

50-275/723

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PACIFIC GAS AND ELECTRIC COMPANY

8  
9 UNITED STATES BANKRUPTCY COURT  
10 NORTHERN DISTRICT OF CALIFORNIA  
11 SAN FRANCISCO DIVISION

12 In re

No. 01 30923 DM

13 PACIFIC GAS AND ELECTRIC  
COMPANY, a California corporation,

Chapter 11 Case

14 Debtor.

Date: December 19, 2001  
Time: 9:30 a.m.  
Place: 235 Pine Street, 22nd Floor  
San Francisco, California

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

HOWARD  
RICE  
NEMEROVSKI  
CANADY  
FALK  
& RABKIN  
A Professional Corporation

17  
18  
19 DECLARATION OF DAVID W. ANDERSON IN SUPPORT OF DEBTOR'S MOTION  
20 FOR (1) AUTHORITY TO COMPROMISE CLAIMS DUE ESTATE BY SEMPRA  
ENERGY TRADING CORPORATION AND SEMPRA ENERGY CORPORATION; (2)  
21 AUTHORITY TO ENTER INTO MASTER GAS AGREEMENT; AND (3) APPROVAL  
22 OF PROVISIONS OF MASTER GAS AGREEMENT MODIFYING AUTOMATIC STAY  
23  
24  
25

26  
27 *Acc: Add: Rids Ggc Mail Center*  
28

ANDERSON DECL. ISO MOTION FOR AUTH TO COMPROMISE CLAIM AGAINST SEMPRA

1 I, David W. Anderson, declare that:

2 1. I am an attorney at law licensed to practice in California. I have been  
3 employed in the Law Department by Pacific Gas and Electric Company ("PG&E" or  
4 "Debtor"), the debtor and debtor in possession in the above-captioned Chapter 11 case, since  
5 1979. I make this declaration from personal knowledge except where otherwise indicated in  
6 this declaration and could, if called as a witness, competently testify to the matters set forth  
7 herein.

8 2. I make this declaration in support of PG&E's Motion for (1) Authority to  
9 Compromise Claims Due Estate by Sempra Energy Trading Corporation ("SET") and  
10 Sempra Energy Corporation ("Sempra Corp.") (collectively "Sempra"); (2) Authority to  
11 Enter into Master Gas Agreement; and (3) Approval of Provisions of Master Gas Agreement  
12 Modifying Automatic Stay. Attached hereto as Exhibit "A" is a true and correct copy of the  
13 Settlement Agreement and General Release among PG&E, SET and Sempra Corp. (the  
14 "Agreement"), of which PG&E seeks approval.

15 3. I specialize in natural gas transactional matters and Public Utilities  
16 Commission of the State of California ("CPUC") gas tariff-related work for the California  
17 Gas Transmission function ("CGT") and Core Procurement Departments ("Core  
18 Procurement") at PG&E. Generally speaking, CGT operates PG&E's in-state natural gas  
19 pipeline transmission and gas storage business. PG&E provides natural gas transmission,  
20 storage, lending, and parking services to customers, which include natural gas suppliers and  
21 other energy wholesalers, including SET. Core Procurement is responsible for acquiring the  
22 natural gas needed to serve PG&E's "core" customers, primarily residential and small  
23 business gas users. I am familiar with the agreements described below entered into by  
24 PG&E on behalf of Core Procurement and CGT with SET for purchase, sale and other  
25 transportation and storage-related transactions in natural gas.

26 4. Effective January 1, 1998, PG&E and SET entered into the Master Gas  
27 Purchase and Sale Agreement (the "MGPSA"), which contains the general terms applicable  
28 to gas purchase, sale and exchange transactions between PG&E, for its core customers, and

1 SET. A true and correct copy of the MGPSA is attached hereto as Exhibit A at Ex. 2. SET  
2 and PG&E entered into a number of sales transactions under the MGPSA.

3 5. On January 19, 2001 and January 23, 2001, the United States Secretary of  
4 Energy issued Temporary Emergency Natural Gas Purchase and Sale Orders (collectively,  
5 the "DOE Orders") in order to "assure the continued availability of natural gas for high-  
6 priority (including electric generation) uses in the central and northern regions of  
7 California." True and correct copies of the DOE Orders are attached hereto as Exhibit A at  
8 Ex. 5. Inter alia, the DOE Orders directed SET to sell natural gas to PG&E under terms  
9 consistent with existing contractual arrangements in existence within 30 days prior to  
10 January 19, 2001, namely, consistent with the terms of the MGPSA.

11 6. Effective March 1, 1998, PG&E and SET entered into the Gas Transmission  
12 Service Agreement (the "GTSA"). A true and correct copy of the GTSA is attached hereto  
13 as Exhibit A at Ex. 1. In the GTSA, PG&E agreed to make available to SET certain gas  
14 transmission (i.e., transportation) services. It also agreed to make available to SET gas  
15 "lending" and "parking" services, whereby PG&E would provide loans of natural gas to SET  
16 from PG&E's system, to be paid back in kind within a specified term, which could run from  
17 one day to a number of months; or would permit SET to "park" natural gas by providing  
18 storage of gas on PG&E's system. The GTSA provides the general terms applicable to  
19 PG&E's provision of gas transmission, parking and lending services. The specific terms of  
20 individual transactions were separately specified in individual written confirmations (entitled  
21 "Exhibits") subsequently entered into by the parties under the GTSA. In particular, the  
22 precise amounts of natural gas lent or parked, the duration of each separate lending or  
23 parking transaction, and the pricing agreed upon for each transaction were specified in the  
24 Exhibits completed by SET and PG&E on a per-transaction basis.

25 7. Parking and lending services are subject to the terms of CPUC-approved  
26 tariff, including the tariff schedule entitled "G-BAL," which addresses imbalances in the  
27 parties' gas lend or parking positions, i.e. any failure of PG&E's customers to return lent gas  
28 or remove parked gas from PG&E's system at the end of the transaction. Schedule G-BAL

1 provides that in the event that a customer fails to return gas lent in accordance with an  
2 Exhibit, and agreement is not reached between PG&E and the customer within 30 days for  
3 return of the gas, the outstanding gas imbalance is subject to a mandatory cash-out provision  
4 and certain imbalance and reimbursement charges payable to PG&E. SET and PG&E  
5 entered into a number of park and lend transactions under the GTSA.

6 8. I am informed and believe that in July 1999, PG&E and SET entered into the  
7 International Swap Dealers Association Inc. Agreement (the "ISDA"). A true and correct  
8 copy of the ISDA is attached hereto as Exhibit A at Ex. 4. The ISDA governs various swap  
9 or hedging transactions in financial instruments, which the parties may enter into, which  
10 were intended to hedge the parties' risk in the natural gas markets. Generally speaking,  
11 upon events of defined default, the ISDA provides for a close-out of certain outstanding  
12 transactions between the parties and a setoff of amounts remaining outstanding between the  
13 parties arising out of such transactions. SET and PG&E entered into a number of  
14 transactions under the ISDA.

15 9. Furthermore, SET asserts that it supplied electricity into the Independent  
16 System Operator ("ISO") and the California Power Exchange ("PX") markets. SET has  
17 claimed that the ISO and the PX were PG&E's agents for the purchase of electricity that  
18 SET supplied into the ISO and PX markets and that PG&E owes it approximately \$70  
19 million for the asserted supply of electricity into the ISO and PX markets over this period.

20 10. Beginning in January 2001, disputes arose between PG&E and SET regarding  
21 their respective performance under the MGPSA, the GTSA, the ISDA (collectively the "Gas  
22 Agreements") and electricity supplied by SET into the ISO and PX markets.

23 11. On January 18, 2001, SET purported to terminate all of the Gas Agreements  
24 with PG&E and net out the outstanding amounts thereunder. SET purported to exercise its  
25 setoff rights under the ISDA and MGPSA to setoff gas volumes (valued in dollars) it owed  
26 under the GTSA against amounts that SET claimed PG&E owed SET for electricity supplied  
27 to the ISO and PX. As a result, SET claimed that it owed nothing to PG&E under the Gas  
28 Agreements and that PG&E owed SET certain amounts. As a further result of its claimed

1 setoff, Sempra claimed it had no obligation to return any net amounts of lent gas owing to  
2 PG&E under the GTSA because it claimed that all the transactions set forth in the  
3 outstanding exhibits had been also terminated and setoff effective January 18, 2001.

4 12. As of the date of Sempra's purported termination of its obligations to return  
5 gas to PG&E under the GTSA and related transactions, there were approximately nine  
6 billion cubic feet which SET asserted it would not return to PG&E over the remainder of the  
7 year 2000. I am informed and believe that as certain volumes of gas became due and were  
8 undelivered, PG&E was obliged to replace it at its own expense in order to ensure that  
9 service to its customers and the integrity of PG&E system operations would be maintained.

10 13. Furthermore, as SET failed to return gas under the transactions (Exhibits) that  
11 had, in PG&E's view, become due, PG&E believes that significant imbalance charges were  
12 accruing under Schedule G-BAL at the rate of millions of dollars per week.

13 14. To partially address PG&E's claims and ensure that PG&E received certain  
14 of the outstanding gas deliveries, which it had not as yet replaced, on May 17, 2001, the  
15 parties entered into a stipulation providing that SET would deliver all the gas PG&E claimed  
16 Sempra was obliged to deliver from June 1, 2001 onwards (the "Stipulation") with the  
17 parties reserving all rights as to whom—PG&E or SET—should bear the cost of the gas to  
18 be delivered. A true and correct copy of the Stipulation is attached as Exhibit A at Ex. 6 to  
19 the Agreement.

20 15. Apart from the disputes under the GTSA, disputes also arose between the  
21 parties in relation to amounts outstanding under SET's claimed termination of the ISDA and  
22 the claimed termination of MGPSA. Disputes also arose as to volumes owed to PG&E and  
23 amounts owed to SET under the DOE Orders.

24 16. On November 5, 2001, PG&E entered into the Agreement with SET and  
25 Sempra Corp., which, subject to this Court's approval, settles all the outstanding disputes  
26 with SET and Sempra Corp. under the Gas Agreements and DOE Orders and reserves  
27 resolution of the electricity disputes between SET and PG&E for another day. The  
28 Agreement provides, inter alia, that:

(i) All disputes between Sempra and PG&E in relation to the Gas Agreements (the GTSA, the MGPSA, and the ISDA) and the DOE Orders are resolved with a one-time payment by Sempra to PG&E of \$48.5 million payable upon the "effective date" of the Agreement, as defined.

(ii) SET agrees to deliver the remainder of the post-June 1 gas as provided for in the Stipulation, waiving any claim that PG&E is required to pay for the post-June 1 gas in any amount.

(iii) Subject to Court approval, SET and PG&E agree to enter into a new Master Gas Agreement providing for SET to deliver natural gas to PG&E's Core Procurement division on substantially similar terms as those set forth in the MGPSA and in accordance with terms outlined in paragraph 6 and Exhibit A at Ex. 9 of the Agreement.

(iv) Sempra and PG&E agree to defer resolution of SET's claims for electricity supplied to the ISO and PX, which Sempra claims was supplied to the ISO and PX as agents for PG&E.

17. The Agreement settles all of the gas disputes between the parties without protracted litigation. I anticipate that litigation would have included arbitration (using a panel of 3 arbitrators), provided for in the GTSA and ordered by the Bankruptcy Court, of some or all of the claims under the three Gas Agreements (and possibly under the DOE Orders), as well as the PX and ISO electricity claims advanced by SET. The litigation would potentially involve further subsequent bankruptcy court or arbitration proceedings to resolve setoff issues. While settling the gas disputes, the Agreement permits the parties to defer resolution of SET's electricity claims. Thus, Sempra waives any claim that its electricity setoff claims eliminate its liability to return net volumes of gas lent by PG&E under the GTSA. In my opinion, dealing with Sempra's claimed electricity claims and setoffs would have added a significant layer of factual, legal, and regulatory complexity; uncertainty, delay, and expense to the arbitration of the parties' disputes.

18. The meaning and applicability of the setoff language in the ISDA to SET's electricity-based setoff claims, and the parties' obligations under the Gas Agreements and

DOE Orders were vigorously disputed by the parties and would have been vigorously litigated by PG&E. PG&E's interpretation of the ISDA and of applicable bankruptcy law would preclude setoff of SET's electricity claims against the amounts outstanding to PG&E under the Gas Agreements. PG&E's arguments might have prevailed. However, the language of the ISDA provision is subject to interpretation under New York law, and its interpretation is a matter of first impression in this factual context. Therefore, in my opinion, there is a significant risk of a determination adverse to PG&E in an arbitration and subsequent bankruptcy proceedings.

19. If SET were to setoff its electricity claims, PG&E would receive no payment at all for (a) the millions of cubic feet owed in gas by SET; (b) the gas replacement costs that had been borne; or (c) the imbalance charges that PG&E believed it could otherwise claim accrued under Schedule G-BAL. Furthermore, had the arbitration panel permitted Sempra's claimed electricity setoffs; then, in my opinion, PG&E would have been obliged to pay for the deliveries of gas SET would make (and is making) pursuant to the Stipulation, together with interest pursuant to the Stipulation. I estimate that PG&E would have paid \$45 million for replacements as had this occurred. In the Agreement, conversely, PG&E's receipt of gas will continue in accordance with the Stipulation, and PG&E will owe no amounts in relation to those deliveries.

20. Furthermore, the Agreement provides for SET's supply of gas to PG&E's Core Procurement function for 12 months. This is significant in terms of ensuring supply of gas for PG&E customers over the coming winter months.

21. For the foregoing reasons, I am of the opinion that the Agreement is of substantial benefit to both PG&E and its creditors.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this declaration was executed this 19th day of November 2001, in San Francisco, California.

By: 

DAVID W. ANDERSON

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](http://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