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UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

In re:

PACIFIC GAS AND ELECTRIC COMPANY, a California corporation,

Debtor.

CASE NO. 01-30923 DFM 11

BANK OF MONTREAL'S OBJECTION TO DEBTOR'S DISCLOSURE STATEMENT

Date: December 19, 2001
Time: 9:30 a.m.
Place: 235 Pine Street, 22nd Floor
San Francisco, CA
Judge: Hon. Dennis Montali

A001 Add: Rods Ogc Mail Center

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TABLE OF AUTHORITIES

Cases

Statutes

TO THE HONORABLE DENNIS MONTALI, UNITED STATES BANKRUPTCY JUDGE, AND ALL PARTIES IN INTEREST:

Bank of Montreal, by and through its attorneys, Perkins Coie LLP, objects to the adequacy of the Disclosure Statement for Plan of Reorganization Under Chapter 11 of the Bankruptcy Code (the "Disclosure Statement") and the accompanying Plan of Reorganization (the "Plan") proposed by Pacific Gas & Electric Company ("PG&E" or the "Debtor") and its parent company, PG&E Corporation (together the "Proponents") and respectfully states as follows[1]:

I. FACTUAL BACKGROUND

PG&E entered into a Reimbursement Agreement (Series D), dated as of May 1, 1996 (the "Reimbursement Agreement[2]") with Bank of Montreal, Union Bank of Switzerland, New York Branch ("UBS"), and The Sumitomo Bank Limited ("Sumitomo") (collectively, the "Banks"). UBS, on behalf of, and in its capacity as Administrative Agent, for, the Banks is the Issuing Agent and Administrative Agent under the Reimbursement Agreement.[3] On or about May 23, 1996, UBS issued irrevocable transferable letter of credit number SBY504295 (the "Letter of Credit"), which provided credit and liquidity support for California Pollution Control Financing Authority Pollution Control Refunding Revenue Bonds (Pacific Gas & Electric Company) 1996 Series D (the "Bonds") that were issued pursuant to a May 1, 1996 Indenture of Trust between the California Pollution Control Financing Authority and Bankers Trust Company, as Trustee. After issuance of the Letter of Credit, the Trustee was authorized to draw upon the Letter of Credit in an aggregate amount not to exceed $105,068,494 with respect to payment of the unpaid principal of, and interest on the Bonds.

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1 Bank of Montreal reserves the right to make further objections to both the Disclosure Statement and the Proponents' Plan of Reorganization (the "Plan").

2 A copy of the Reimbursement Agreement is attached to the Affidavit of Thomas E. McGraw concurrently filed in support of this objection.

3 It is Bank of Montreal's understanding that UBS has sold its position on a participation and/or an assignment basis.

After the Petition Date[4], the Bonds were redeemed and the Letter of Credit was drawn. Pursuant to the terms of the Reimbursement Agreement, on May 4, 2001 and again on May 7, 2001, Bank of Montreal funded letter of credit obligations totaling $19,146,075.47 as required under the Reimbursement Agreement.[5] All of the Prior Bonds were redeemed in whole and no principal or interest remains outstanding with respect thereto. As such, the Banks have no remaining performance obligations under the Reimbursement Agreement.[6] Bank of Montreal's claim in respect of amounts drawn under the Letter of Credit, inclusive of unpaid fees accrued through April 6, 2001, is $19,146,075.47 and continues to accrue interest, fees, and expenses.[7]

II. PLAN TREATMENT OF BANK OF MONTREAL'S CLAIM

Pursuant to the terms of the Plan, Bank of Montreal's claim was placed in "Class 4f—Prior Bond Claims"[8] rather than with the other general unsecured creditors' claims in "Class 5—General Unsecured Claims." Bank of Montreal objects to the classification of its claim as anything but a general unsecured claim and believes that its claim should be accorded the same treatment as that of all other general unsecured creditors in Class 5. The Debtor does not state why Prior Bond Claims are accorded different treatment under the Plan than that of General Unsecured Claims. Under the Plan, Prior Bond Claims are to receive the following, patently unconfirmable treatment: (i) cash representing sixty percent of the outstanding Reimbursement Obligation plus accrued and

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4 Capitalized terms not defined herein shall have the meanings ascribed to them in the Plan and/or Disclosure Statement.

5 See Affidavit of Thomas E. McGraw, ¶ 2.

6 Id. ¶ 4. The draw on the Letter of Credit and associated redemption of the Prior Bonds terminated the Letter of Credit according to its terms. See Letter of Credit p. 1. Upon this termination, the Banks ceased to have any further performance obligations under the Letter of Credit and Reimbursement Agreement.

7 Bank of Montreal timely filed a general unsecured proof of claim in this case for such sum. See Affidavit of Thomas E. McGraw, ¶ 3.

8 The Disclosure Statement states that "[t]he 96B Bonds, 96D Bonds, 97A Bonds and the 97C Bonds, together with any series of 96C Bonds, 96E Bonds, 96F Bonds and/or 97B Bonds that have been redeemed in whole, but not in part, as of the Voting Record Date or the Effective Date, as applicable, are defined collectively in the Plan as the 'Prior Bonds.'" See Disclosure Statement, at 156.

unpaid interest together with all other amounts under the Reimbursement Obligation and (ii) a modification of the Reimbursement Agreement to provide that the Reorganized Debtor shall remain solely liable thereunder for the remaining forty percent of the Reimbursement Obligation which shall be payable in ten years bearing interest at the same rate as the Reorganized Debtor's notes with a ten year maturity.[9]

III. ARGUMENT

A. The Disclosure Statement Does Not Contain Adequate Information.

Section 1125(b) of the Bankruptcy Code provides that an acceptance or rejection of a plan cannot be solicited prior to the transmittal of a "written disclosure statement approved, after notice and a hearing, by the court as containing adequate information." "Adequate information" is defined in Section 1125(a)(1) of the Bankruptcy Code as

> information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of the holders of claims or interests of the relevant class to make an informed judgment about the plan.

Case law has developed a number of factors that a court should examine in ruling upon the adequacy of information in a disclosure statement. One such case is In re Metrocraft Publishing Services, Inc., 39 B.R. 567 (Bankr. N.D. Ga. 1984). Metrocraft identified the following 19 factors as potentially being relevant to the adequacy analysis:

> (1) the events which led to the filing of a bankruptcy petition; (2) a description of the available assets and their value; (3) the anticipated future of the company; (4) the source of information stated in the disclosure statement; (5) a disclaimer; (6) the present condition of the debtor while in Chapter 11; (7) the scheduled claims; (8) the estimated return to creditors under a Chapter 7 liquidation; (9) the accounting method utilized to produce financial information and the name of the accountants responsible for such information; (10) the future management of the debtor; (11) the Chapter 11 plan or a summary thereof; (12) the estimated administrative expenses, including attorneys' and accountants' fees; (13) the collectibility of accounts receivable; (14) financial information, data, valuations or projections

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9 See Plan, Section 4.12(b) at 35.

> relevant to the creditor's decision to accept or reject the Chapter 11 plan; (15) information relevant to the risks posed to creditors under the plan; (16) the actual or projected realizable value for recovery of preferential or otherwise violable transfers; (17) litigation likely to arise in a nonbankrupcty context; (18) tax attributes of the debtor; and (19) the relationship of the debtor with affiliates.

Id. at 568. The Disclosure Statement in this case is deficient in respect of many of these requirements. Accordingly, Bank of Montreal is unable to evaluate and make an informed judgment of the credit risk regarding the Plan's proposed treatment of Prior Bond Claims.

1. Inadequate Disclosure of Financial Information.

Not only does the Disclosure Statement fail to adequately identify all of Debtor's assets, their fair market value and the methodology utilized in determining those values, but the Disclosure Statement also fails to identify which assets will be transferred to each newly established entity, the value of those assets or the methodology in determining the value.[10] Although the Disclosure Statement generally states that assets related to the function of each entity would generally follow that subsidiary, it is impossible to determine which specific assets those would be, or how they affect the ability to pay the obligations under the Plan. For example, Section X.B.4 of the Disclosure Statement states that "as of the Effective Date, many of such arrangements [contracts] will be unwound and the assets related to each business line will be identified, separated and transferred to a newly formed company." As a result, it appears that the assets to be transferred would not even be identified until after confirmation of the Plan. This will, of course, make it essentially impossible to assess the viability of payment of the Debtor's obligations, and, of course, would impact the Debtor's ability to raise new funds. Accordingly, the inadequate disclosure of essential financial information makes it impossible for Bank of Montreal to make an informed judgment of the Plan's treatment of its claim.[11]

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[10] The Plan and Disclosure Statement contemplate that Debtor will "disaggregate and restructure its business by creating new limited liability companies and transferring certain assets of the business lines to each of the entities." See Disclosure Statement at 65.

[11] Additionally, no liquidation analysis has been provided by the Proponents. The Disclosure Statement simply states that "a liquidation under Chapter 11 is a much less attractive alternative to

2. Inadequate discussion of feasibility.

Although the Disclosure Statement does generally describe what will happen following confirmation, it does not adequately describe how it will happen or the resulting economic ramifications. The pro forma financial statements are high level and vague. Furthermore, there is no discussion of how these costs will actually be funded, and which entities will get the benefit of the funding. Although Exhibit C to the Disclosure Statement and Plan discusses the Debtor's prospective ability to meet its obligations, they are summary and do not allow a creditor to test the proposed sources and uses of funds. Finally, the financial projections appear to be more favorable than the Debtor's recent operating history, as well as it postpetition operating history.

3. There is no meaningful discussion of the Debtor's postpetition operations.

As discussed briefly above, the Disclosure Statement should describe the effect of the bankruptcy case on its postpetition operations. The postpetition, preconfirmation performance of the Debtor is a significant baseline from which to test projections.

4. The Disclosure Statement fails to adequately disclose the circumstances surrounding the disposition of surplus property and property rights.

The Disclosure Statement refers to certain land parcels and property rights deemed "not essential" to the Reorganized Debtor's operations. The Disclosure Statement suggests that these will be sold, netting approximately $75 million after taxes. The Disclosure Statement does not address the disposition of the funds, the methodology for valuing the property, or which (if any) entity will get the benefit of the proceeds.[12]

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creditors because a greater return to creditors is provided for in the Plan." See Disclosure Statement, at 175. This statement is self-serving and, at the very least, fails to take into account the fact that a creditor may prefer to realize on a smaller dividend now as opposed to waiting up to ten years for the potential of a larger dividend. Moreover, the Plan Proponents make no attempt to discuss the alternatives of selling the Companies as a single going concern or broken up into separate entities and resold.

12 See Attachment 4, Section VI.I. of Disclosure Statement. The sale of surplus property and property rights is also mentioned in Attachment 5, Article VII.5.a. of the Plan. The sale is to be free of all liens and encumbrances; however, it is unclear if this property is the same as that referred to in the Disclosure Statement.

5. Filing of a Plan Supplement 10 days before Plan voting is insufficient.

The Disclosure Statement states that a Plan Supplement shall be filed at least ten days prior to the last day upon which holders of Claims may vote to accept or reject the Plan. Even assuming the Plan Supplement provides the necessary "adequate information" not disclosed in the Disclosure Statement, the filing of this information ten days prior to the day on which creditors may vote on the Plan is by definition not a court-approved solicitation, nor does it provide sufficient time to allow creditors to adequately review and evaluate this information. Consequently, creditors will be unable to make an informed decision accepting or rejecting the Plan.

B. The Plan of Reorganization Cannot be Confirmed.

If it is apparent that the plan of reorganization described by the disclosure statement cannot be confirmed by the Court, then the disclosure statement should not be approved and the further expense and delay attendant to a hearing on confirmation of the plan should not be incurred. In re Main Street AC, Inc., 234 B.R. 771, 775 (Bankr. N.D.Cal. 1999); In re Cardinal Congregate I, 121 B.R. 760 (Bankr. S.D. Ohio 1990). The Debtor's Plan is so fatally flawed that absent consent by most classes it cannot be confirmed.

1. The purported "modification" treatment of Reimbursement Agreements with Class 4f creditors is unconfirmable on its face.

a) The Reimbursement Agreement is not an executory contract and cannot be assumed.

An executory contract is one on which performance remains due to some extent on both sides. NLRB v. Bildisco, 465 U.S. 513, 523 n.6, 104 S.Ct. 1188, 79 L.Ed.2d 482 (1984); In re Select-A-Seat Corp., 625 F.2d 290, 292 (9th Cir. 1980) (an executory contract is one "under which the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other") (citation omitted); In re Texscan Corp., 976 F.2d 1269, 1272 (9th Cir. 1992). Here, performance does not remain due on both sides of the Reimbursement Agreement. The Banks have no remaining obligations under the Reimbursement Agreement. The draw on the

Letter of Credit and associated redemption of the Prior Bonds terminated the Letter of Credit according to its terms.[13] Upon this termination, the Banks ceased to have any further obligations under the Letter of Credit and Reimbursement Agreement. A contract is not executory where the only remaining obligation is the payment of money. In re Spectrum Inf. Tech., Inc., 190 B.R. 741, 747 (Bankr. E.D.N.Y. 1996). Accordingly, the Reimbursement Agreement is not an executory contract because the only obligation remaining is the Debtor's reimbursement of the respective Prior Letter of Credit Issuing Banks for, among other things, the amount drawn under the related Prior Letters of Credit.

b) Even if the Reimbursement Agreement is an executory contract, it cannot be assumed because the Reimbursement Agreement is a financial accommodation and the Debtor has not cured its default under the Reimbursement Agreement.

11 U.S.C. Section 365(c)(2) provides that a debtor may not assume an executory contract if "such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security for the debtor." In re Sun Runner Marine, Inc., 945 F.2d 1089, 1093 (9th Cir. 1991) ("Section 365(c)(2) unambiguously prohibits the assumption of financial accommodation contracts, regardless of the consent of the non-debtor party.") The accompanying legislative history to Section 365(c)(2) illustrates that "under this provision, contracts such as loan commitments and letters of credit are nonassignable, and may not be assumed by the [debtor.]" H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 348 (1977). Proponents' Plan proposes to do exactly that which Section 365(c)(2) prohibits. According to the Plan, the Reimbursement Agreement shall be modified to provide that the Reorganized Debtor shall remain solely liable thereunder for the remaining forty percent of the Reimbursement Obligation which shall be payable in ten years, "unless and until Refunding Bonds are issued with

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13 The Proponents state that:

[a]ll of the Prior Bonds have been redeemed in whole and no principal or interest remains outstanding with respect thereto. With respect to each series of Prior Bonds, under the terms of the respective Prior Reimbursement Agreement the Debtor is obligated to reimburse the respective Prior Letter of Credit Issuing Bank for, among other things, the amount drawn under the related Prior Letter of Credit which was applied to the payment of the redemption price of the Prior Bonds. See Disclosure Statement, at 161.

respect thereto secured by, among other things, a new letter of credit issued by such Prior Letter of Credit Issuing Bank." See Plan § 4.12(b) at 35. These Plan provisions violate Section 365(c)(2) and improperly require holders of Prior Bond Claims to involuntarily finance Debtor's reorganization.

11 U.S.C. Section 365(b)(1) provides that a debtor may not assume an executory contract unless, at the time of assumption of such contract, the debtor—

> (a) cures, or provides adequate assurance that the trustee will promptly cure such default;
>
> (b) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any pecuniary loss to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and
>
> (c) provides adequate assurance of future performance under such contract or lease.

Even if it were executory and not a financial accommodation contract, the Debtor cannot assume the Reimbursement Agreement until it cures or provides adequate assurance that it will promptly cure the outstanding obligations due and owing under the Reimbursement Agreement. The Proponents' Plan does neither. For example, the Disclosure Statement acknowledges Debtor's outstanding obligation under the Prior Reimbursement Agreement, but provides for repayment "in ten years." See Disclosure Statement at 161. Not only is ten years not a prompt cure of the default, but repayment depends upon the uncertain future prospects of the Reorganized Debtor.

c) Even if the Reimbursement Agreement were assumable, it cannot be modified.

Executory contracts may only be assumed with the benefits and burdens agreed to by the parties when they entered into the contract. In re Orgell, 117 B.R. 574, 576 (Bankr. C.D. Cal. 1990). The Debtor proposes to force "a modification of the Reimbursement Agreement" without each affected creditor's consent. Section 365 does not modify contracts. Id. at 577, 11 U.S.C. §365(f)(3). The proposed treatment cannot stand.

2. The Plan impermissibly classifies and treats Prior Bond Claims differently than other general unsecured claims.

The Plan impermissibly classifies the Prior Bond Claims separately from that of other general unsecured creditors and then proposes to discriminate unfairly against the holders of Prior Bond Claims. Separate classification of similar claims is only be permitted when there are legitimate business reasons for separately classifying claims. In re Barakat, 99 F.3d 1520 (9th Cir. 1996), cert. denied, 117 S. Ct. 1312 (1997); In re Johnston, 21 F.3d 323 (9th Cir. 1994); In re Boston Post Road Limited Partnership, 21 F.3d 477 (2d Cir. 1994), cert. denied, 115 S. Ct. 897 (1995). The Prior Bond Claims appear to have been separately classified solely to force the holders of such claims to issue new letters of credit upon terms and conditions satisfactory to the Reorganized Debtor with respect to the Bonds while the rest of the Debtor's general unsecured creditors receive liquid notes. Such disparate treatment constitutes unfair discrimination that prevents confirmation under section 1129(b)(1).

3. There are a significant number of conditions precedent required to both confirmation of the Plan and the Effective Date of the Plan.

These conditions both set forth the essence of the Proponents' Plan and demonstrate that there are no meaningful creditor protections. The more significant conditions precedent to Confirmation include:

i. an order that the Debtor, the Parent and its affiliates are not liable for any DWR contracts (except DWR Claims) or purchases of power by the DWR;

ii. an order prohibiting reassumption of the Net Open Position (the "NOP") unless (a) the Reorganized Debtor establishes and maintains an investment grade credit rating from S&P and Moody's, (b) the Reorganized Debtor receives assurances from S&P and Moody's that its credit rating will not be downgraded as a result of the reassumption of the NOP, (c) an objective retail rate recovery mechanism is put in place, and (d) objective standards regarding procurement transactions are established[14];

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[14] See Attachment 7, Article VII.5.f. of Plan.

iii. the Federal Energy Regulatory Commission ("FERC") approves ETrans joining a FERC-approved Regional Transmission Organization; and

iv. state and local regulatory approval of the Plan Proponents' restructuring of the Debtor is obtained.

Significant Conditions Precedent to the Effective Date include S&P and Moody's establishing credit ratings for the securities to be issued by ETrans, GTrans, Gen and the Reorganized Debtor which are acceptable to the Plan Proponents as well as the consummation of the sale of the New Money Notes by each of the companies.[15] On their face, these conditions appear to provide creditors some comfort that their economic interest will be protected by limitations on the Debtor's ability to change the Plan and a market that will provide liquidity.

Notwithstanding all of the above conditions, Section 8.4 of the Plan allows the Proponents to waive, without obtaining approval from either the court or creditors, one or more of the conditions precedent to Effectiveness and Confirmation. The result of the Proponents' right to waive any conditions is that there are no meaningful safeguards that creditors will receive their stated treatment under the Plan.

IV. CONCLUSION

For the foregoing reasons, both the Disclosure Statement and the Plan fall short of the requirements of the Bankruptcy Code. Accordingly, the Court should enter an order denying approval of the Disclosure Statement.

DATED: November 26, 2001.

PERKINS COIE LLP

By ______________________
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Bank of Montreal

[15] For a complete list of the Conditions Precedent to Effectiveness, see Attachment 6, Article VIII.2. of Plan.