

James E. Spiotto [Admitted *Pro Hac Vice*]
Chapman and Cutler
111 West Monroe Street
Chicago, IL 60603-4080
Telephone: (312) 845-3000
Facsimile: (312) 701-2361

50-275/323

William R. Pascoe, Esq. (State Bar #54284)
Pascoe & Rafton
1050 Northgate Drive
Suite 356
San Rafael, CA 94903
Telephone: (415) 492-1003
Facsimile: (415) 492-3312

ATTORNEYS FOR THE SENIOR DEBTHOLDERS

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 DM

Chapter 11 Case

Date: March 25, 2002

Time: 9:30 a.m.

Place: 235 Pine Street

Federal I.D. No. 94-0742640

San Francisco, California

DECLARATION OF TERRILL C. ARMSTRONG IN FURTHERANCE OF THE SENIOR
DEBTHOLDERS' STATEMENT IN SUPPORT OF PACIFIC GAS AND ELECTRIC COMPANY'S
MOTION FOR ORDER (A) APPROVING SETTLEMENT AND SUPPORT AGREEMENT BY AND
AMONG PLAN PROPONENTS AND SENIOR DEBTHOLDERS, (B) AUTHORIZING PAYMENT OF
PRE- AND POST-PETITION INTEREST TO HOLDERS OF UNDISPUTED CLAIMS IN CERTAIN
CLASSES, (C) AUTHORIZING PAYMENT OF FEES AND EXPENSES OF INDENTURE TRUSTEES
AND PAYING AGENTS AND (D) AUTHORIZING DEBTOR TO ENTER INTO
SIMILAR SETTLEMENTS

Add: Kids General Center

armstrong.doc

Declaration of State Teachers Retirement System of Ohio in Furtherance of Senior Debtholders' Statement

A001

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2 I, Terrill C. Armstrong, declare as follows:

3 1. I am an Assistant Portfolio Manager and senior member of the fixed income
4 department of the State Teachers Retirement System of Ohio ("*STRS Ohio*"). I maintain an
5 office at 275 East Broad Street, Columbus, Ohio 43215. I analyze companies across a number
6 of industrial and financial sectors and share the responsibility of constructing portfolios of
7 corporate securities. My responsibilities also include maintaining an Approved Issuer list for
8 short-term investments. I have been employed by STRS Ohio, primarily as a credit analyst,
9 since 1994. I was promoted into my current position in July 2001. I earned the right to use the
10 Chartered Financial Analyst designation and received a CFA charter in September 1997 and a
11 Masters of Business Administration from The Ohio State University in June 2000. This
12 Declaration is based on my personal knowledge of the facts stated herein. If called as a witness,
13 I could and would testify competently to the following facts.

14 2. I make this Declaration in furtherance of the Senior Debtholders' Statement in
15 Support of Pacific Gas and Electric Company's Motion for Order (A) Approving Settlement and
16 Support Agreement By and Among Plan Proponents and Senior Debtholders, (B) Authorizing
17 Payment of Pre- and Post-Petition interest to Holders of Undisputed Claims in Certain Classes,
18 (C) Authorizing Payment of Fees and Expenses of Indenture Trustees and Paying Agents and
19 (D) Authorizing Debtor to Enter into Similar Settlements.

20 3. STRS Ohio is a retirement system serving almost 400,000 active, inactive and
21 retired Ohio public educators. With assets of more than \$50 billion, STRS Ohio is one of the
22 largest public pension funds in the United States. The basic investment policy is preservation of
23 the capital investment and realization of sufficient returns to secure and facilitate payment of the
24 statutory benefit requirements of the system of its participants and beneficiaries. Liquidity
25 reserves are designed to fund the normal business needs of STRS Ohio.

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2 4. STRS Ohio routinely purchases securities that are consistent with the investment
3 strategies of the system. In making the decision to purchase a given security, STRS Ohio
4 considers, among other things, the creditworthiness of the issuer, the contractual rate of interest
5 and the likelihood that the agreed-upon interest will be paid as promised. Pursuant to the
6 Investment Objective and Policy of STRS Ohio, commercial paper must generally be rated A-1
7 by Standard & Poors and P-1 by Moody's. STRS Ohio regularly maintains an Approved Issuer
8 List, which identifies commercial paper issuers approved for investment. The Approved Issuer
9 List is used by STRS Ohio internal Investments staff and a third-party making investments on
10 behalf of STRS Ohio. Investments made by the third-party result in STRS Ohio being the
11 beneficial owner of such investments.

12 5. Prior to the Petition Date,¹ a third-party purchased on our behalf and STRS Ohio
13 became the beneficial owner of \$56,635,000 in commercial paper (the "*Commercial Paper*")
14 issued by the Debtor, Pacific Gas and Electric Company ("*PG&E*").

15 6. STRS Ohio approved PG&E for the Approved Issuer List based upon the
16 understanding that the Commercial Paper was A-1/P-1 rated paper of a utility offering an
17 appropriate yield, certain liquidity, and timely repayment. The capital markets generally
18 consider such highly-rated Commercial Paper to be a very secure investment appropriate for
19 governmental bodies, pension funds and the like.

20 7. Further, STRS Ohio approved PG&E for the Approved Issuer List in reliance on
21 representations by PG&E that payment of the Commercial Paper would be made in a timely
22 manner. The assumption that the Commercial Paper would be paid on a timely basis in the
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24 ¹ Unless otherwise defined herein, all capitalized terms not defined herein shall have the same meaning
25 ascribed to them in the Motion and Settlement Agreement or in the Second Amended Plan of
26 Reorganization proposed by the Debtor and PG&E Corporation.

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2 amounts agreed to by PG&E in turn influenced other investment decisions made by STRS Ohio
3 for the pension funds it invests.

4 8. STRS Ohio understood that the issuance of the Commercial Paper was
5 specifically approved, during an energy crisis, not only by the Board of Directors of PG&E, but
6 also by the California Public Utility Commission ("CPUC") as a reasonable cost and an
7 appropriate part of the rate base. On October 19, 2000, the CPUC issued Decision No. 00-10-
8 065, which authorized the Debtor to increase its short-term borrowing authority by \$1.4 billion to
9 \$3.1 billion in the form of commercial paper, bank debt and notes that PG&E could issue. See In
10 the Matter of the Application of Pacific Gas and Electric Co. for an Expedited Order Modifying
11 Decision No. 87-09-056 (Application No. 87-08-008), Decision No. 00-10-065 (Oct. 19, 2000).
12 In its application, the Debtor argued that immediate approval of the additional financing was
13 required because, otherwise, "it may exhaust its currently authorized level of short-term debt
14 before the end of November." *Id.* at 2. The CPUC granted the Debtor's request and the Debtor
15 issued such securities, including the Commercial Paper. Moreover, the Debtor, in its 10-Q for
16 the quarterly period ended September 30, 2000, told the investing public that on October 18,
17 2000, it executed a credit agreement for an additional \$1 billion in revolving credit facilities to
18 provide commercial paper back-up for the additional Commercial Paper (Page 45). This meant
19 that there was a clear source of repayment for the Commercial Paper that had the support of the
20 CPUC.

21 9. During the pendency of the case, PG&E has been able to amass large amounts of
22 cash while valid obligations to governmental bodies and pension funds are unpaid. As will be
23 set forth below, this has created significant problems for the Senior Debtholders.

24 10. Those capital market creditors who purchased the securities of PG&E in 2000,
25 including the Commercial Paper, did not intend a long term financial commitment. (For

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2 example, STRS Ohio purchased the Commercial Paper because it was a short-term investment of
3 less than 90 days that would contribute to the liquidity reserves of its portfolio.) Commercial
4 Paper investors provided capital to PG&E during the California energy crisis based upon the
5 representations by PG&E that sufficient revolving credit facilities to provide commercial paper
6 backup would be available to pay the principal and interest on the securities when due. Those
7 financial investors relied on the statements of PG&E regarding the availability of revolving
8 credit facilities to pay the securities and had other uses planned for the funds after the maturity
9 date of the Commercial Paper. They suffered a tremendous loss when the Debtor began
10 defaulting on obligations issued less than 90 days prior. These institutions had to function
11 without the funds, while PG&E, which has indicated it is solvent, had the benefit of over \$4
12 billion in cash, most of which it presently is holding for the sole purpose of paying debt service
13 and debt that has matured or is otherwise due.

14 11. STRS Ohio has filed a Proof of Claim in the above matter and has been closely
15 monitoring the proceedings. STRS Ohio is aware of the proposed treatment accorded the
16 Commercial Paper and other Senior Debtholders in the Second Amended Plan and Disclosure
17 Statement filed by the Plan Proponents. STRS Ohio is also aware of the proposed treatment of
18 the Commercial Paper and other Senior Debtholders in term sheet for a Plan proposed by the
19 CPUC.

20 12. STRS Ohio has been involved in the negotiation of the Settlement Agreement and
21 supports the Settlement Agreement as the best alternative currently available for Senior
22 Debtholders. The Settlement Agreement is desirable because it fixes the rate to be paid on the
23 Commercial Paper and Senior Indebtedness at the appropriate contract rate as of the Petition
24 Date and protects investors from risks inherent in delays in the reorganization process by
25 allowing for increases in interest rates if the Plan does not go effective by certain dates. The

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2 rates the Debtor and Senior Debtholders have agreed to are fair and, in some cases, lower than
3 the rates the Senior Debtholders felt they were entitled to under California law. The early
4 payment of interest would mitigate some of the loss suffered by the holders of Commercial Paper
5 and other Senior Debtholders. Moreover, it seeks to defray the fees and costs of all entitled
6 indenture trustees and paying agents and otherwise ameliorate the damage suffered by Senior
7 Debtholders by reason of the cessation of interest payments since the bankruptcy filing. PG&E
8 is solvent and will be required to pay the Commercial Paper and other Senior Indebtedness in
9 order to emerge from bankruptcy. PG&E has available cash to make the payments, the payments
10 now will avoid negative arbitrage as discussed in the Declaration of Kent M. Harvey filed on
11 March 5, 2002 in support of PG&E's motion to approve the Settlement Agreement (which
12 PG&E claims is as much as \$35 million annually) and may be viewed by investors as the first
13 step by the Debtor toward restoring its capital market credibility and confidence.

14 13. The terms of the Settlement Agreement, if approved, will be available to all
15 general unsecured creditors similarly situated and therefore will not favor any individual
16 creditors of the Debtor. If the Settlement Agreement is approved, one of the conditions to its
17 effectiveness will be fulfilled. Another is that a significant number of the approximately
18 \$4.5 billion of Class 5 Creditors (at least \$3 billion) support the Settlement Agreement. Thus,
19 the Senior Debtholders are not receiving special treatment.

20 14. The capital markets have been distressed by the bankruptcy filing by PG&E. That
21 is because PG&E has stated they are a solvent entity. In the absence of an effort to build capital
22 market acceptance while the Debtor is still in bankruptcy, PG&E may have difficulty
23 establishing capital market credibility post-bankruptcy. A key part of any plan of reorganization
24 will be the issuance of debt securities to the capital markets. The feasibility of such issuance will
25 be called into question if the Debtor does not signal to the capital markets that it intends to treat

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2 creditors fairly. Absent an effort to build market acceptance, normally, financial investors would
3 avoid the securities of a financially troubled debtor in the future or demand a significant interest
4 rate increase over market to reflect the risk of nonpayment. Approval of the Settlement
5 Agreement is a first step to restoring capital markets credibility and confidence. Other steps
6 include a Plan of Reorganization detailing an appropriate rate structure, an appropriate capital
7 structure for the Debtor and its reorganized entities, and an investment grade senior unsecured
8 bond rating. All of these combined will have the benefit of reducing the cost of borrowing. This
9 will benefit PG&E, the Estate and those who deal with PG&E, such as its customers, California
10 ratepayers. The Settlement Agreement should result in assembling support from the unsecured
11 creditors, critical for the Debtor to emerge from bankruptcy.

12 15. Based upon my experience, I believe that continued failure to make timely
13 payments to STRS Ohio and other investors during the pendency of this case will seriously
14 jeopardize the ability of PG&E to obtain financing post-confirmation at attractive rates. This is
15 particularly true because, while PG&E's creditors have been faced with Chapter 11, other
16 utilities in the market have been making their debt payments and even SoCal Edison is making or
17 has made scheduled payments to its creditors.

18 16. As part of my duties, I evaluate Chapter 11 plans and the proposed treatment of
19 creditors under those plans. It is my opinion that the treatment of the unsecured creditors of
20 PG&E as envisioned by the Settlement Agreement is appropriate and in the best interests of the
21 Estate.

22 17. The STRS Ohio offers this Declaration solely in support of its own position.
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1 I declare under penalty of perjury under the laws of the United States of America and the
2 State of Ohio that the foregoing is true and correct. Executed this 15th day of March, 2002 at
3 Columbus, Ohio.

4 DATED: MARCH 15, 2002.

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7 TERRILL C. ARMSTRONG