

50-275/328

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PACIFIC GAS AND ELECTRIC COMPANY

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

In re

PACIFIC GAS AND ELECTRIC
COMPANY, a California corporation,

Debtor.

Federal I.D. No. 94-0742640

Case No. 01-30923 DM

Chapter 11 Case

Date: October 29, 2001

Time: 9:30 a.m.

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

DECLARATION OF RAYMOND WELCH IN SUPPORT OF MOTION BY
PACIFIC GAS AND ELECTRIC COMPANY FOR ORDER
AUTHORIZING INCURRENCE OF POST-PETITION SECURED DEBT IN
CONNECTION WITH AGREEMENT WITH NATURAL GAS EXCHANGE

R. WELCH DECL ISO MOT FOR AUTH TO INCUR POST-PET. SEC. DEBT

Accd Add: Kids Ogc Mail Center

HOWARD
RICE
NEMEROVSKI
CANADY
FALK
& RABKIN
A Professional Corporation

1 I, Raymond Welch, declare as follows:

2 1. I have been employed by Pacific Gas and Electric Company, the debtor and
3 debtor in possession in the above-referenced chapter 11 bankruptcy case ("PG&E"), for the
4 past ten years. My current position is that of Gas Portfolio Manager, a position I have held
5 for the past eight years. I make this declaration from personal knowledge and could, if
6 called as a witness, competently testify to the matters set forth herein.

7 2. I make this declaration in support of PG&E's Motion for Order Authorizing
8 Incurrence of Post-Petition Secured Debt in Connection with Agreement with Natural Gas
9 Exchange (the "Motion"). In my capacity as Gas Portfolio Manager, I am personally
10 responsible for the procurement and sale of gas supplies by PG&E. More particularly, I am
11 also familiar with the history of PG&E's relationship with Natural Gas Exchange, Inc.
12 ("Natural Gas Exchange") and NGX Financial, Inc. ("NGX Financial"), with which PG&E
13 proposes to contract. Natural Gas Exchange and NGX Financial (sometimes collectively
14 referred to herein as "NGX") are Canadian corporations and subsidiaries of NGX Canada,
15 Inc.

16 3. NGX operates and maintains a natural gas commodities exchange (the
17 "Exchange") on which qualified entities ("Contracting Parties") may purchase or sell natural
18 gas and related financial contracts. Contracting Parties wishing to participate in the
19 Exchange must enter into a form of agreement with NGX. Because NGX Financial "clears"
20 all accounts for all Contracting Parties in the Exchange, the debts which Contracting Parties
21 incur as a result of transactions entered into through the Exchange are deemed to be owed by
22 the Contracting Parties to NGX. Accordingly, the form of agreement contains provisions
23 concerning the payment of debts incurred by Contracting Parties to NGX Financial as a
24 consequence of Exchange transactions, as well as a number of stringent requirements
25 concerning the creditworthiness of Contracting Parties.

26 4. Prior to the commencement of this bankruptcy case, PG&E was a
27 Contracting Party on the Exchange, pursuant to an agreement with NGX dated February 27,
28 1998 (the "Pre-Petition Agreement"). Up until the time that NGX terminated its relationship

1 with PG&E in January 2001, for reasons described below, PG&E regularly participated in
2 purchase and sale transactions through the Exchange. PG&E found the Exchange to be a
3 particularly favorable means of purchasing and selling gas supplies for a number of reasons.
4 The Exchange is immediately accessible to Contracting Parties, and Contracting Parties may
5 electronically view and post in "real time" bid and sale prices for natural gas traded on the
6 Exchange. There are approximately 80 Contracting Parties, giving PG&E immediate access
7 to many possible sources of supply. The Exchange is also available to Contracting Parties
8 seven days a week, which PG&E believes is an especially valuable aspect for weekend
9 transactions, when there is often a need to balance supplies with demand due to unforeseen
10 changes in temperature, yet when there may be few available counterparties to buy from or
11 sell to. In addition, all bids and quotes are submitted anonymously, which PG&E believes
12 contributes to fairer pricing.

13 5. PG&E's financial condition deteriorated dramatically beginning in late May
14 2000. On or about January 18, 2001, in response to a variety of factors, credit reporting
15 agencies down-graded PG&E's credit rating status to a level below that permissible under
16 the Pre-Petition Agreement. Although the Pre-Petition Agreement did provide that
17 Contracting Parties whose creditworthiness was not within permissible standards could
18 continue to qualify to trade on the Exchange through a variety of credit-enhancing measures,
19 PG&E was unable at that time to obtain any such credit enhancements. NGX accordingly
20 terminated its relationship with PG&E by letter dated as of January 19, 2001.

21 6. NGX is willing to enter into a new form of Agreement with PG&E,
22 pursuant to which PG&E would again become a Contracting Party on the Exchange. A true
23 and correct copy of the proposed form of Agreement (the "Proposed Agreement") is
24 attached hereto as Exhibit "A." (The actual agreement that is to be signed by PG&E may
25 differ from the form of the Proposed Agreement in that it may contain certain limitations
26 consistent with PG&E's credit standing; however, PG&E does not expect that the final
27 agreement will contain material deviations from the form.) PG&E's maximum aggregate
28 liability to NGX under the Proposed Agreement as a Contracting Party on the Exchange

1 would be limited to \$10 million.¹ However, NGX's Risk Management Policy (attached as
2 Schedule "C" to the Proposed Agreement) requires that non-investment grade Contracting
3 Parties, such as PG&E, deposit certain acceptable types of collateral with NGX as security
4 for performance of such party's obligations to NGX pursuant to the Proposed Agreement
5 before such Contracting Party is entitled to enter into physical or financial contracts with the
6 Exchange. One such acceptable form of collateral from PG&E is a letter of credit in the
7 amount of PG&E's maximum aggregate liability to NGX (i.e., \$10 million). The letter of
8 credit must be an irrevocable standby letter of credit from an institution acceptable to NGX,
9 and may be drawn upon by NGX Financial upon default by PG&E, including partial draws
10 for amounts less than the total amount available under the letter of credit.

11 7. Because of the importance to PG&E of securing gas supplies for its
12 customers and the desirability to PG&E of being able to participate on the Exchange, PG&E
13 is willing to provide a letter of credit for the benefit of NGX Financial in order to become a
14 Contracting Party on the Exchange. Union Bank of California, N.A. ("Union Bank"), a bank
15 with which PG&E maintains a deposit account as well as disbursement accounts, has agreed
16 to provide such a letter of credit (the "L/C"), in exchange for a fee equal to one and one half
17 percent (1½%) of the face amount of the L/C, payable quarterly in advance, provided that
18 PG&E secures any obligations to reimburse Union Bank for amounts drawn by NGX
19 Financial under the L/C and other obligations arising under or in connection with the
20 issuance of the L/C (collectively, the "Reimbursement Obligations") by a certificate of
21 deposit (the "CD") maintained at Union Bank, in an amount equal to the maximum amount
22 available under the L/C (i.e., \$10 million). PG&E believes that the terms and conditions for
23 the issuance of the L/C by Union Bank are reasonable and are the most favorable terms
24 available to PG&E at this time.² Attached hereto as Exhibits "B" and "C," respectively, are

25
26 ¹Although NGX calculates the aggregate amount of liability by any Contracting Party
27 on a daily basis, Contracting Parties on the Exchange, including PG&E, are billed for such
28 amounts on a monthly basis.

²PG&E explored the feasibility and cost-effectiveness of providing other types of
collateral permissible under the NGX Risk Management Policy, and has determined that the
(continued . . .)

1 true and correct copies of the form of Letter of Credit Agreement and the form of Security
2 Agreement to be entered into by PG&E for the issuance of the L/C and the maintenance of
3 the CD as security for the payment of the Reimbursement Obligations.

4 8. Based upon current market prices, \$10 million worth of gas purchases
5 would represent as much as one-third (1/3) of the amount of Canadian gas supply to be
6 procured by PG&E in one month. Because the Proposed Agreement would permit PG&E
7 access to the Exchange, in my opinion the transaction would be in the best interests of the
8 estate.

9 9. I am informed and believe that the Indenture Trustee, who holds a lien on
10 substantially all of PG&E's assets for the benefit of certain holders of mortgage bonds issued
11 by PG&E, has consented to the cash collateralization as described above, subject to the
12 terms of the Security Agreement.

13 10. I am informed and believe that entering into the Proposed Agreement
14 clearly would be within the ordinary course of PG&E's business—the purchase and sale of
15 gas on an international exchange—were it not for the requirement that PG&E provide a
16 letter of credit to support its obligations under the Proposed Agreement.

17 11. I am informed and believe that sound business justifications exist for PG&E
18 to enter into the Proposed Agreement. PG&E believes the Exchange is advantageous for the
19 purchase and sale of gas supplies, because it is immediately accessible to Contracting Parties
20 seven days a week and Contracting Parties may electronically view and post in real time bid
21 and sale prices for commodities traded on the Exchange. In addition, all bids and quotes are
22 submitted anonymously, which PG&E believes contributes to fairer pricing and benefits all
23 Contracting Parties, including PG&E.

24 I declare under penalty of perjury under the laws of the United States of America
25 that the foregoing is true and correct. Executed at San Francisco, California on October 5,
26 2001.

27 (. . . continued)
28 Union Bank L/C is the most efficient and cost-effective alternative currently available to it.

Raymond Welch
RAYMOND WELCH

WD 100501/1-1419905/120/943233/v4

HOWARD
RICE
NEMEROVSKI
CANADY
FALK
& RABKIN

A Professional Corporation

R. WELCH DECL ISO MOT. FOR AUTH TO INCUR POST-PET. SEC. DEBT

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 Hunt, Three Embarcadero Center, 7th Floor, San Francisco, California 94111-4065