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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 <u>HEARING</u> Date: February 27, 2002 Time: 1:30 p.m. Place: 235 Pine Street, 22nd Floor San Francisco, California

DECLARATION OF KENT HARVEY IN SUPPORT OF RESPONSE BY PACIFIC GAS AND ELECTRIC COMPANY AND PG&E CORPORATION TO TERM SHEET SUBMITTED BY CALIFORNIA PUBLIC UTILITIES COMMISSION FOR PROPOSED CHAPTER 11 PLAN FOR PACIFIC GAS AND ELECTRIC COMPANY

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I, Kent Harvey, declare as follows:

1. I am the chief financial officer of Pacific Gas and Electric Company, the debtor and debtor in possession in the above-captioned Chapter 11 case (the "Debtor" or "PG&E"). This Declaration is based on my personal knowledge of the Debtor's operations and financial position. If called as a witness, I could and would testify competently to the facts stated herein.

2. I make this declaration in support of the response by the Debtor and PG&E Corporation ("Parent") (collectively, the "Respondents") to the "Proposed Plan Term Sheet" (the "Term Sheet") submitted by the California Public Utilities Commission ("CPUC") regarding the CPUC's proposed alternative to the pending First Amended Plan of Reorganization, as modified to date (the "PG&E Plan"), jointly propounded by PG&E and its Parent.

3. The Term Sheet proposes to reinstate certain debt and other obligations, take existing cash along with cash to be received from retaining existing rates in effect until January 31, 2003, and use the cash balance at that date to repay remaining claims. The Term Sheet starts with an adjusted aggregate claim amount of $12.659 billion, proposes to reinstate (or reestablish obligations to be dealt with in the ordinary course) $5.795 billion of that amount, and proposes to use estimated cash on hand of $6.864 billion at January 31, 2003 to repay remaining claims.

4. As detailed below, this analysis of cash sources and uses falls short by at least $4.5 billion dollars, based on an overstatement of available cash on the proposed effective date of more than $2.0 billion and an understatement of obligations to be paid out of cash on the proposed effective date of over $2.5 billion.

5. The Term Sheet (in Schedule 3 of Exhibit B) forecasts approximately $1.75 billion of "utility residual generation revenues" that are projected to accrue over a 14 month period (from December 1, 2001 through January 31, 2003). Even if the CPUC's estimates are accepted as accurate, the Term Sheet fails to reflect the state and federal income taxes that PG&E is required to pay with respect to this income. Such taxes, which are payable at

the rate of 40.75%, would amount to approximately $710 million. Accordingly, the initial available cash projected under the Term Sheet as of the proposed effective date should be reduced by this $710 million amount.

6. The Term Sheet (in Schedules 1, 3 and 4 of Exhibit B) overstates initial projected cash available by failing to reflect payments of $650 million made by PG&E in December of 2001 for income and property taxes. At December 31, 2001, PG&E's cash balance amounted to approximately $4.22 billion, as compared to the amount of approximately $4.88 billion as of November 30, 2001 reflected on the Term Sheet. Accordingly, the available cash projected under the Term Sheet as of the proposed effective date should be reduced by this $650 million amount.

7. The Term Sheet's analysis of cash available on the proposed effective date to pay claims fails to account for capital expenditures in excess of depreciation by PG&E. PG&E's annual capital expenditures in 2002 (as described Appendix C to PG&E's Disclosure Statement) are expected to be approximately $1.5 billion. Based on annual depreciation of approximately $1 billion, this requires approximately $500 million of incremental cash sources to fund annual capital expenditures, such as new distribution lines or gas pipeline replacements. By assuming that all of PG&E's return on investment will be accrued to fund payments to creditors, the Term Sheet fails to include any funds in excess of depreciation for these capital expenditures. Accordingly, the available cash projected under the Term Sheet as of the proposed effective date should be reduced by $500 million, based on expected 2002 capital expenditures, net of annual depreciation.

8. The Term Sheet (in Schedule 3 of Exhibit B) forecasts postpetition interest of $282 million with respect to PG&E's mortgage bonds and $746 million with respect to other claims, or a total of $1.028 billion. PG&E's calculations reflect that, based on the provisions set forth in the Term Sheet, the amount of post-petition interest is approximately $1.251 billion, or an understatement of $223 million. Since the Term Sheet provides for the payment of all postpetition interest in cash as of the proposed effective date, the available cash projected under the Term Sheet as of the proposed effective date should be decreased

by approximately $220 million to account for payment of the understated postpetition interest.

9. The Term Sheet (in Schedule 2 of Exhibit B) "adjusts" Class 5 (General Unsecured) Claims by reducing them by $1.06 billion (from $4.57 billion to $3.51 billion) from the amount set forth in the First Amended Disclosure Statement pertaining to the PG&E Plan (as amended, "PG&E's Disclosure Statement"). Footnote 3 to Schedule 2 explains that such reduction reflects the reclassification of $1.06 billion of QF claims to administrative expense claims. However, PG&E's Disclosure Statement already reflects this adjustment. Thus, the Term Sheet understates Class 5 Claims by $1.06 billion. Since the Term Sheet provides for the payment of all Class 5 Claims in cash, the Term Sheet's projected cash requirements on the proposed effective date should be increased by $1.06 billion to account for payment in cash of the understated Class 5 Claims.

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10. The Term Sheet (in Schedules 1, 2 and 5 of Exhibit B) reflects reinstated obligations of approximately $5.8 billion. However, approximately $940 million of these obligations apparently cannot be reinstated. This includes the following:

(a) Approximately $333 million (1992 Series A) of PG&E's Secured First Mortgage Bonds (Class 3) cannot be reinstated under the CPUC's contemplated plan, because such debt matures by its terms on March 1, 2002, well before the effective date of the CPUC's contemplated plan.

(b) The Term Sheet proposes to reinstate Letter of Credit Backed PC Bond Claims and Letter of Credit Bank Claims (Classes 4d and 4e under the PG&E Plan) aggregating $610 million. If the Letter of Credit Banks do not agree to the CPUC's proposed plan (and Respondents believe that it is unlikely they will), such claims would apparently not be subject to reinstatement, as the Letter of Credit Banks cannot be forced to renew or extend these letters of credit, all of which expire by their own terms in 2002 or 2003, and as to which the Letter of Credit Banks can trigger draws on the Letters of Credit (based on existing defaults under the Letter of Credit Reimbursement Agreements) and redeem the Letter of Credit Backed PC Bonds.

Accordingly, the Term Sheet's proposed effective date cash requirements should be increased by $943 million to account for payment in cash of the foregoing debts.

11. The Term Sheet (in Exhibit A at 6) estimates Class 6 (ISO, PX and Generator) Claims at $1.07 billion and Class 7 (ESP) Claims at $420 million. These are the same estimated amounts set forth in PG&E's Disclosure Statement, which reflects estimated reductions of $400 million and $100 million, respectively, for refunds that FERC is expected to order. However, the Term Sheet (at 3) provides for establishment of a litigation trust for the sole benefit of PG&E's ratepayers (rather than creditors), and would assign to the litigation trust "affirmative recoveries related to refund claims pending before the FERC." Thus, if the CPUC intends to credit the FERC refunds to the litigation trust (for the benefit of ratepayers), such $500 million in estimated refunds would not be available to offset Class 6 and Class 7 Claims. Accordingly, the $500 million in estimated FERC refunds already reflected as an offset in the Class 6 and 7 Claims in the PG&E Plan should be added back to the Class 6 and Class 7 claims as stated in the Term Sheet, thereby raising the cash requirements on the proposed effective date by $500 million to account for payment in cash of such obligations.

12. In order to correct the foregoing errors in the Term Sheet, projected initial cash available to pay creditors as of the proposed effective date should be reduced by more than $2.0 billion (based on failure to account for approximately $710 million of taxes payable on utility residual generation revenues, failure to account for payments of approximately $650 million in December 2001 for income and property taxes, failure to provide for net capital expenditures of approximately $500 million in 2002 and understatement of postpetition interest of approximately $220 million), and projected cash requirements for satisfying claims on the proposed effective date should be increased by over $2.5 billion (based on understatement of $1.06 billion in Class 5 (General Unsecured) Claims, required payment of approximately $940 million of debt not subject to reinstatement and understatement of $500 million in Class 6 (ISO, PX and Generator) and Class 7 (ESP) Claims).

13. The foregoing adjustments to the CPUC's figures will result in a shortfall of more

than $4.5 billion between the obligations under the CPUC's contemplated plan and the resources available to satisfy such obligations. Given that PG&E will have a sub-investment grade credit rating, large capital investment requirements, and significant working capital requirements, it is my understanding that PG&E would be unable to finance a shortfall of this magnitude under the Term Sheet proposed by the CPUC.

14. While the Term Sheet contemplates PG&E securing a credit facility to fund, among other things, capital expenditures and working capital, based on the lack of assurance regarding PG&E's creditworthiness, it is my understanding that such a credit facility, in combination with the more than $4.5 billion necessary to fund the cash shortfall in the Term Sheet, would be unavailable to PG&E under the Term Sheet proposed by the CPUC.

15. Under the tariffs of the California Independent System Operator ("ISO"), PG&E is foreclosed from purchasing power through the ISO's markets unless it is investment grade or is able to post collateral, including cash, letters of credit or surety bonds. It is my understanding that the CPUC's contemplated plan and PG&E's expected sub-investment grade status thereunder would leave PG&E with inadequate resources for posting collateral or pre-paying for necessary obligations (*e.g.*, natural gas supplies for core gas customers, electrical energy and ancillary services procured for electric customers and workers compensation liabilities). It is also my understanding that PG&E would be unable to procure sufficient power and gas on anything other than a monthly or "spot" basis. Therefore, its customers would be directly exposed to the price volatility of the gas and power markets beyond the current month.

16. The Plan contemplated by the Term Sheet purports to reinstate more than $4 billion of claims that would not be subject to reinstatement under the PG&E Plan, including $3.3 billion of mortgage bonds that would be paid fully in cash under the PG&E Plan. Given that these bondholders originally purchased bonds that were rated "A" or better (by both Moody's and Standard & Poor's) and the CPUC's contemplated plan is expected to have their credit rating be well into the speculative range, the Debtor and its financial advisors estimate that, based on current market conditions, the mortgage bonds would

reasonably be expected to trade at a material discount of their par value upon consummation of the CPUC's contemplated plan.

I declare under penalty of perjury under the laws of the United States of America and the State of California that the foregoing is true and correct. Executed this 20th day of February, 2002 at San Francisco, California.

KENT HARVEY

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