

September 12, 2002

CONFIDENTIAL

California Public Utilities Commission  
505 Van Ness Avenue  
San Francisco, CA 94111

Attention: Gary M. Cohen  
General Counsel

Official Unsecured Creditors Committee  
appointed in the PG&E Chapter 11 Case  
c/o Milbank, Tweed, Hadley & McCloy LLP  
601 S. Figueroa St., 30<sup>th</sup> Floor  
Los Angeles, CA 90017

Attention: Paul S. Aronzon

Ladies and Gentlemen:

1. UBS Warburg LLC ("UBS Warburg") is pleased to act as financing and capital markets arranger for the California Public Utilities Commission ("CPUC") and the Official Unsecured Creditors Committee appointed in the Pacific Gas and Electric Company Chapter 11 Case ("OCC") in connection with the financing of the First Amended Chapter 11 Plan of Reorganization filed by the CPUC and the OCC (each, a "**Proponent**" and, collectively, the "**Proponents**"), as it may be amended from time to time (the "**Plan**"), for Pacific Gas and Electric Company (together with its subsidiaries, the "**Debtor**") in its Chapter 11 Case currently pending before the United States Bankruptcy Court for the Northern District of California (the "**Bankruptcy Court**"). This letter agreement (the "**Agreement**") confirms the terms of our engagement by the Proponents. The term ("**Term**") of UBS Warburg's engagement hereunder shall commence on the date this Agreement becomes effective and continue until the consummation the Plan or, if earlier, the date as of which the services of UBS Warburg are terminated pursuant to Section 5 below.

As used in this Agreement, the term "financing of the Plan" of means, whether effected directly or indirectly in one or a series of transactions, the consummation by the Debtor (or its affiliated entities or subsidiaries, whether now existing or newly created) of a bank financing or the issuance and/or sale of debt or equity securities in the public or private markets or otherwise, for the purpose of financing or funding the Plan.

On the terms and subject to the conditions of this Agreement, UBS Warburg will provide the Proponents with such financial and market related advice and assistance with respect to the financing of the Plan as may be appropriate and mutually agreed upon by the Proponents and UBS Warburg,

which may include assisting the Proponents in analyzing, structuring, negotiating and effecting any financing by the Debtor of the Plan. UBS Warburg acknowledges that each of the Proponents has other financial professionals providing it with financial advisory services. The parties will endeavor to avoid duplication in these various engagements.

UBS Warburg and its affiliates will have the exclusive right to provide or arrange for any financing in connection with the Plan or for any other plan of reorganization for the Debtor proposed by the CPUC. The CPUC agrees not to become a co-proponent of any reorganization plan for the Debtor, and the Proponents agree not to permit any person, group, committee or other entity to become an additional co-proponent of the Plan, unless all plan proponents agree to UBS Warburg acting in such capacity. In such capacity, UBS Warburg shall have the right to act as book running lead manager for any capital markets financings of debt, equity, equity-linked and/or preferred securities to be executed by the Debtor or by PG&E Corporation pursuant to the Plan or any other plan of reorganization for the Debtor proposed by the CPUC. If UBS Warburg provides such services, UBS Warburg will be compensated as set forth herein or pursuant to separate agreements referred to herein.

It is understood and agreed that nothing contained in this Agreement shall constitute a commitment by UBS Warburg to underwrite, place or purchase any securities, to arrange any other form of financing or to provide the USB Warburg Financing Proposal (as defined below). Such a commitment, if any, shall only be set forth in the UBS Warburg Commitment (as defined below), or in a separate underwriting, placement, agency or similar agreement relating to the financing which contains customary underwriting spreads and other terms and conditions, including appropriate indemnification provisions, satisfactory to UBS Warburg, and which is subject to required Bankruptcy Court and regulatory approvals.

2. For UBS Warburg's services hereunder, UBS Warburg will be paid the following fees in cash (such fees to be payable by the Debtor pursuant to order of the Bankruptcy Court as set forth below):

Retainer Fees

(a) Retainer fees, payable in two parts as follows:

(i) \$2,000,000 promptly upon the effectiveness of this Agreement; and

(ii) for the period from March 1, 2003 through the earlier to occur of December 31, 2003 or the end of the Term, a monthly fee of \$150,000, payable on the first day of each month or portion thereof.

(b) An additional \$6,000,000 promptly upon the delivery to the Proponents of a "highly confident" letter by UBS Warburg (the "**UBS Warburg Financing Proposal**") to provide or arrange for the financing of the Plan, which

(i) shall be based on reasonably detailed assumptions regarding market conditions, rate path and financial performance of reorganized Debtor, (ii) include reasonably detailed term sheets describing the current terms of each class and series of debt and equity securities to be issued and sold in public and private transactions and (iii) shall be subject to terms and conditions normally included in such arrangements in similar contexts, including but not limited to customary market pricing in connection with any underwriting. The UBS Warburg Financing Proposal shall be delivered to the Proponents at a time that is mutually agreed in conjunction with the confirmation hearing for the Plan.

#### Commitment Fees

(c) Following the delivery of the UBS Warburg Financing Proposal and the payment in full of the fee specified in Section 2(b) above, the Proponents may request in writing that UBS Warburg deliver a binding commitment (the “**UBS Warburg Commitment**”) of UBS Warburg to acquire some or all of the securities to be issued under the Plan that are not sold to third parties. UBS Warburg will deliver the UBS Warburg Commitment subject to, among other things, (i) then existing market conditions, (ii) the financial performance and credit quality of the Debtor and (iii) the terms and conditions of each class or series of the securities to be acquired, being acceptable to UBS Warburg. UBS Warburg reserves the right to syndicate the UBS Warburg Commitment. The UBS Warburg Commitment shall also be subject to pricing and other terms and conditions normally included in such arrangements in similar contexts, including compliance with applicable law and regulation. The UBS Warburg Commitment shall not be delivered prior to the Proponents’ obtaining Bankruptcy Court approval therefor and for the payment of the commitment fee agreed between UBS Warburg and the Proponents.

#### Consummation Fee

(d) At the time of occurrence of a Consummation Transaction (as defined below) with respect to the Debtor, UBS Warburg shall receive a fee (the “**Consummation Fee**”) equal to \$60 million, *minus* up to \$60 million of the following:

- (i) the cumulative fees previously paid to UBS Warburg pursuant to Section 2(c) above; and
- (ii) the portion of any underwriting commissions retained by UBS Warburg in its capacity as lead manager or co-manager of any underwritten financing in connection with such Consummation Transaction for acting in such capacity.

For purposes hereof, a “Consummation Transaction” means the consummation of any reorganization or restructuring of liabilities of the Debtor that is in material compliance with California law, including, without limitation,

the earliest to occur of (A) the effective date of any chapter 11 plan of reorganization with respect to the Debtor, or (B) any repayment, exchange, conversion, modification, amendment, deferral, restructuring, rescheduling, moratorium or adjustment of the terms and/or conditions of liabilities of the Debtor outstanding on the date of commencement of its chapter 11 proceedings, whether pursuant to a chapter 11 plan of reorganization, order of the Bankruptcy Court or otherwise; provided that a Consummation Transaction shall not include either of the following: (x) any plan of reorganization that results in the disaggregation of the Debtor into separate business entities with the effect of substantially removing from the CPUC its authority under current law to regulate the rates of any one or more of such separate entities; or (y) any plan of reorganization with respect to which (1) the CPUC does not agree with the plan proposed by the plan proponent for the reorganization of the Debtor; or (2) the plan does not involve the sale of debt and/or equity securities to make distributions to holders of allowed claims (an “**Alternate Creditor Plan**”). It is understood and agreed that the granting by the CPUC of normal and customary regulatory approval for any transaction that is part of a confirmed Alternate Creditor Plan shall not transform such Alternate Creditor Plan into a Consummation Transaction. A Consummation Transaction of the type referred to in clause B immediately above shall be deemed to have occurred when the plan of reorganization or other binding document or agreement providing for such Consummation Transaction becomes effective.

Whether or not any financing transaction is consummated, in addition to any fees payable to UBS Warburg, UBS Warburg shall be entitled to be reimbursed, promptly upon its request from time to time, for reasonable expenses incurred by it (including expenses incurred in connection with two previous letter agreements with the CPUC) in entering into and performing services pursuant to this Agreement, including the reasonable fees, disbursements and other charges of its legal counsel.

The parties agree that the fee arrangement hereunder, pursuant to Section 328(a) of title 11 of the United States Code (the “**Bankruptcy Code**”), is reasonable, fairly compensates UBS Warburg and provides certainty to the Proponents and the Debtor.

The OCC and the CPUC shall promptly apply to the Bankruptcy Court pursuant to Section 328(a) of the Bankruptcy Code for an order approving the retention of UBS Warburg as financing and capital markets arranger for the Proponents in connection with the financing of the Plan under this Agreement (including, without limitation, payment of the Retainer Fees, Consummation Fees and the reimbursement of UBS Warburg’s expenses, all as provided herein), and this Agreement shall become effective upon the entry of such order. UBS Warburg shall not be required to serve hereunder unless the order approving its retention is satisfactory to UBS Warburg. Drafts of the employment application and the order authorizing employment shall be provided to UBS Warburg in advance of their filing, and must be acceptable to UBS Warburg in its discretion. If the order authorizing the retention of UBS Warburg is obtained, the Debtor

shall pay all fees and expenses as promptly as possible in accordance with the terms of this Agreement, the Bankruptcy Code, the Federal Rules of Bankruptcy Procedure and applicable local rules and orders, and the Proponents will work with UBS Warburg to promptly file any and all necessary applications regarding such fees and expenses with the Bankruptcy Court. The terms of this paragraph are solely for the benefit of UBS Warburg and may be waived, in whole or in part, only by UBS Warburg.

3. Except to the extent legally required (after consultation with UBS Warburg and its counsel), none of (i) any advice rendered by UBS Warburg to the Proponents, or (ii) any communication from UBS Warburg in connection with the services performed by UBS Warburg pursuant to this Agreement will be quoted or referred to orally or in writing, or reproduced or disseminated, by the Proponents, without UBS Warburg's prior written consent, such consent not to be unreasonably withheld or delayed.

4. The Proponents, subject to compliance with existing confidentiality agreements, will furnish UBS Warburg (and will request or seek an order of the Bankruptcy Court requiring that the Debtor furnish UBS Warburg) with such information as UBS Warburg believes appropriate to its assignment (all such information so furnished being the "**Information**"). Each of the Proponents recognizes and confirms that UBS Warburg (a) will use and rely primarily on the Information and on information available from generally recognized public sources in performing the services contemplated by this Agreement without having assumed responsibility for independently verifying the same, (b) will assume that such Information is complete and accurate and does not assume responsibility for the accuracy, completeness or reasonableness of the Information and such other information and (c) will not make an appraisal of any assets or liabilities (contingent or otherwise) of the Debtor.

5. UBS Warburg's services hereunder may be terminated by the Proponents or UBS Warburg upon 30 days prior written notice without liability or continuing obligation of the parties, except that (a) if terminated by the Proponents, UBS Warburg shall be entitled to the fees payable pursuant to Section 2 hereof in respect of any Consummation Transaction consummated within a period of 18 months following any such termination, (b) expenses incurred by UBS Warburg as a result of services rendered prior to the date of the termination by any party shall become immediately payable in full and (c) Sections 3, 4 (other than the first sentence thereof) 5, 6, 9, 10, 11, 12 and 13 hereof shall remain operative and in full force and effect regardless of any termination by any party.

6. In rendering its services Proponents' hereunder, UBS Warburg is not assuming any responsibility for the Proponents' or the Debtor's underlying business decision to pursue or not to pursue any plan of reorganization or to effect or not to effect any financing transaction. The Proponents agree that UBS Warburg shall not have any obligation or responsibility to provide "crisis

management” services for the Debtor or to provide any solvency or fairness opinion in connection with any financing transaction.

7. UBS Warburg may, at its own expense, place customary tombstone announcements or advertisements in financial newspapers and journals describing its services hereunder with the consent of the Proponents, such consent not to be unreasonably withheld or delayed.

8. The Proponents acknowledge and agree that UBS Warburg has been retained to act solely as financing and capital markets arranger for the Plan, and not as an advisor to any person, and the engagement of UBS Warburg is not intended to confer rights upon any person (including the Debtor and its shareholders, employees or creditors) not a party hereto as against UBS Warburg or its affiliates, or their respective directors, officers, employees or agents, successors, or assigns. UBS Warburg shall act as an independent contractor under this Agreement, and not in any other capacity including as a fiduciary and any duties arising out of its engagement shall be owed solely to the Proponents. UBS Warburg acknowledges and agrees that the Proponents (including individual members of the OCC) shall have no obligation or liability for any amount payable to UBS Warburg arising out of or relating to this Agreement and that all such amounts shall be payable by the Debtor pursuant to one or more orders of the Bankruptcy Court referred to above.

9. UBS AG (the parent of UBS Warburg) and its subsidiaries, branches and affiliates (the “**UBS Group**”) are involved in a wide range of commercial banking, investment banking and other activities (including investment management, corporate finance and securities issuing, trading and research) from which conflicting interests or duties may arise. Information which is held elsewhere within UBS Warburg or within the UBS Group but of which none of the individuals in the Corporate Finance Department of UBS Warburg involved in providing the services contemplated by this engagement actually has (or without breach of internal procedures can properly obtain) knowledge, will not for any purpose be taken into account in determining UBS Warburg’s responsibilities under this engagement. Neither UBS Warburg nor any other part of the UBS Group will have any duty to disclose to the Proponents or utilize for their benefit any non-public information acquired in the course of providing services to any third party, engaging in any transaction (on its own account or otherwise) or otherwise carrying on its business. In addition, in the ordinary course of business, UBS Warburg and its affiliates may trade the securities of the Debtor for its own account and for the accounts of customers, and may at any time hold a long or short position in such securities.

10. Each of the Proponents agrees that neither UBS Warburg nor any of its affiliates, directors, agents, employees or controlling persons shall have any liability to the CPUC or the OCC, and each Proponent hereby releases, acquits and forever discharges UBS Warburg and such persons of and from any and all losses, claims, damages, liabilities and expenses, of any kind or nature

whatsoever, from or in connection with or as a result of either UBS Warburg's engagement under this Agreement or any matter referred to in the Agreement, including, without limitation, related services and activities prior to the date of the Agreement, except to the extent that it shall be determined by a court of competent jurisdiction in a judgment that has become final in that it is no longer subject to appeal or other review that any losses, claims, damages, liabilities or expenses incurred by the CPUC or the OCC resulted solely from the (i) nonperformance by UBS Warburg of its services under this Agreement or (ii) gross negligence or willful misconduct of UBS Warburg in performing the services that are the subject of the Agreement. Except for the enforcement of the rights or claims described in (i) and (ii) above, each of the Proponents covenants that it will not sue or bring any claim or action against UBS Warburg or any of its affiliates, directors, agents, employees or controlling persons. This covenant shall be a complete defense to any such claim or suit by the CPUC or the OCC.

11. THIS AGREEMENT AND ANY CLAIM, COUNTERCLAIM OR DISPUTE OF ANY KIND OR NATURE WHATSOEVER ARISING OUT OF OR IN ANY WAY RELATING TO THIS AGREEMENT ("CLAIM"), DIRECTLY OR INDIRECTLY, SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF NEW YORK. TO THE EXTENT THAT THE BANKRUPTCY COURT DOES NOT HAVE OR RETAIN JURISDICTION OVER SUCH MATTER AND EXCEPT AS MAY BE REQUIRED BY APPLICABLE LAW, NO CLAIM MAY BE COMMENCED, PROSECUTED OR CONTINUED IN ANY COURT OTHER THAN THE COURTS OF THE STATE OF NEW YORK LOCATED IN THE CITY AND COUNTY OF NEW YORK OR IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK, WHICH COURTS SHALL HAVE EXCLUSIVE JURISDICTION OVER THE ADJUDICATION OF SUCH MATTERS, AND THE CPUC, THE OCC AND UBS WARBURG CONSENT TO THE JURISDICTION OF SUCH COURTS AND PERSONAL SERVICE WITH RESPECT THERETO. THE CPUC AND THE OCC (BUT NOT INDIVIDUAL OCC MEMBERS) HEREBY CONSENT TO PERSONAL JURISDICTION, SERVICE AND VENUE IN ANY COURT IN WHICH ANY CLAIM ARISING OUT OF OR IN ANY WAY RELATING TO THIS AGREEMENT IS BROUGHT BY ANY THIRD PARTY AGAINST UBS WARBURG OR ANY INDEMNIFIED PARTY. EACH OF UBS WARBURG, THE CPUC AND THE OCC WAIVES ALL RIGHT TO TRIAL BY JURY IN ANY PROCEEDING OR CLAIM (WHETHER BASED UPON CONTRACT, TORT OR OTHERWISE) ARISING OUT OF OR IN ANY WAY RELATING TO THIS AGREEMENT. EACH OF THE CPUC AND THE OCC AGREES THAT A FINAL JUDGMENT IN ANY PROCEEDING OR CLAIM ARISING OUT OF OR IN ANY WAY RELATING TO THIS AGREEMENT BROUGHT IN ANY SUCH COURT SHALL BE CONCLUSIVE AND BINDING UPON THE CPUC AND THE OCC AND MAY BE ENFORCED IN ANY OTHER COURTS TO THE JURISDICTION OF WHICH THE CPUC OR THE OCC IS OR MAY BE SUBJECT, BY SUIT UPON SUCH JUDGMENT.

12. This Agreement embodies the entire agreement and understanding between the parties hereto and supersedes all prior agreements and understandings relating to the subject matter hereof (except that the continuing validity of the letter agreement dated August 12, 2002 between UBS Warburg and the CPUC shall be governed by a separate letter between UBS Warburg and the CPUC). If any provision of this Agreement is determined to be invalid or unenforceable in any respect, such determination will not affect such provision in any other respect or any other provision of this Agreement, which will remain in full force and effect. This Agreement may not be amended or otherwise modified or waived except by an instrument in writing signed by all of the parties. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which shall constitute one and the same agreement.

13. This Agreement shall be binding upon the parties and their respective successors and assigns.

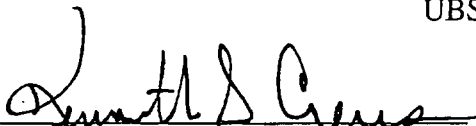





If the foregoing correctly sets forth our understanding, please indicate your acceptance thereof in the space provided below, whereupon this Agreement and your acceptance shall constitute a binding agreement between us.

Very truly yours,

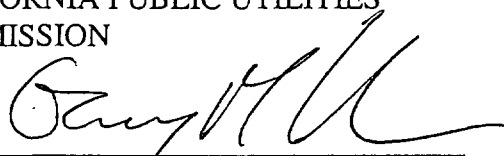
UBS WARBURG LLC

By:   
Kenneth S. Crews  
Vice Chairman  
Global Head, Energy and Power

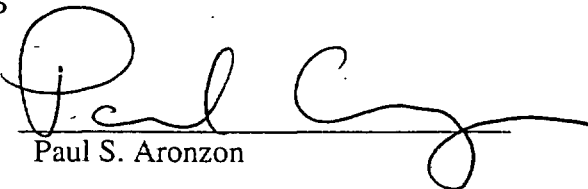
By:   
George C. Stephenson  
Managing Director

Accepted and agreed to as of the date first  
above written:

CALIFORNIA PUBLIC UTILITIES  
COMMISSION

By:   
Gary M. Cohen  
General Counsel

OFFICIAL UNSECURED CREDITORS  
COMMITTEE APPOINTED IN THE  
PG&E CHAPTER 11 CASE  
c/o Milbank, Tweed, Hadley and McCloy  
LLP

By:   
Paul S. Aronzon