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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

Case No. 01 30923 DM

Chapter 11 Case

Date: September 29, 2003

Time: 1:30 p.m.

Place: 235 Pine Street, 22nd Floor  
San Francisco, California

Judge: Hon. Dennis Montali

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**DECLARATION OF JOSHUA BAR-LEV IN SUPPORT OF DEBTOR'S MOTION  
FOR ORDER AUTHORIZING PACIFIC GAS AND ELECTRIC COMPANY TO  
COMPROMISE CLAIMS AGAINST EL PASO NATURAL GAS COMPANY ET  
ALIA AND TO ENTER INTO AGREEMENTS RESOLVING THE CLAIMS**

BKRP01

HOWARD  
RICE  
NEMEROVSKI  
CANADY  
FALK  
& RABKIN  
A Professional Corporation

1 I, Joshua Bar-Lev, declare as follows:

2 1. I am an attorney licensed to practice law in the State of California and  
3 counsel for Pacific Gas and Electric Company ("PG&E" or the "Debtor"), a position I have  
4 held for twenty-five years. I am currently Chief Counsel for Electric and Gas Transmission  
5 and Supply in PG&E's Law Department, where I am responsible for gas and electric  
6 transmission and procurement matters, legal assignments related to electricity crisis issues  
7 and matters pending at the California Independent System Operator (the "ISO"), the  
8 California Power Exchange (the "PX") and the Federal Energy Regulatory Commission (the  
9 "FERC"). I am also involved in assessing setoffs and affirmative claims that PG&E may  
10 have against the ISO, the California Department of Water Resources (the "CDWR"), market  
11 participants and others arising out of power purchases and sales.

12 2. I make this Declaration in support of the Debtor's Motion For Order  
13 Authorizing Pacific Gas and Electric Company To Compromise Claims Against El Paso  
14 Natural Gas Company Et Alia And To Enter Into Agreements Resolving the Claims. I make  
15 this Declaration based upon my leading role in the negotiation of this settlement, my  
16 personal knowledge of PG&E's litigation and claims resolution process and my review of  
17 PG&E's records concerning the matters stated herein. If called as a witness, I could and  
18 would testify competently to the facts stated herein.

19  
20 **Summary and Status of the Claims**

21 3. From June 2000 to June 2001, the prices paid by California citizens for  
22 electricity and natural gas rose to unprecedented levels, creating a state-wide emergency (the  
23 "California energy crisis"). Because gas is a key cost-input in most electric generation, spot  
24 gas prices in the Topock, Arizona spot market (a key market for incremental supplies of gas  
25 for delivery to California) affected open market prices for electric power during the  
26 California energy crisis. As a result, California consumers paid at least \$8.3 billion more  
27 than they expected to pay for natural gas supplies and the natural gas component of electrical  
28

1 energy supplies. PG&E and its ratepayers bore a substantial portion of these massive  
2 overpayments.

3 4. On April 4, 2000, the California Public Utilities Commission (the "CPUC")  
4 filed a complaint against El Paso Natural Gas Company ("EPNG"), El Paso Merchant  
5 Energy-Gas, L.P., and El Paso Merchant Energy Company at the FERC (Docket No. RP00-  
6 241-000) alleging that firm contracts held by El Paso Merchant Energy-Gas, L.P. and El  
7 Paso Merchant Energy Company for transportation capacity on the EPNG system were  
8 obtained in violation of the FERC's Standards of Conduct and raising issues regarding the  
9 exercise of market power (the "FERC Natural Gas Proceeding"). Southern California  
10 Edison ("Edison") and PG&E, among others, subsequently intervened in that proceeding.

11 5. Since then, at least seven class action complaints have been filed against El  
12 Paso Corporation, EPNG and El Paso Merchant Energy, L.P. (collectively, "El Paso") and  
13 other defendants in California state courts, alleging that El Paso and others had committed  
14 antitrust violations and engaged in unfair competition or unfair business practices in the  
15 California gas and/or electric power markets. The Attorneys General of the States of  
16 California and Nevada, the cities of Long Beach and Los Angeles, and various utility  
17 companies have filed complaints in state court and at the FERC alleging violations of laws  
18 and regulations by El Paso and other power sellers with respect to the California energy  
19 crisis.

20 6. In September 2001, the Attorney General of the State of California  
21 commenced an investigation into the facts relating to El Paso's participation in the  
22 California gas and electric power markets from 1998 to the present, which to date has  
23 resulted in the production by El Paso of hundreds of thousands of pages of documents and  
24 numerous investigative hearings. The Attorneys General of Washington and Oregon have  
25 also been investigating the facts relating to El Paso's direct and indirect participation in the  
26 Oregon and Washington electric power and gas markets from 1998 to the present.

27 7. In addition, the California Attorney General, PG&E and Edison have each  
28 filed federal court actions in the United States District Court of the Central District of

1 California alleging that El Paso's manipulation of the California energy market during the  
2 energy crisis violated federal and state anti-trust and unfair competition laws. The  
3 complaints in these now-consolidated actions are based, legally and factually, in large part,  
4 on investigation and analysis undertaken by Edison, the CPUC and PG&E in the FERC  
5 Natural Gas Proceeding. PG&E's complaint against El Paso is attached hereto as Exhibit A.

6  
7 **The Settlement Terms**

8 8. In order to resolve the many claims set forth above<sup>1</sup> in a manner that would  
9 provide prompt and effective relief to the people of the states of California, Nevada, Oregon  
10 and Washington without the burden, expense and uncertainty of continued litigation, PG&E  
11 and the other claimants (collectively, the "Settling Claimants")<sup>2</sup> negotiated a settlement with  
12 El Paso (the "Settlement").

13 9. The terms of the Settlement are set forth in the Master Settlement  
14 Agreement ("MSA"), executed on June 24, 2003. The MSA resolves the claims of the  
15 Settling Claimants against El Paso (collectively, the "Parties") in both state and federal  
16 court, as well as at the FERC. A true and correct copy of the MSA is attached hereto as  
17 Exhibit B.

18 10. To implement the payment of consideration under the MSA, the Settling  
19 Claimants entered into an Allocation Agreement (the "AA") and a Designated

20  
21 <sup>1</sup>The claims and allegations of all of the Settling Claimants are set forth in greater  
22 detail in Part 2 of the Master Settlement Agreement, attached hereto as Exhibit B.

23 <sup>2</sup>In addition to PG&E, the Settling Claimants consist of: the Attorney General of the  
24 State of California, the Governor of the State of California, the California Public Utilities  
25 Commission, the California Department of Water Resources, the California Energy  
26 Oversight Board, the Attorney General of the State of Washington, the Attorney General of  
27 the State of Oregon, the Attorney General of the State of Nevada, Southern California  
28 Edison Company, the City of Los Angeles, the City of Long Beach, and classes consisting of  
all individuals and entities in California that purchased natural gas and/or electricity for use  
and not for resale or generation of electricity for the purpose of resale, between September 1,  
1996 and March 20, 2003, inclusive, represented by class representatives Continental Forge  
Company, Andrew and Andrea Berg, Gerald J. Marcil, United Church Retirement Homes of  
Long Beach, Inc., doing business as Plymouth West, Long Beach Brethren Manor, Robert  
Lamond, Douglas and Valerie Welch, William Patrick Bower, Thomas L. French, Frank and  
Kathleen Stella, John Clement Molony, SierraPine, Ltd., John and Jennifer Frazee, John  
W.H.K. Phillip, and Cruz Bustamante.

1 Representative Agreement (the "DRA"), and will soon enter into an Escrow Agreement (the  
2 "EA"). True and correct copies of the AA and DRA are attached hereto as Exhibits C and D,  
3 respectively.

4 11. The AA was entered into between the Settling Claimants and sets forth the  
5 terms under which the settlement proceeds are to be allocated and administered.

6 12. The DRA, also entered into between the Settling Claimants, designates the  
7 Office of the California Attorney General as the Designated Representative (the "DR") of  
8 the Settling Claimants and governs how and when the DR is to act on behalf of the Settling  
9 Claimants.

10 13. The AA and the DRA were executed simultaneously with the MSA.

11 14. The EA will govern the escrow account in which the settlement funds will  
12 be held until disbursed and is still being negotiated and drafted. I expect the EA to be  
13 finalized and the escrow account to be established by approximately September 2003.

14  
15 **The Master Settlement Agreement**

16 15. Under the terms of the MSA, El Paso has agreed to provide, inter alia, \$1.55  
17 billion in settlement consideration, valued in nominal dollars,<sup>3</sup> in three principal forms: (1)  
18 up-front payments; (2) deferred payments; and (3) a contract concession. Specifically, El  
19 Paso will make up-front payments to the Settling Claimants totaling approximately \$550  
20 million; will make semiannual payments to the Settling Claimants over twenty years totaling  
21 approximately \$875 million; and will reduce the price of power to the Settling Claimants by  
22 \$125 million under a long-term power supply contract between El Paso and the CDWR.

23 16. Pursuant to the MSA, the approximately \$550 million in up-front payments  
24 consists of the following:

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28 <sup>3</sup>Nominal dollars are amounts that have not been adjusted to take into account the  
effect of inflation.

- 1 (a) El Paso will deposit into escrow a payment in the amount of  
2 \$78,590,071 upon the later of the execution of the MSA or the Escrow  
3 Effective Date<sup>4</sup>;
- 4 (b) El Paso will deposit into escrow a payment in the amount of  
5 \$243,229,464 by December 22, 2003;
- 6 (c) El Paso Corporation will sell 26,371,308 shares of its common stock  
7 (worth approximately \$227,000,000 when the MSA was executed) at  
8 the direction of the Settling Claimants after a shelf registration  
9 statement authorizing issuance of the shares becomes effective.<sup>5</sup> The  
10 proceeds of that stock sale will be deposited into escrow; and
- 11 (d) El Paso will deposit into escrow prior to the Effective Date<sup>6</sup> a payment  
12 in the amount of \$2 million, from a bonus pool for El Paso officers.

13 17. Beginning on the later of the Effective Date or July 1, 2004, El Paso will  
14 begin making deferred payments totaling approximately \$875 million in forty semi-annual  
15 installments over a period of twenty years (the "Deferred Payments"). El Paso may prepay  
16 its deferred payment obligation, in full or in part, before or after the Effective Date. If El  
17 Paso regains an investment grade credit rating for a period of six months or longer, the  
18 remaining payments are accelerated so that the obligation is paid off within fifteen instead of  
19 twenty years. Under a twenty-year amortization schedule, each semiannual payment will be  
20 in the amount of \$21,890,651. If the amortization schedule is accelerated to fifteen years,  
21 the amount of each payment will increase, although the precise amount of the increase will  
22

23 <sup>4</sup>The Escrow Effective Date is the date on which all Parties (or their designated  
24 representatives) and an acceptable escrow agent execute an escrow agreement.

25 <sup>5</sup>It should be noted that the value of this component of the up-front payments may be  
26 significantly affected by the value of El Paso common stock when it is registered and sold.

27 <sup>6</sup>The Effective Date is defined as the date when all conditions precedent have been  
28 satisfied, including, *inter alia*, entry of a judgment by the San Diego Superior Court  
approving the class action settlement, approval of the settlement by the FERC and dismissal  
of various FERC proceedings against El Paso, the approval by the Bankruptcy Court of the  
settlement as to PG&E, and entry of a stipulated judgment in federal district court  
encompassing the structural relief agreed to by the parties. Ex. A ¶¶ 3.1, 3.2.

1 depend on when the acceleration takes place. The amortization schedule will not revert to  
2 twenty years if El Paso thereafter becomes non-investment grade.

3 18. El Paso will secure the Deferred Payments with oil and gas reserves with a  
4 value equal to 130% (a coverage ratio of 1.3 to 1) of the net present value of the outstanding  
5 Deferred Payments, measured as of the close of each calendar quarter. El Paso will deliver  
6 letters of credit or other collateral acceptable to the Settling Claimants and to any applicable  
7 rating agency (if the obligations have been monetized).

8 19. As of the Effective Date, El Paso will amend the Master Power Purchase  
9 and Sale Agreement dated as of February 9, 2001, between El Paso Merchant LP and  
10 CDWR to reduce the price of the contract by \$125,000,000 over the remaining two and half  
11 years of the term of the contract. Under the AA, CDWR has committed to use all  
12 consideration allocated to it (including this contract concession) to reduce its annual revenue  
13 requirement.

14 20. El Paso agrees to certain "structural remedies" to prevent any future  
15 manipulation of the California gas market, including guarantees to make physically available  
16 the capacity to deliver 3,290 MMcf/day of gas to California and clarification of the  
17 procedure whereby northern California shippers may recall Block II capacity in order to  
18 serve customers in PG&E's service area, as set forth in the settlement approved by the FERC  
19 in Docket No. RP95-363-000 on April 16, 1997 (the "1996 Settlement").<sup>7</sup> With the  
20 exception of issues that are within the exclusive jurisdiction of the FERC, the structural  
21 remedies are to be enforced in Federal District Court through a special master.

22 21. Pursuant to the MSA, PG&E agrees to release all claims against El Paso  
23 related to, inter alia, the exercise of market power; manipulation or misreporting of gas or  
24 electric power prices; and reduction of the supply of natural gas, electric power or gas  
25 pipeline capacity for the period September 1, 1996 through March 20, 2003. In return, El  
26

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27 <sup>7</sup>The parties to the 1996 Settlement divided EPNG's 1.614 Epf/day of turnback  
28 capacity into three blocks (Blocks I, II and III) for the term of that settlement. Block II  
contains 614 MMcf/day of capacity and consists of primary point deliveries to Topock for  
PG&E and others.

1 Paso agrees to release all claims against PG&E related to, inter alia, the price or supply of  
2 natural gas, electric power or gas pipeline capacity for the period through March 20, 2003,  
3 including El Paso's bankruptcy claim against PG&E for approximately \$57.5 million, the  
4 amount PG&E allegedly owes for sales of power to PG&E through the California ISO and  
5 the California PX (Claim No. 0008837).

6 22. The release does not cover claims asserted by PG&E against other parties in  
7 various regulatory proceedings, such as the FERC Refund Proceeding and the 390 QF  
8 Proceeding at the California Public Utilities Commission (the "CPUC"), where PG&E is  
9 seeking refunds of excessive energy payments made to Qualifying Facilities ("QFs") during  
10 the energy crisis (including El Paso owned/controlled QFs).

### 11

### 12 The Allocation Agreement

13 23. In addition to the settlement with El Paso, the Settling Claimants also  
14 agreed on the allocation of and administration of the settlement proceeds. Pursuant to the  
15 AA entered into between the Settling Claimants, all consideration is being divided pro rata  
16 based on calculation of the "damages" suffered by each party.<sup>8</sup> The percentages can only be  
17 estimated at this time because, depending on the final allocation of consideration to  
18 municipal claimants (which are subject to a claims procedure), the allocation percentages of  
19 the other Settling Claimants may change to some extent.

20 24. Under the AA, PG&E will receive approximately 6% (currently estimated  
21 at \$81 million) of the total consideration for damages incurred as a result of gas purchases  
22 and approximately 16% (currently estimated at \$217 million) of the total consideration for  
23 damages as a result of electricity purchases (the "Settlement Amount").

24  
25 <sup>8</sup>Such pro rata sharing percentages apply to the up-front and deferred consideration  
26 received from El Paso. The consideration reflects prior deduction of certain fixed amounts,  
27 including (1) fixed allocations for the settlement shares of the states of Washington, Oregon  
28 and Nevada, and for the consideration going to certain other non-class claimants; (2)  
attorneys' fees for the attorneys representing the plaintiff classes and for the attorneys  
representing the Office of the California Attorney General, the CPUC, PG&E, Edison, and  
the City of Los Angeles; and (3) the \$125 million CDWR contract concession. Ex. B ¶¶3, 4,  
6.

1           25. In a rulemaking proceeding initiated pursuant to a recent Order Instituting  
2 Rulemaking ("OIR"), the CPUC, pursuant to the AA, will determine how the El Paso  
3 settlement proceeds paid to PG&E should be allocated among various classes of customers  
4 and will designate the refund and accounting mechanisms for PG&E's portion of the  
5 proceeds.

6           26. The CDWR is allocated, pursuant to the AA, approximately 33%  
7 (approximately \$461 million) for damages as a result of electricity purchases, which include  
8 the reduced price of its contracts with El Paso. All consideration received by the CDWR  
9 shall be used to reduce the CDWR's revenue requirement, and the allocation of such  
10 reduction among utilities shall be determined by the CPUC.

11  
12 **Evaluation of the Settlement**

13           27. In a case of this type, the outcome is always uncertain, and the probability  
14 of success is difficult to weigh. El Paso has denied all wrongdoing and disputes the amount  
15 of damages suffered by PG&E and the other Settling Claimants. If PG&E's federal action  
16 were to proceed through trial, there is a reasonable risk that the factfinder would award  
17 PG&E damages that would be lower than the Settlement Amount.

18           28. The pursuit of PG&E's claims against El Paso in the federal action and  
19 elsewhere (to the extent necessary) would require lengthy and expensive litigation, and the  
20 judgment would likely be subject to appeal. Consequently, a considerable amount of time  
21 would pass before El Paso would be required, if at all, to compensate PG&E for its alleged  
22 damages. The Settlement minimizes this delay and uncertainty by preventing further  
23 appeals and disputes and by providing for guaranteed up-front and deferred payments by El  
24 Paso to PG&E and the other Settling Claimants.

25           29. Under the terms of the MSA, in the event of default, the Settling Claimants  
26 may, upon prior notice to El Paso, accelerate the Deferred Payments, making the entire  
27 discounted amount immediately due and payable. El Paso will also secure the Deferred  
28 Payments with its oil and gas reserves. As such, I expect collection of the Settlement

1 Amount to be without difficulty.

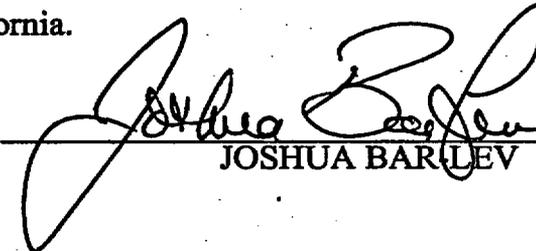
2 30. The Settlement resolves the complex and various claims against El Paso of  
3 over twenty parties who previously differed in their willingness to settle. If the Settlement  
4 were not approved, each of the Settling Claimants would presumably continue litigating its  
5 particular claims at great expense and inconvenience to the parties involved and the courts.

6 31. PG&E's litigation against El Paso raises many complex and challenging  
7 issues, including El Paso's expected challenge of PG&E's damages. These complex issues  
8 would presumably require extensive expert analysis and testimony and result in protracted  
9 and costly litigation. Based on the foregoing considerations, I believe that the Settlement  
10 eliminates such unnecessary expense, inconvenience and delay and is thus favorable to the  
11 Debtor.

12 32. The Settlement fully resolves PG&E's claims against El Paso without the  
13 expense, risk and delay inherent in PG&E's civil action against El Paso. Avoidance of  
14 unnecessary litigation will benefit PG&E's creditors by minimizing costs and delay and  
15 allowing PG&E's personnel to focus on more critical functions.

16 33. The Settlement Amount will avoid the risk of a lower net recovery for the  
17 estate if PG&E were to pursue its civil action against El Paso through trial. The Settlement  
18 not only preserves estate assets, but also provides the estate with funds which will assist the  
19 Debtor in implementing its plan of reorganization.

20 I declare under penalty of perjury under the laws of the United States of America  
21 and the State of California that the foregoing is true and correct. Executed this 5<sup>th</sup> day of  
22 September, 2003, at San Francisco, California.

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24   
25 JOSHUA BARLEV

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