed PC Bonds shall be remarketed, at par, in accordance with the terms of the Indenture and the other PC Bond Documents.

In such event, on the Effective Date, the Letter of Credit Issuing Bank will receive (i) from the Debtor, Cash in an amount

equal to the sum of (A) the interest portion of the purchase price of the tendered Letter of Credit Backed PC Bonds paid out of a draw on the respective Letter of Credit, and (B) the aggregate amount paid by the respective Letter of Credit Issuing Bank to the respective Bond Trustee under the terms of the applicable Letter of Credit with respect to the payment of the interest on the respective Letter of Credit Backed PC Bonds during the period from the Confirmation Date to and including the last scheduled interest payment date on such Letter of Credit Backed PC Bonds preceding the Effective Date, together with interest at the non-default rate due on such amounts to the extent provided in the respective Reimbursement Agreement, and (ii) from the Bond Trustee, an amount equal to the principal portion of the purchase price of the tendered Letter of Credit Backed PC Bonds paid out of a draw on the respective Letter of Credit, which amount shall be paid from the remarketing proceeds of the respective Letter of Credit Backed PC Bonds in accordance with the terms of the respective Indenture.

-or-

No Bonds Option: With respect to each Letter of Credit Issuing Bank and the related Banks, if any, in the event that neither the Purchase Option nor the Remarketing Option, as applicable, can be consummated or the respective series of Letter of Credit Backed PC Bonds are redeemed on or prior to the Effective Date as the result of the expiration of the respective Letter of Credit or otherwise, then either:

(A) The Class 4e Claim of such Letter of Credit Issuing Bank and the applicable Banks, if any, would be

converted to a Class 4f Claim in an amount equal to the amount due by the Debtor under the terms of the respective Reimbursement Agreement as reimbursement for amounts paid by such Letter of Credit Issuing Bank under its respective Letter of Credit to the Bond Trustee for the payment of the principal portion of the redemption price of the related series of Letter of Credit Backed PC Bonds;

-or-

(B) If (i) the Letter of Credit Issuing Bank maintains its Letter of Credit outstanding in the stated amount set forth on Schedule 1 attached hereto through the Effective Date and does not provide the Trustee with notice of default under its Reimbursement Agreement or non-reinstatement of its Letter of Credit or take any other action which would result in the redemption, either in whole or in part, of the outstanding Letter of Credit Backed PC Bonds without the prior written consent of the Debtor, and (ii) the Letter of Credit Issuing Bank and each of the related Banks, if any, take all action reasonably required by the Debtor to keep the Letter of Credit Backed PC Bonds outstanding and to facilitate either the Purchase Option or the Remarketing Option, as applicable, including, without limitation, giving direction to the Trustee, providing commercially reasonable indemnification to the Issuer and Trustee, and using their best efforts to consummate the proposed amendments to the terms of the Letter of Credit Backed PC Bonds as set forth herein and to consummate either the Purchase Option or the Remarketing Option as applicable, so as to maintain for the

Debtor the benefits of the tax-exempt financing provided by the related series of Letter of Credit Backed PC Bonds, then in the event that the Letter of Credit Backed PC Bonds are redeemed on or prior to the Effective Date for reasons beyond the control of the Letter of Credit Issuing Bank, either (1) the Letter of Credit Issuing Bank will receive (i) Cash in an amount equal to sixty percent (60%) of the principal portion of the redemption price of the redeemed Letter of Credit Backed PC Bonds paid out of a draw on the respective Letter of Credit, and (ii) Long Term Notes having an aggregate face value equal to forty percent (40%) of the principal portion of the redemption price of the redeemed Letter of Credit Backed PC Bonds paid out of a draw on the respective Letter of Credit, plus a placement fee in an amount equal to 1.5% of the aggregate principal amount of such long-term notes, or (2) at the option of the Letter of Credit Issuing Bank, the reimbursement for the principal portion of the redemption price of the redeemed Letter of Credit Backed PC Bonds paid out of a draw on the respective Letter of Credit shall be paid on the Effective Date through a combination of Cash and long term notes upon terms equivalent to the Cash, long term notes and other consideration provided for treatment of unsecured creditors generally in the confirmed Plan.

Except as otherwise set forth herein, the confirmed Plan shall not contain other terms which, taken as a whole, are materially adverse to the Letter of Credit Issuing Banks as compared with such other terms as set forth in the Plan as filed with the Bankruptcy Court on September 20, 2001.

**Tax Exemption:**

With respect to each series of Letter of Credit Backed PC Bonds, the Reorganized Debtor and each Issuer, Bond Trustee, and credit enhancer, if any, shall, on the Effective Date, receive an opinion of the original bond counsel to the effect that the transactions contemplated herein do not, in and of themselves, cause interest on such series of Letter of Credit Backed PC Bonds to become includable in the gross income of the holders thereof for federal income tax purposes.

This term sheet is intended to summarize certain of the terms presently under discussion with respect to the potential treatment of Letter of Credit Backed PC Bond Claims (Class 4d) and Letter of Credit Bank Claims (Class 4e). The delivery of this term sheet is not intended and shall not be deemed to be a commitment, approval or binding offer of any kind on the part of Debtor, PG&E Corporation, any of the Letter of Credit Issuing Banks, any of the Banks or any of their respective affiliates, and receipt of this term sheet does not in any way constitute a commitment by any of the Letter of Credit Banks, any of the Banks or any of their respective affiliates to make any loan, to enter into any extension or modification of any existing loan or credit facility, or to provide the above described financing or modifications or otherwise. Without limiting the foregoing, it is expressly understood and agreed that the terms hereof require the approval of the Bankruptcy Court, as well as senior credit and other approvals within the Debtor, PG&E Corporation, and each of the Letter of Credit Issuing Banks which has not been, and may never be, obtained. None of the parties hereto or referred to herein shall be bound by any of the terms hereof unless and until such time as (i) with respect to each of the Letter of Credit Issuing Banks, the Consent to Term Sheet attached hereto has been executed by such Letter of Credit Issuing Bank, and (ii) with respect to the Debtor, the Consent to Term Sheet attached hereto has been executed by the Debtor and the terms hereof shall have been reduced to mutually agreeable formal documents and approved or authorized by final order of the Bankruptcy Court. Nothing herein shall be construed as a solicitation of, or agreement to vote in favor of, a Plan by any party. Solicitation of votes to accept or reject a Plan may only be made after a Disclosure Statement regarding the Plan has been approved by the Bankruptcy Court and a Disclosure Statement has not been approved as of the date hereof. Except as specifically set forth herein, the Debtor, PG&E Corporation and each of the Letter of Credit Issuing Banks reserve all of their rights and remedies in connection with, or related in any manner to, the Debtor's Chapter 11 bankruptcy proceedings, the Letters of Credit, the Letter of Credit Backed PC Bond Claims, the Letter of Credit Bank Claims and all of the documents, instruments and agreements executed or delivered in connection therewith.

Dated: \_\_\_\_\_

CONSENT TO TERM SHEET

Accepted and Approved:

BANK OF AMERICA, N.A.,  
as Issuing Agent

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

DEUTSCHE BANK AG, NEW YORK BRANCH,  
as Issuing and Administrative Agent

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

BNP PARIBAS,  
as Issuing Agent

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

MORGAN GUARANTY TRUST COMPANY OF NEW YORK  
as Issuing Agent

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

PACIFIC GAS AND ELECTRIC COMPANY,  
as Debtor

By: *KM Harvey*  
Name: KEAT M. HARVEY  
Title: SENIOR VICE PRESIDENT,  
CHIEF FINANCIAL OFFICER & TREASURER

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**CONSENT TO TERM SHEET**

Accepted and Approved:

**BANK OF AMERICA, N.A.**  
as Issuing Agent

By:   
Name: Chara Yang Shuang  
Title: Managing Director

**DEUTSCHE BANK AG, NEW YORK BRANCH,**  
as Issuing and Administrative Agent

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**BNP PARIBAS.**  
as Issuing Agent

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**MORGAN GUARANTY TRUST COMPANY OF NEW YORK**  
as Issuing Agent

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**PACIFIC GAS AND ELECTRIC COMPANY,**  
as Debtor

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

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**CONSENT TO TERM SHEET**

Accepted and Approved:

**BANK OF AMERICA, N.A.,  
as Issuing Agent**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**DEUTSCHE BANK AG, NEW YORK BRANCH,  
as Issuing and Administrative Agent**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**BNP PARIBAS,  
as Issuing Agent**

By: *Barbara Espino*  
Name: **BARBARA ESPOLITO**  
Title: **Vice President**

*Kathryn B. Quinn*  
**KATHRYN QUINN**  
**Vice President**

**MORGAN GUARANTY TRUST COMPANY OF NEW YORK  
as Issuing Agent**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

**PACIFIC GAS AND ELECTRIC COMPANY,  
as Debtor**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

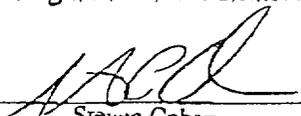
CONSENT TO TERM SHEET

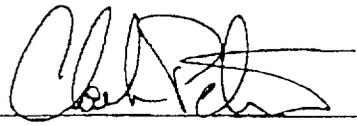
Accepted and Approved:

BANK OF AMERICA, N.A.,  
as Issuing Agent

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

DEUTSCHE BANK AG, NEW YORK BRANCH,  
as Issuing and Administrative Agent

By:   
Name: Steven Cohen  
Title: Director

By:   
Name: Clark G. Peterson  
Title: Vice President

BNP PARIBAS,  
as Issuing Agent

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

MORGAN GUARANTY TRUST COMPANY OF NEW YORK  
as Issuing Agent

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

PACIFIC GAS AND ELECTRIC COMPANY,  
as Debtor

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

SCHEDULE 1

<u>Series</u>	<u>Original Principal Amount</u>	<u>Letter of Credit Issuing Bank</u>	<u>Stated Amount of Letter of Credit</u>	<u>Letter of Credit Expiry Date</u>
California Pollution Control Financing Authority, Pollution Control Revenue Bonds (Pacific Gas and Electric Company) 1996 Series C (the "96C Bonds")	\$200,000,000	Bank of America, N.A.	\$202,191,781	May 23, 2002
California Pollution Control Financing Authority, Pollution Control Revenue Bonds (Pacific Gas and Electric Company) 1996 Series E (the "96E Bonds")	\$165,000,000	Morgan Guaranty Trust Company of New York	\$166,808,220	May 23, 2003
California Pollution Control Financing Authority, Pollution Control Revenue Bonds (Pacific Gas and Electric Company) 1996 Series F (the "96F Bonds")	\$100,000,000	BNP Paribas	\$101,095,891	May 23, 2003
California Pollution Control Financing Authority, Pollution Control Refunding Revenue Bonds (Pacific Gas and Electric Company) 1997 Series B (the "97B Bonds")	\$148,550,000	Deutsche Bank AG	\$150,177,945	September 16, 2002