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

15 In re
16 PACIFIC GAS AND ELECTRIC
17 COMPANY, a California corporation,

18 Debtor.

19 Federal I.D. No. 94-0742640

No. 01-30923 DM

Chapter 11 Case

Date: October 9, 2003
Time: 1:30 p.m.
Place: 235 Pine Street, 22nd Floor
San Francisco, California
Judge: Hon. Dennis Montali

20 DECLARATION OF MICHAEL J. DONNELLY IN SUPPORT OF DEBTOR'S NOTICE
21 OF MOTION AND MOTION FOR ORDER APPROVING DEBTOR'S EXECUTION
22 AND PERFORMANCE UNDER THE AMENDMENT TO FIRST AMENDED AND
23 RESTATED SUMMARY OF TERMS WITH RESPECT TO FORBEARANCE AND
24 PROPOSED REVISED TREATMENT OF LETTER OF CREDIT BANK CLAIMS IN
25 THE PLAN OF REORGANIZATION;
26 SUPPORTING MEMORANDUM OF POINTS AND AUTHORITIES

27
28
DECLARATION OF MICHAEL J. DONNELLY

BKRP01

1 I, Michael J. Donnelly, declare:

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

13 **In General:**

14 2. By the Motion, PG&E seeks the Court's approval of PG&E's execution of, and
15 performance under, an Amendment to First Amended and Restated Summary of Terms With
16 Respect to Forbearance and Proposed Revised Treatment of Letter of Credit Bank Claims in
17 the Plan of Reorganization (the "Amendment," a true and correct copy of which is attached
18 hereto as Exhibit A), which PG&E has entered into with the various counterparties described
19 below, subject to Bankruptcy Court approval, amending that certain First Amended and
20 Restated Summary of Terms With Respect to Forbearance and Proposed Revised Treatment
21 of Letter of Credit Bank Claims in the Plan of Reorganization (the "Term Sheet," a true and
22 correct copy of which is attached as Exhibit B hereto) which PG&E has previously entered
23 into with the same counterparties pursuant to the Debtor's Motion For Order Approving
24 Debtor's Execution and Performance under the Amended and Restated Summary of Terms
25 with Respect to Forbearance and Proposed Revised Treatment of Letter of Credit Bank
26 Claims in the Plan of Reorganization dated May 28, 2002 (Docket No. 6738), which was
27 granted by this Court's Order dated June 17, 2002 (Docket No. 7334) (hereinafter the "Prior
28 Motion and Order"), in order to maximize the chance that PG&E can preserve for the

1 bankruptcy estate and the anticipated reorganized Debtor the benefits of favorable tax-
2 exempt bond financing.

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

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

13 5. Under the terms of the documents under which the bonds were issued, due to
14 certain payment defaults by PG&E as debtor in possession, the letter of credit issuing banks
15 had the right to cause the bonds to be redeemed through draws on their letters of credit.
16 However, under the terms of the Prior Motion and Order, PG&E and the letter of credit
17 issuing banks entered into an agreement, pursuant to which the letter of credit issuing banks
18 agreed, among other things, to extend the terms of their respective letters of credit and to
19 forbear from exercising such remedies under the terms of the bond documents for a limited
20 period of time in exchange for the agreement by the Debtor to make certain payments,
21 including the payment of certain increased letter of credit fees, and certain other concessions
22 by the Debtor. This agreement was embodied in the Term Sheet and approved by the Prior
23 Motion and Order.

24 6. Under the terms of the Term Sheet, among other things, the letter of credit
25 issuing banks are, subject to certain conditions, required to maintain their letters of credit
26 securing the bonds and forbear from exercising remedies that would result in the redemption
27 of the bonds unless, among other things, a plan of reorganization which provides for the
28 treatment of their claims in the manner set forth in the Original PG&E Plan (as hereinafter

1 defined) and as later incorporated into the Current Plan (as hereinafter defined) or for
2 alternative treatment which is acceptable to the letter of credit issuing banks, does not
3 become effective on or before June 1, 2003 (the "Plan Condition"). The Debtor has
4 requested, and the letter of credit issuing banks have agreed, subject to certain terms and
5 conditions, to amend the Term Sheet to, among other things, modify the Plan Condition.

6 7. Accordingly, PG&E desires to enter into a new consensual arrangement with
7 the letter of credit issuing banks, as set forth in the Amendment, which would modify the
8 agreement set forth in the Term Sheet, pursuant to which, among other things, in exchange
9 for certain additional fees, the letter of credit issuing banks would agree to maintain their
10 existing letters of credit for the benefit of PG&E for an extended period, extend the Plan
11 Condition deadline from June 1, 2003 to May 18, 2004, allow the existing letters of credit to
12 continue to be drawn to pay accruing interest on outstanding tax-exempt bonds, refrain from
13 taking certain actions and agree to take certain other actions in cooperation with PG&E to
14 keep the tax-exempt bonds (and the related below-market-rate loans to PG&E) outstanding.

15 8. For the reasons set forth above and as more fully described below, PG&E
16 believes that the agreement set forth in the Amendment and in the Term Sheet as amended
17 thereby is beneficial to the Debtor and its estate.

18 9. On April 19, 2002, PG&E and its parent company, PG&E Corporation (the
19 "Parent"), jointly propounded and filed a Plan of Reorganization Under Chapter 11 of the
20 Bankruptcy Code for Pacific Gas and Electric Company (as modified by various
21 modifications through May 22, 2003, the "Original PG&E Plan"). On May 17, 2002, the
22 California Public Utilities Commission (the "Commission") filed a competing plan of
23 reorganization for the Debtor; the Official Unsecured Creditor's Committee (the
24 "Committee") joined with the Commission to file an amended plan of reorganization for the
25 Debtor; and in December 5, 2002, the Commission and the Committee filed their Third
26 Amended Plan of Reorganization under Chapter 11 of the Bankruptcy Code for Pacific Gas
27 and Electric Company Dated December 5, 2002 (the "Competing Plan").

28 10. In accordance with an order of the Bankruptcy Court dated March 4, 2003,

DECLARATION OF MICHAEL J. DONNELLY

1 the Debtor entered into mandatory settlement discussions with the Commission that
2 culminated in a tentative settlement agreement, subject to final approvals, between the
3 Debtor and the Commission (the "Settlement Agreement"). This in turn resulted in the filing
4 by the Debtor, its Parent and the Committee of a Plan of Reorganization under Chapter 11 of
5 the Bankruptcy Code for Pacific Gas and Electric Company filed July 31, 2003 (as may be
6 amended from time to time, the "Current Plan"), which incorporates the provisions of the
7 Settlement Agreement. The confirmation hearings on the Original PG&E Plan and the
8 Competing Plan have been stayed indefinitely, and the confirmation hearing on the Current
9 Plan is scheduled to begin on November 10, 2003.¹

10 **Background and Mechanics of Subject Bond Issuances:**

11 11. Pursuant to the terms of various separate trust indentures (each, an
12 "Indenture") each between the California Pollution Control Financing Authority, a public
13 instrumentality and political subdivision of the State of California (the "Issuer") and
14 Deutsche Bank Trust Company Americas (formerly known as Bankers Trust Company), as
15 trustee (the "Bond Trustee"), and various corresponding loan agreements between the Issuer
16 and PG&E, as of the commencement of this Chapter 11 case, the Issuer had issued and
17 outstanding 15 series of its revenue bonds in aggregate principal amount of approximately
18 \$1.69 billion. As of the filing of the Motion, 11 series of such revenue bonds in the
19 aggregate principal amount of approximately \$1.24 billion remain outstanding. Of this
20 \$1.24 billion, the revenue bonds that are the subject of the Motion consist of four series of
21 credit-enhanced revenue bonds in the aggregate principal amount of approximately
22 \$613,550,000, as set forth more specifically on Schedule 1 attached to the Amendment
23 (collectively, the "Letter of Credit Backed PC Bonds").²

24 ¹ The treatment of Class 4e under each of the Original Plan and the Current Plan
25 reflect the treatment of the subject letter of credit issuing banks that is provided for in the
26 Prior Motion and Order. If the Motion is granted, the treatment of Class 4e in the Current
Plan will be modified to reflect the Amendment to the Term Sheet.

27 ² 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 Amendment, the Term Sheet and the

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

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

23 14. The Letter of Credit Backed PC Bonds are special limited obligations of the
24 Issuer payable exclusively out of the trust estates under each of the Indentures. None of the
25 Letter of Credit Backed PC Bonds constitute a debt or liability, or a pledge of the faith,
26 credit or taxing power of the Issuer, the State of California or any of its instrumentalities or
27 political subdivisions. Rather, each series of Letter of Credit Backed PC Bonds is a limited
28 Motion.

DECLARATION OF MICHAEL J. DONNELLY

1 obligation of the Issuer payable solely from the revenues derived by the Issuer from PG&E
2 pursuant to the terms of the related Loan Agreement to the extent pledged by the Issuer to
3 the Bond Trustee under the terms of the applicable Indenture and from certain other funds
4 pledged and assigned as part of the trust estates under the applicable Indentures.

5 **Letter of Credit Backed PC Bonds:**

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

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

1 Credit Backed PC Bonds, the amount so drawn is subject to reinstatement upon the terms set
2 forth in the applicable Letter of Credit.

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

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

21 **Tax-Exempt Status of Letter of Credit Backed PC Bonds:**

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

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1 20. The tax-exempt status of the Letter of Credit Backed PC Bonds allowed such
2 bonds to be issued at favorable interest rates, thus allowing PG&E to finance or refinance
3 certain of its capital improvements and other qualified costs at rates substantially below
4 comparable conventional taxable financing alternatives available to PG&E. Based on the
5 tax-exempt status of the Letter of Credit Backed PC Bonds, their credit enhancement and
6 their commensurate credit rating, the Letter of Credit Backed PC Bonds currently accrue
7 interest at the average blended interest rate of only 0.83% per annum.³ In the event that any
8 of the Letter of Credit Backed PC Bonds were to be redeemed in accordance with the terms
9 of their respective Indentures, it may not be possible under current law to reissue such bonds
10 on a tax-exempt basis. Accordingly, PG&E has made the determination that the continued
11 existence of such favorable tax-exempt financing is a valuable asset of PG&E's bankruptcy
12 estate, and that it is in the best interest of PG&E's estate to keep the Letter of Credit Backed
13 PC Bonds outstanding in order to preserve the substantial benefits of such tax-exempt
14 financing.

15 **Post-Chapter 11 Filing Status of Letter of Credit Backed PC Bonds:**

16 21. Since PG&E's Chapter 11 filing on April 6, 2001 (the "Petition Date"), all of
17 the Letter of Credit Backed PC Bonds have remained outstanding, and all of the scheduled
18 interest payments on the Letter of Credit Backed PC Bonds have been fully and timely paid,
19 when due, through periodic draws by the Bond Trustee on the Letters of Credit provided by
20 the Letter of Credit Issuing Banks. To date, following each such drawing, each of the Letter
21 of Credit Issuing Banks has allowed the Interest Portion of its respective Letter of Credit to
22 automatically reinstate in accordance with the terms thereof each month, which has resulted
23 in automatic reinstatements each month since PG&E's Chapter 11 filing in April 2001.

24 22. In accordance with the provisions of the Term Sheet and the Prior Motion
25 and Order, the Debtor has reimbursed the Letter of Credit Issuing Banks, as required by the
26 terms of the Reimbursement Agreements, for the amounts paid by the Letter of Credit

27 _____
28 ³This rate was calculated as of September 1, 2003, shortly before the filing of the Motion.

1 Issuing Banks to the Bond Trustee pursuant to the monthly post-petition draws on the Letters
2 of Credit made by the Bond Trustee for the payment of interest on the related Letter of
3 Credit Backed PC Bonds.

4 23. Subject to the provisions of the Term Sheet, during any period that one or
5 more "Events or Defaults" under its Reimbursement Agreement exist, each of the Letter of
6 Credit Issuing Banks has the right upon the passage of time, the giving of notice or both, (i)
7 to declare a default under its respective Reimbursement Agreement, (ii) to notify the Bond
8 Trustee of such default, and (iii) to direct the Bond Trustee to call an Event of Default under
9 the terms of the respective Indenture and, in accordance with the terms of the respective
10 Indenture, to cause the Bond Trustee to declare the respective series of Letter of Credit
11 Backed PC Bonds immediately due and payable. In such event the Bond Trustee would, in
12 accordance with the terms of the respective Indentures and the respective Letters of Credit,
13 draw upon the respective Letters of Credit, and apply such drawn funds to the full payment
14 and cancellation of the related outstanding Letter of Credit Backed PC Bonds, with the end
15 result that this tax-preferred financing would no longer be outstanding.

16 24. Further, pursuant to the terms of each of the Indentures, with respect to each
17 series of Letter of Credit Backed PC Bonds, subject to certain exceptions, unless 35 days
18 prior to the expiration of the respective Letter of Credit, the Bond Trustee shall have
19 received either (a) a renewal or extension of the existing Letter of Credit for a period of at
20 least one year, or (b) a substitute letter of credit or other credit facility meeting the
21 requirements of the respective Loan Agreement and Indenture, the Bond Trustee is required
22 to call the series of Letter of Credit Backed PC Bonds for redemption and cancellation on the
23 last business day which is at least five calendar days preceding the expiration date of the
24 respective Letter of Credit. In such event the Bond Trustee would again, in accordance with
25 the terms of the respective Indenture and the respective Letter of Credit, draw upon the
26 respective Letter of Credit, and apply such drawn funds to the full payment and cancellation
27 of the related series of outstanding Letter of Credit Backed PC Bonds, with the end result
28 that this tax-preferred financing would no longer be outstanding.

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1 25. However, pursuant to the Term Sheet and the Prior Motion and Order, each
2 of the Letter of Credit Issuing Banks has agreed, among other things, to forbear from the
3 exercise of such remedies, to maintain its Letter of Credit outstanding in the stated amounts
4 set forth in the Term Sheet, and not provide the Bond Trustee with notice of the non-
5 reinstatement of its Letter of Credit or of any default under its Reimbursement Agreement or
6 take any other action which would result in the mandatory tender or redemption, either in
7 whole or in part, of any of the outstanding Letter of Credit Backed PC Bonds without the
8 prior written consent of the Debtor until the earlier of (i) the last interest payment date on the
9 related series of Letter of Credit Backed PC Bonds immediately preceding the expiration
10 date of such Letter of Credit, as such expiration date has been extended in accordance with
11 the terms of the Term Sheet; or (ii) the occurrence of any "Termination Event," which is
12 defined in the Term Sheet to include certain payment defaults by Debtor, the failure of a
13 plan of reorganization of the Debtor which provides for the treatment of allowed Letter of
14 Credit Bank Claims in the manner provided in the Term Sheet or for alternative treatment of
15 such claims which is acceptable to the Letter of Credit Issuing Banks to become effective on
16 or before June 1, 2003, the confirmation of a plan of reorganization of the Debtor which
17 does not provide for such treatment of Letter of Credit Bank Claims, the occurrence of the
18 "Effective Date" as defined in the Current Plan, or the dismissal of the Debtor's chapter 11
19 case or the conversion of the case to a case under chapter 7.

20 26. Further, pursuant to the Term Sheet and the Prior Motion and Order, each of
21 the Letter of Credit Issuing Banks agreed to extend the term of its Letter of Credit to a date
22 not earlier than the first business day subsequent to the one-year anniversary of its prior
23 expiry date.

24 27. The forbearance by the Letter of Credit Issuing Banks, together with the
25 extension of their Letters of Credit, have allowed the Debtor to keep the Letter of Credit
26 Backed PC Bonds and the related Bond Loans outstanding, which has resulted and will
27 continue to result in substantial interest cost savings for the Debtor and its estate. However,
28 the Debtor's plan of reorganization did not become effective on or prior to June 1, 2003,

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1 which has resulted in the occurrence of a Termination Event as defined in the Term Sheet.

2 28. Further, even though each of the Letter of Credit Issuing Banks extended the
3 term of its Letter of Credit for a period of not less than one year as provided in the Term
4 Sheet, with respect to certain of the Letters of Credit such extended period has since expired.
5 As an accommodation to the Debtor and in order to prevent the early redemption of the
6 related series of Letter of Credit Backed PC Bonds, certain of the Letter of Credit Issuing
7 Banks have voluntarily further extended the terms of their Letters of Credit pending the
8 Court's approval of the Motion.

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

18 30. Because either (i) the exercise by the Letter of Credit Issuing Banks of their
19 remedies under their respective Reimbursement Agreements and the related Indentures or
20 (ii) the Letter of Credit Issuing Bank's refusal to voluntarily extend the term of their
21 respective Letters of Credit, could result in the redemption of the Letter of Credit Backed PC
22 Bonds, which in turn could result in the permanent loss to PG&E and its bankruptcy estate
23 of the significant benefits of the tax-exempt financing afforded by the respective Letter of
24 Credit Backed PC Bonds, PG&E has determined that it is in the best interests of the estate
25 and its creditors for PG&E to amend the terms of the Term Sheet by entering into the
26 Amendment and to seek this Court's approval of PG&E's execution of, and performance
27 under, the terms of the Amendment and the Term Sheet as amended thereby.

28 **Summary Of Terms Of The Amended Term Sheet:**

1 31. The principal terms of the Term Sheet and the changes to the Term Sheet
2 provided in the Amendment are summarized and explained as follows:

3 **A. Agreements by the Letter of Credit Issuing Banks:**

4 32. Extension of Forbearance: Each of the Letter of Credit Issuing Banks has
5 agreed to (i) maintain its Letter of Credit outstanding in its current stated amount, and (ii)
6 not provide the Bond Trustee with notice of any default under its Reimbursement Agreement
7 or non-reinstatement of its Letter of Credit or take any other action which would result in the
8 mandatory tender or redemption of any of the outstanding Letter of Credit Backed PC Bonds
9 without the prior written consent of PG&E, until the earlier of: (x) the last interest payment
10 date on the related series of Letter of Credit Backed PC Bonds immediately preceding the
11 expiration date of such Letter of Credit, as such expiration date shall be extended in
12 accordance with the terms of the Term Sheet, and (y) the occurrence of a "Termination
13 Event" (as hereinafter defined).

14 33. For such purpose, a "Termination Event" shall have occurred, and the Letter
15 of Credit Issuing Banks will no longer be obligated to continue to forbear from the exercise
16 of their remedies under their respective Reimbursement Agreements and the related
17 Indentures, if (a) PG&E fails to timely remit to the Letter of Credit Issuing Banks any of the
18 payments set forth in the Term Sheet, (b) a plan of reorganization of PG&E which provides
19 for the treatment of Allowed Letter of Credit Bank Claims (as defined in the Current Plan) in
20 the manner described in the Term Sheet or for alternative treatment of Allowed Letter of
21 Credit Bank Claims which is acceptable to the Letter of Credit Issuing Banks does not
22 become effective on or before May 18, 2004, (c) a plan of reorganization is confirmed in
23 PG&E's Chapter 11 case which does not provide for the treatment of Allowed Letter of
24 Credit Bank Claims in the manner described in the Term Sheet or for alternative treatment of
25 Allowed Letter of Credit Bank Claims which is acceptable to the Letter of Credit Issuing
26 Banks, (d) the "Effective Date" as defined in the Current Plan (the "Effective Date") occurs,
27 or (e) the Chapter 11 case of PG&E is dismissed or converted to a case under Chapter 7.

28 34. Explanation of Extension of Forbearance: At any time there is an "Event of

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

14 35. Under the terms of the Term Sheet, each of the Letter of Credit Issuing Banks
15 had agreed to forbear, for a limited period, from taking such action or taking any other action
16 which would result in the mandatory tender or redemption of any of the outstanding Letter
17 of Credit Backed PC Bonds without the prior written consent of PG&E. This concession by
18 the Letter of Credit Issuing Banks allows PG&E to maintain the benefits of the tax-exempt
19 financing during the forbearance period at a significant savings to the Debtor's bankruptcy
20 estate.

21 36. Prior to the Amendment, under the Term Sheet the Letter of Credit Issuing
22 Banks were permitted to cease their forbearance if, among other things, a plan of
23 reorganization which provides for the treatment of their claims either (i) in the manner set
24 forth in the Term Sheet and as presently set forth in the Current Plan, or (ii) in an alternative
25 manner which is acceptable to the Letter of Credit Issuing Banks, does not become effective
26 on or before June 1, 2003 (the "Effective Date Deadline"). The terms of the Term Sheet, as
27 amended by the Amendment, maintains all of the same forbearance provisions as the Term
28 Sheet with the exception that, in accordance with the terms of the Amendment, the Letter of

1 Credit Banks have agreed to modify the Effective Date Deadline as a condition to their
2 continued forbearance to provide that a plan of reorganization which provides for the
3 treatment of their claims in the manner set forth in the Term Sheet (as described below), or a
4 plan of reorganization of the Debtor which provides for alternative treatment of their claims
5 in a manner which is acceptable to the Letter of Credit Issuing Banks, becomes effective on
6 or before May 18, 2004. Accordingly, the provisions of the Term Sheet as amended by the
7 Amendment will provide the Debtor with additional time to confirm and effectuate a plan of
8 reorganization that would permit the reorganized Debtor to retain the benefits of the tax-
9 exempt exempt financing offered by the continued existence of the Letter of Credit Backed
10 PC Bonds.

11 37. Extension of Letter of Credit Expiration: Pursuant to the provisions of the
12 Amendment, each of the Letter of Credit Issuing Banks has agreed that, unless it has already
13 done so, it shall, on or before the date thirty days after the date that the Debtor's execution
14 and performance under the Amendment has been approved or authorized by final order of
15 the Bankruptcy Court, extended the term of its Letter of Credit to a date not earlier than the
16 first business day subsequent to the one-year anniversary of the prior expiration date of such
17 Letter of Credit.

18 38. Explanation of Extension of Letter of Credit Expiration: Unless each of the
19 Letters of Credit is renewed or replaced in accordance with the terms of the Indentures at
20 least 35 days prior to its expiration date, the Bond Trustee will be required to call the related
21 series of Letter of Credit Backed PC Bonds for redemption and cancellation. Under the
22 terms of the Reimbursement Agreements, the Letter of Credit Issuing Banks have the right
23 to refuse to extend the terms of their Letters of Credit beyond their respective maturities.

24 39. Pursuant to the terms of the Term Sheet prior to the Amendment, each Letter
25 of Credit Issuing Bank agreed to extended the term of its respective Letter of Credit for an
26 additional term of not less than one year from its then existing expiration date.

27 40. The Term Sheet, as amended by the Amendment, provides that, unless it has
28 already done so, each Letter of Credit Issuing Bank will extend the term of its respective

1 Letter of Credit for an additional year beyond that required under the provisions of the
2 original Term Sheet.

3 41. The agreement by the Letter of Credit Banks to extend the terms of their
4 Letters of Credit for an additional year provides PG&E with necessary additional time in
5 which to confirm and effectuate its plan of reorganization while both maintaining the
6 benefits of the tax-exempt financing provided by the Letter of Credit Backed PC Bonds for
7 the Debtor's bankruptcy estate, and giving the Debtor the opportunity to secure the
8 continuing benefits of such tax-exempt financing for the reorganized Debtor.

9 **B. Agreements by the Debtor:**

10 42. Reimbursement of Interest Draws: The Term Sheet provides that PG&E will
11 currently reimburse the Letter of Credit Issuing Banks for all amounts drawn under their
12 Letters of Credit for the payment of interest on the Letter of Credit Backed PC Bonds, which
13 amounts will be paid by PG&E when due pursuant to the terms of the applicable
14 Reimbursement Agreements.

15 43. Explanation of Reimbursement of Interest Draws: The Debtor has agreed
16 pursuant to the terms of the Term Sheet to currently reimburse the Letter of Credit Issuing
17 Banks for all amounts drawn under their Letters of Credit for the payment of interest on the
18 Letter of Credit Backed PC Bonds, which amounts will continue to be paid by PG&E when
19 due pursuant to the terms of the applicable Reimbursement Agreements. The Amendment
20 does not change any of the Debtor's obligations with respect to the timing or payment of
21 such amounts from those it agreed to in the Term Sheet as approved by the Prior Motion and
22 Order.

23 44. Additional Fees: The Term Sheet provides that PG&E is required to pay to
24 each of the Letter of Credit Issuing Banks quarterly, in arrears, the Letter of Credit fee as set
25 forth in the respective Reimbursement Agreement (the "Original Letter of Credit Fee"),
26 together with an amount equal to the positive difference, if any, of an amount per annum
27 equal to three (3%) percent of the Stated Amount of the Letter of Credit, less the Original
28 Letter of Credit Fee, which total fee is to be payable on the same dates as are set forth for

1 payment of Letter of Credit fees in the applicable Reimbursement Agreement through the
2 Effective Date.

3 45. The Term Sheet as amended by the Amendment also provides that within 10
4 days after the Debtor's execution and performance under the Amendment has been approved
5 or authorized by final order of this Court (the "Amendment Effective Date"), PG&E is
6 required to pay to each of the Letter of Credit Issuing Banks with respect to its Letter of
7 Credit, an additional fee, in an amount equal to one-half (0.50%) percent of the Stated
8 Amount of the Letter of Credit Issuing Bank's Letter of Credit.

9 46. Explanation of Additional Fees: As set forth in the Current Plan and the
10 Term Sheet, the Letter of Credit Issuing Banks and the Banks will be paid their outstanding
11 Allowed Letter of Credit Bank Claims, together with pre- and post-petition interest thereon,
12 in full on the terms set forth therein. The Current Plan and Term Sheet also provide for the
13 payment of certain increased fees to the Letter of Credit Issuing Banks as consideration for
14 their agreements to forbear and extend the maturities of the Letters of Credit.

15 47. Pursuant to the provisions of the Term Sheet as approved by the Prior Motion
16 and Order, PG&E will continue to make current payments of the letter of credit fees due
17 under the terms of the respective Reimbursement Agreements, plus pay an additional fee in
18 the amount necessary to bring the total annual fee payable to each Letter of Credit Issuing
19 Bank up to an aggregate amount per annum equal to three (3%) percent of the Stated
20 Amount of each Letter of Credit for the period that the respective Letter of Credit remains
21 outstanding in the Stated Amount through the Effective Date.

22 48. The increased total letter of credit fees continue to be calculated, and will
23 either accrue or be payable, in the same manner as letter of credit fees are currently provided
24 for in each of the existing Reimbursement Agreements.

25 49. In addition to the increased letter of credit fees provided for in the original
26 Term Sheet and approved by Prior Motion and Order, the Term Sheet as amended by the
27 Amendment provides that PG&E is also required to pay to each of the Letter of Credit
28 Issuing Banks with respect to its Letter of Credit, an additional fee (the "Forbearance

1 Extension Fee”), in an amount equal to one-half (0.50%) percent of the Stated Amount of
2 the Letter of Credit Issuing Bank’s Letter of Credit which additional fee is payable within 10
3 days after the Amendment Effective Date.

4 50. The total fees payable by PG&E under the Term Sheet, as amended by the
5 Amendment, are similar to the fees that PG&E has already agreed to pay under the terms of
6 the Term Sheet as approved by the Prior Motion and Order with the exception that PG&E
7 will also be required to pay each of the Letter of Credit Issuing Banks its respective
8 Forbearance Extension Fee. The total fees payable by PG&E under the terms of the Term
9 Sheet as amended by the Amendment are, in the opinion of PG&E, fair compensation to the
10 Letter of Credit Issuing Banks for their agreements under the provisions of the Term Sheet
11 as amended by the Amendment to, among other things, extend the terms of their respective
12 Letters of Credit and to continue to forbear from the exercise of remedies under their
13 respective Reimbursement Agreements for an extended period as described above. Even
14 after the payment of the increased fees set forth in the Term Sheet as amended by the
15 Amendment, PG&E will continue to realize substantial interest cost savings over the cost of
16 conventional taxable financing by maintaining the benefits of the outstanding tax-exempt
17 financing provided by the Letter of Credit Backed PC Bonds, which cost savings more than
18 offset the cost of the fees. Thus, under the current circumstances, the Debtor believes that
19 the increased total fees payable to the Letter of Credit Issuing Banks are a reasonable and
20 necessary component of any agreement to extend the forbearance period.

21 51. Professional Fees: The Term Sheet provides that PG&E will pay the
22 reasonable fees and expenses of unrelated third party professionals retained by the Letter of
23 Credit Issuing Banks ("Professional Fees"), to the extent incurred subsequent to April 6,
24 2001 in connection with the Chapter 11 case of PG&E no later than 30 days subsequent to
25 each date a reimbursement request therefor (with appropriate backup) is made in writing by
26 the Letter of Credit Issuing Bank to PG&E. These provisions are not changed by the
27 Amendment.

28 52. Explanation of Professional Fees: The Amendment does not change any of

1 the Debtor's obligations with respect to the timing and payment of such professional fees
2 from those it agreed to in the Term Sheet as approved by the Prior Motion and Order.

3 53. Purchase in Lieu of Redemption: The Term Sheet provides that, if no
4 Termination Event shall have occurred and remain uncured prior to the Effective Date, then
5 upon written request of PG&E, each Letter of Credit Issuing Bank shall cause the related
6 series of Letter of Credit Backed PC Bonds to be tendered for purchase through a draw upon
7 the respective Letter of Credit and instruct the respective Bond Trustee to either register the
8 purchased Letter of Credit Backed PC Bonds in the name of the Letter of Credit Issuing
9 Bank or in the name of PG&E subject to a first lien security interest in favor of the
10 respective Letter of Credit Issuing Bank to additionally secure the obligations of PG&E
11 under the related Reimbursement Agreement.

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

26 55. Finally, the Term Sheet as amended by the Amendment provides that in the
27 event that a plan of reorganization which provides for the treatment of Allowed Letter of
28 Credit Bank Claims in the manner described in the Term Sheet or for alternative treatment of

1 Allowed Letter of Credit Bank Claims which is acceptable to the Letter of Credit Issuing
2 Banks does not become effective on or before May 18, 2004, then each Letter of Credit
3 Issuing Bank shall have the right, but not the obligation, to cause the related series of Letter
4 of Credit Backed PC Bonds to be tendered for purchase through a draw upon the respective
5 Letter of Credit and to instruct the respective Bond Trustee to either register the purchased
6 Letter of Credit Backed PC Bonds in the name of the Letter of Credit Issuing Bank or, at the
7 direction of the Letter of Credit Issuing Bank, in the name of PG&E subject to a first lien
8 security interest in favor of the respective Letter of Credit Issuing Bank to additionally
9 secure the obligations of PG&E under the related Reimbursement Agreement, and shall not
10 thereafter take any action which would cause the related series of Letter of Credit Backed
11 PC Bonds to be called for redemption unless certain Termination Events occur.

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

26 57. The amendments to the bond documents proposed in the Term Sheet as
27 amended by the Amendment would also grant the Letter of Credit Issuing Banks the right,
28 but not the obligation, to cause a purchase of Letter of Credit Backed PC Bonds on or after

1 May 18, 2004, if a plan of reorganization which provides for the treatment of Allowed Letter
2 of Credit Bank Claims in the manner described in the Term Sheet or for alternative treatment
3 of Allowed Letter of Credit Bank Claims which is acceptable to the Letter of Credit Issuing
4 Banks does not become effective on or before such date. This provision is again similar to
5 the provision the Debtor agreed to in the original Term Sheet as approved by the Prior
6 Motion and Order except that, pursuant to the terms of the Amendment, the date before
7 which the Letter of Credit Issuing Banks are permitted to exercise the purchase right is
8 extended from June 1, 2003 to May 18, 2004, thus again granting the Debtor additional time
9 to confirm and consummate its plan of reorganization while maintaining the Letter of Credit
10 Backed PC Bonds outstanding at the tax-exempt rate.

11 58. Additional Default Right: Pursuant to the terms of the Term Sheet as
12 amended by the Amendment, PG&E has agreed that, with respect to each of the Letter of
13 Credit Issuing Banks and their respective Letters of Credit, provided that (i) the Letter of
14 Credit Issuing Bank shall at all times be in full compliance with the terms of the Term Sheet,
15 their respective Letter of Credit and Reimbursement Agreement, (ii) the respective Letter of
16 Credit is outstanding in its original stated amount, (iii) the respective Letter of Credit Issuing
17 Bank has not provided the Trustee with notice of any default under its Reimbursement
18 Agreement or non-reinstatement of its Letter of Credit, and (iv) no action has been taken
19 that has resulted, or would result, in the mandatory tender, redemption or purchase in lieu of
20 redemption, either in whole or in part, of any of the related Letter of Credit Backed PC
21 Bonds, then on any date on or after May 18, 2004, the respective Letter of Credit Issuing
22 Bank shall have the right, but not the obligation, to give notice to the Bond Trustee of the
23 occurrence of an event of default under the terms of the Reimbursement Agreement and to
24 direct the Bond Trustee to declare an event of default under the respective Indenture as a
25 result thereof to the extent provided under the terms of the respective bond documents.

26 59. Explanation of Additional Default Right. Pursuant to the terms of the
27 Amendment, each of the Letter of Credit Issuing Banks have agreed to extend the term of
28 their respective Letters of Credit for at least one year from their prior expiration date as

1 explained above. However, because of differences in the original expiration dates of each of
2 the Letters of Credit, each of the Letters of Credit will continue to expire on a different date.
3 After giving effect to the extensions of the terms of each of the Letters of Credit as provided
4 in the Amendment, the first of the Letters of Credit to expire will be the Letter of Credit
5 Issued by Bank of America, N.A. which will expire on May 23, 2004.

6 60. As explained above, unless each of the Letters of Credit is renewed or
7 replaced in accordance with the terms of the Indentures at least 35 days prior to its expiration
8 date, the Bond Trustee is required to call the related series of Letter of Credit Backed PC
9 Bonds for redemption and cancellation on the last business day which is not less than five
10 days preceding the expiration date of such Letter of Credit. Accordingly, unless Bank of
11 America, N.A. voluntarily agrees to further extend the term of its Letter of Credit, the
12 related series of Letter of Credit Backed PC Bonds may be subject to redemption on May 18,
13 2004 (the date five days prior to the expiration date of its Letter of Credit).

14 61. In order to give each of the other three Letter of Credit Issuing Banks the
15 same economic right that Bank of America, N.A. has to cause a drawing on its Letter of
16 Credit and the purchase or redemption of the related series of Letter of Credit Backed PC
17 Bonds on or after May 18, 2004, the Amendment and the Term Sheet as amended thereby
18 provides that, with respect to each of the Letter of Credit Issuing Banks and their respective
19 Letters of Credit, subject to certain conditions, on any date on or after May 18, 2004, the
20 respective Letter of Credit Issuing Bank shall have the right, but not the obligation, to give
21 notice to the Bond Trustee of the occurrence of an event of default under the terms of the
22 Reimbursement Agreement and to direct the Bond Trustee to declare an event of default
23 under the respective Indenture as a result thereof to the extent provided under the terms of
24 the respective bond documents.

25 **C. Treatment of Allowed Letter of Credit Bank Claims:**

26 62. The Term Sheet provides that the plan of reorganization propounded by
27 PG&E will provide for the treatment of Allowed Letter of Credit Bank Claims (as defined in
28 the Current Plan) in substantially the manner provided in the Original PG&E Plan. The

1 same treatment of Allowed Letter of Credit Bank Claims has been incorporated into the
2 Current Plan. The Amendment does not change any of the Debtor's obligations with respect
3 to the proposed treatment of Letter of Credit Bank Claims from those provided in the Term
4 Sheet as approved by the Prior Motion and Order.

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


11 64. The Court should approve PG&E's execution of and performance under the
12 Amendment and the Term Sheet as amended thereby in order to provide PG&E with the
13 additional time it may need to confirm and effectuate its plan of reorganization while both
14 maintaining the benefits of the tax-exempt financing provided by the Letter of Credit Backed
15 PC Bonds for the Debtor's bankruptcy estate, and giving the Debtor the opportunity to
16 secure the continuing benefits of such tax-exempt financing for the reorganized Debtor.

17 65. The tax-exempt financing provided by the Letter of Credit Backed PC Bonds
18 provides a substantial interest cost savings to PG&E (and will provide such savings to the
19 Reorganized Debtor) over the cost of alternative conventional taxable financing. As such,
20 the tax-exempt bond financing is an asset of the bankruptcy estate that, in the opinion of
21 PG&E, is best preserved through the transactions contemplated in the Amendment and the
22 Term Sheet as amended thereby.

23 66. PG&E believes that the benefits of the extended forbearance offered by the
24 Letter of Credit Issuing Banks and the other agreements by the Letter of Credit Issuing
25 Banks set forth in the Amendment and the Term Sheet as amended thereby, outweigh any
26 concessions made by PG&E in the Amendment and the Term Sheet as amended thereby, and
27 that the agreement reached with the Letter of Credit Issuing Bank and the Banks, as set forth
28 in the Amendment and the Term Sheet as amended thereby, is fair and reasonable and is in

1 the best interests of PG&E's estate.

2 I declare under penalty of perjury under the laws of the United States of America
3 that the foregoing is true and correct. Executed this 16th day of September, 2003, at San
4 Francisco, California.

5 
6 MICHAEL J. DONNELLY

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14 HOWARD
15 RICE
16 NEMEROVSKI
17 CANADY
18 BALK
19 & RABKIN
20 A Professional Corporation

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DECLARATION OF MICHAEL J. DONNELLY

Exhibits are not attached to the service copies of this document. You may obtain copies of the Exhibits in one of the following ways: through the "Pacific Gas & Electric Company Chapter 11 Case" link accessible through the Bankruptcy Court's website (www.canb.uscourts.gov), or by written request to Howard, Rice, Nemerovski, Canady, Falk & Rabkin, Attn: Nathaniel H. Hunt, Three Embarcadero Center, 7th Floor, San Francisco, California 94111-4024.