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PACIFIC GAS AND ELECTRIC COMPANY
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9 UNITED STATES BANKRUPTCY COURT
10 NORTHERN DISTRICT OF CALIFORNIA
11 SAN FRANCISCO DIVISION

12 In re

13 PACIFIC GAS AND ELECTRIC
14 COMPANY, a California corporation,

15 Debtor.

16 Federal I.D. No. 94-0742640
17

Case No. 01-30923 DM

Chapter 11 Case

Date: February 26, 2004

Time: 1:30 p.m.

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

Judge: Hon. Dennis Montali

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19 DECLARATION OF MICHAEL J. DONNELLY IN SUPPORT OF MOTION FOR
20 AUTHORITY TO ESTABLISH CASH-COLLATERALIZED LETTER OF CREDIT
21 PROGRAM AND FACILITY TO SECURE GAS PURCHASES, AND TO INCUR
22 SECURED DEBT RELATED THERETO
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BKLPD

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 Authority To Establish Cash-
5 Collateralized Letter Of Credit Program And Facility To Secure Gas Purchases, And To
6 Incur Secured Debt Related Thereto (the "Motion"). Except as otherwise stated herein, all
7 capitalized words and terms used herein have the same meanings ascribed to them in the
8 Motion. I know the following of my own knowledge (except as to any matters stated on
9 information and belief, and as to such matters, I am informed and believe they are true) and,
10 if called upon as a witness, could and would testify competently thereto.

11 2. I am informed and believe that commencing shortly before its Chapter 11
12 filing in April 2001 (and, with the approval of this Court shortly after the Chapter 11 filing,
13 continuing through the present date), PG&E has made ongoing and substantial use of its
14 GSSA Program to provide credit support for its gas purchases for core customers. In broad
15 outline, I am informed and believe that under the GSSA Program, with the approval of the
16 Commission and the above-captioned Bankruptcy Court at appropriate junctures, PG&E
17 entered into the GSSA (i.e., the Gas Supplier Security Agreement) with a group of gas
18 suppliers, pursuant to which PG&E granted a security interest in its Gas Accounts, to secure
19 PG&E's payments for gas purchases from the Existing Gas Suppliers. I am informed and
20 believe that the GSSA Program has worked relatively smoothly to facilitate the
21 uninterrupted flow of gas to PG&E's customers throughout the Chapter 11 case to date.

22 3. It is now time for PG&E to prepare for its emergence from Chapter 11 and, in
23 connection therewith, to replace the GSSA Program with the proposed Gas LC Program.
24 More specifically, PG&E is now preparing for the implementation of the confirmed Plan in
25 this case, which was confirmed by Court order dated December 22, 2003. Section 7.3 of
26 the confirmed Plan provides that as of the Effective Date of the confirmed Plan, PG&E, as
27 the Reorganized Debtor, shall establish one or more credit facilities for a wide range of
28 purposes, including funding operating expenses, providing letters of credit or other forms of

1 credit support, and, to the extent PG&E deems it appropriate, to perform its obligations
2 under the Plan. Section 7.3 also authorizes PG&E, as the Reorganized Debtor, to establish
3 one or more customer accounts receivable securitization programs for the same purposes.
4 Accordingly, consistent with the confirmed Plan, PG&E intends, as of the Effective Date, to
5 have in place various financings, including, without limitation, (1) a conventional credit
6 facility that allows for revolving credit borrowings and for the issuance of letters of credit
7 under the facility, which may be secured by various assets of the company, and (2) one or
8 more accounts receivable securitization programs, to be secured by both gas and electric
9 customer accounts.

10 4. In order for the transition to these new facilities provided for in the confirmed
11 Plan to occur smoothly on or about the Effective Date, PG&E believes that it is appropriate
12 from both a cost and efficiency standpoint to begin transition to the proposed Gas LC
13 Program in early March 2004, so that the process of obtaining and recording the termination
14 of the Gas Suppliers' security interest in the Gas Accounts can be completed before the
15 Effective Date of the Plan. This should enable the Gas Accounts to be freed up to be
16 pledged in connection with one or more of the facilities contemplated under the confirmed
17 Plan as of the Effective Date. Because PG&E anticipates an Effective Date for the Plan at
18 approximately the end of the first quarter of this year, and because of the somewhat arcane
19 way the cycle of gas purchases and payments works as explained more fully in the
20 Declaration of Raymond X. Welch filed concurrently herewith, PG&E believes that
21 migration to the new Gas LC Program commencing in early March 2004, with the aim of
22 having fully terminated the GSSA by the end of March 2004, will facilitate the earliest
23 possible Effective Date.

24 5. I am informed and believe that in order to terminate the GSSA prior to the
25 Effective Date of the Plan and have the Existing Gas Suppliers' security interest in the Gas
26 Accounts terminated, PG&E will need to provide an alternative form of credit support for
27 the Existing Gas Suppliers for all amounts then owed under the GSSA, as well as for new
28 gas purchases that take place between the time the GSSA is terminated and the Effective

1 Date of the Plan. PG&E has determined that the issuance of irrevocable standby letters of
2 credit ("LCs") for the benefit of the Gas Suppliers is the most efficient and practicable
3 alternative form of credit support that will be acceptable to the Gas Suppliers. Thus, PG&E
4 is proposing to replace the GSSA Program with the Gas LC Program, such that the Gas
5 Suppliers will receive LCs as credit support for amounts owed them by PG&E, in lieu of the
6 Gas Accounts pledged under the GSSA.

7 6. This, in turn, requires PG&E to establish the Interim LC Facility with one or
8 more LC Banks, so that LCs can be issued thereunder for the benefit of Gas Suppliers until
9 the Effective Date of the confirmed Plan, in the amounts that are owed Existing Gas
10 Suppliers under the GSSA at the time the GSSA is terminated, plus the amount of PG&E's
11 new gas purchases from Gas Suppliers between the time the Gas LC Program is put in place
12 and the Effective Date of the Plan. Once the Effective Date of the Plan occurs, to the extent
13 credit support is required for post-Effective Date gas purchases, PG&E will post letters of
14 credit issued under a new credit facility established pursuant to Section 7.3 of the Plan.

15 7. PG&E has determined that in light of its current credit rating (which will not
16 be upgraded to investment grade until the Effective Date), it cannot establish the requisite
17 Interim LC Facility without posting cash collateral with the LC Banks in an amount
18 approximately equal to the face amount of the LCs issued under the facility. I am informed
19 and believe that based on PG&E's experience over the past several years, PG&E believes
20 that it may need to cause up to \$400 million of LCs to be issued under the Interim LC
21 Facility. PG&E by the Motion therefore seeks authority to establish the Interim LC Facility
22 and pledge up to \$420 million in cash to the LC Banks to secure PG&E's obligations to the
23 LC Banks under the Interim LC Facility.¹ In connection with such Interim LC Facility,

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25 ¹ Banks that require cash collateral as a condition of issuing letters of credit typically
26 require a small cushion over the face amount of the issued letters of credit, to cover interest,
27 fees and costs, to the extent applicable. Accordingly, PG&E needs discretion to post this
28 slight cushion, which PG&E estimates would not exceed five percent of the face amount of
the issued letters of credit and may be less. The \$420 million cash collateral limit sought by
this Motion includes a maximum 5% cushion on \$400 million of maximum face amount of
outstanding letters of credit.

1 PG&E expects that, consistent with market standards, PG&E will be required to pay a small
2 percentage fee for such facility, based on the maximum amount of the LCs issued
3 thereunder, and may be required to pay or reimburse some expenses of the LC Banks, and
4 also seeks approval therefor.

5 8. Assuming the proposed Gas LC Program and Interim LC Facility are
6 approved by the Court, they will be in place as a transitional mechanism for only a limited
7 period of time. This is because pursuant to the terms of the confirmed Plan, it is a condition
8 concurrent to the Effective Date that PG&E emerge on such date with an investment grade
9 credit rating. Once so restored to investment grade status, PG&E not only expects demands
10 for credit support to diminish, but PG&E expects that it will not be restricted to cash-
11 collateralized LCs for LCs issued under one or more of its post-Effective Date credit
12 facilities, but rather will have the ability under one or much of such facilities to issue LCs up
13 to some material dollar amount that are unsecured or secured by non-cash assets. Thus, for
14 any gas purchases made after the Effective Date that require credit support, PG&E will
15 cause LCs to be issued under its new credit facility established pursuant to Section 7.3 of the
16 Plan. And while PG&E also may seek to transfer to a post-Effective Date credit facility any
17 LCs that may then be outstanding under the Interim LC Facility (thereby hastening the
18 termination of the Interim LC Facility), even if that proves to be impractical, all such
19 outstanding LCs issued under Interim LC Facility prior to the Effective Date will mature
20 within some reasonable period after the Effective Date based on their respective expiry
21 dates. Thus, under all circumstances, the Interim LC Facility will phase out and be fully
22 supplanted by a post-Effective Date LC facility within a limited period of time after the
23 Effective Date.

24 9. I am informed and believe that the substitution of the Gas LC Program for the
25 GSSA Program commencing in early March 2004 should allow PG&E to transition fully to
26 the Gas LC Program and make a full and clean break from the lien under the GSSA by
27 around the end of the first quarter of 2004, thereby maximizing the amount of its Gas
28 Accounts that can be included in PG&E's contemplated accounts receivable securitization

1 program put in place on the Effective Date of the Plan as one of the financing devices
2 contemplated in Section 7.3 of the Plan. This is beneficial to PG&E, its estate and its
3 creditors because the accounts receivable financing contemplated under Section 7.3 of the
4 Plan will help PG&E access commercial paper markets for working capital, commencing on
5 the date the Plan goes effective and continuing thereafter. This helps PG&E achieve an
6 Effective Date by approximately the end of the first quarter of 2004, and, because creditors
7 with allowed claims are paid on the Effective Date, this is in the interests of PG&E, its estate
8 and creditors alike.

9 10. Because, as explained more fully below, PG&E will be required to post
10 cash collateral to secure its obligations under the proposed Interim LC Facility, there will be
11 little or no credit risk to the LC Banks that provide such facility. Thus, assuming a cash-
12 collateralized letter of credit facility, and based on its due diligence to date, PG&E
13 anticipates that the pricing and other terms of such facility will be on relatively standard and
14 commercially reasonable terms, with PG&E being required to execute a reimbursement
15 agreement and related documentation pertaining to the facility, and to pay a small percentage
16 fee based on the amount of the LCs issued under the facility.

17 11. Accordingly, by the Motion PG&E seeks authority (i) to establish an
18 Interim LC Facility with one or more LC Banks of PG&E's choice, on commercially
19 reasonable terms for such a facility that is fully cash collateralized, to be used for the gas
20 procurement purpose specified in the Motion, (ii) to enter into a reimbursement agreement
21 and any related documentation in favor of the LC Bank(s) memorializing such Interim LC
22 Facility, and (iii) to pledge cash or cash equivalents to the LC Bank(s) who provide such
23 facility (or their designated agent, subject to PG&E's satisfaction with any such agent's
24 reputation and creditworthiness) in an amount equal to the outstanding face amount of the
25 LCs issued under the Interim LC Facility (plus a small cushion as described in footnote 1
26 above), which pledged cash shall secure PG&E's reimbursement and other obligations to the
27 LC Banks under the documentation pertaining to the Interim LC Facility.

28 12. Until the Effective Date of the Plan, BNY Western Trust Company in its
DECL OF M. DONNELLY ISO MOT. FOR AUTH. TO EST. CASH-COLLAT. LC FACILITY AND INCUR SECURED DEBT RELATED THERETO [ETC.]

1 capacity as the Indenture Trustee has a lien on substantially all of PG&E's real and personal
2 property under the 1920 Indenture. Such lien is the subject of that certain "Stipulation (I)
3 Authorizing and Restricting Use of Cash Collateral Pursuant to 11 U.S.C. §363 and
4 Bankruptcy Rule 4001 and (II) Granting Adequate Protection Pursuant to 11 U.S.C. §§361
5 and 363" entered into between PG&E and the Indenture Trustee on May 9, 2001, as
6 amended to date (the "Cash Collateral Stipulation") and approved by the Bankruptcy Court
7 by its Order thereon dated the same date and by subsequent Orders approving the
8 amendments to the Cash Collateral Stipulation.

9 13. PG&E believes the interest of the Indenture Trustee is fully secured and
10 adequately protected by a substantial equity cushion, as has been repeatedly demonstrated in
11 previous motions filed by PG&E in this case. As set forth in the Debtor's most recent
12 Operating Report filed with this Court on December 30, 2003, as of November 30, 2003, the
13 Debtor's total reported assets exceed \$28 billion (including cash on hand of approximately
14 \$4 billion), while the Debtor's outstanding obligations under the 1920 Indenture, which are
15 secured by substantially all of the Debtor's assets, aggregate approximately \$3 billion.
16 Further, PG&E, by a separate motion filed January 26, 2004 that is scheduled to be heard at
17 the same time as the Motion, has sought authority to pay timely \$310 million in principal
18 amount of the bonds issued and outstanding pursuant to the 1920 Indenture that mature on
19 March 1, 2004, which, assuming such other motion is granted, will reduce the outstanding
20 obligations under the 1920 Indenture to approximately \$2.7 billion.

21 14. Thus, the Indenture Trust has an equity cushion of in excess of 800%, and
22 the Indenture Trustee's interest here is therefore adequately protected by a substantial equity
23 cushion, which will remain equal to many times the value of the Indenture Trustee's lien
24 interest after giving affect to the maximum \$420 million amount of collateral that PG&E
25 seeks to grant a senior lien on pursuant to the Motion. In addition, at the same time PG&E
26 posts cash collateral in favor of the Banks of up to an aggregate amount of \$420 million for
27 LCs issued under the Interim LC Facility, the Gas Accounts will be freed from the lien under
28 the GSSA, restoring the Indenture Trustee to whatever senior position on the Gas Accounts

1 it had prior to PG&E entering into the GSSA, pending the Effective Date. This creation of
2 equivalent value constitutes further adequate protection for the Indenture Trustee.

3 15. PG&E has had discussions with the Indenture Trustee concerning the
4 Motion and the use of cash collateral that it entails in order to provide security to LC Banks
5 under the Interim LC Facility pursuant to Bankruptcy Code Section 364(d). The Indenture
6 Trustee has indicated that it has no objection to PG&E's filing of the Motion, but at the same
7 time, pending its further consideration of the relief requested, the Indenture Trustee has
8 reserved the right to object to the use of cash collateral and to require that PG&E carry its
9 burden of establishing that the Indenture Trustee's interests are adequately protected.

10 16. PG&E seeks to obtain credit on a senior secured basis under the proposed
11 Interim LC Facility because PG&E has determined that, in light of its current sub-investment
12 grade status, any banks that are likely to be acceptable to the Gas Suppliers as LC issuers
13 will require, as a condition of establishing an Interim LC Facility for PG&E, that PG&E post
14 cash collateral in which the LC Banks have a senior perfected interest in order to secure
15 PG&E's reimbursement and related obligations to the LC Banks providing the Interim LC
16 Facility. Thus, PG&E, prior to the Effective Date, is unable to obtain a letter of credit
17 facility under which it can issue LCs to Gas Suppliers as a substitute for the Gas Accounts
18 under the GSSA unless PG&E incurs obligations on a senior secured basis to the LC Banks.

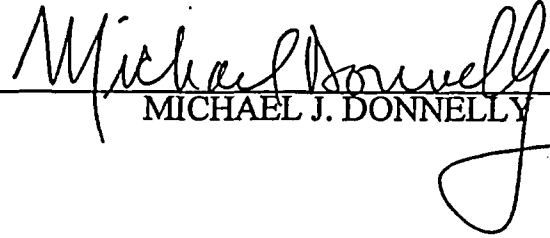
19 17. Based on the foregoing, the facts in the Declaration of Raymond X. Welch
20 filed concurrently herewith, and the Motion, PG&E requests that the Court authorize PG&E,
21 pursuant to Bankruptcy Code Sections 363(b) and 364(d), to incur post-petition secured debt
22 in favor of the LC Banks up to an aggregate of \$400 million outstanding at any one time
23 under the proposed Interim LC Facility, and to grant a senior lien in favor of such LC Banks
24 (or their designated agent acceptable to PG&E) in cash or cash-equivalents of PG&E up to
25 an aggregate of \$420 million at any one time.

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1 I declare under penalty of perjury that the foregoing is true and correct, and that
2 this declaration was executed on January 29, 2004 at San Francisco, California.

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5 MICHAEL J. DONNELLY

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& RABKIN
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