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Sent: 7/26/2011 8:21:13 AM
To: cjs@cpuc.ca.gov (cjs@cpuc.ca.gov)
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Subject: FW: Analyst Report: BofA-ML – Upgrading Diversified and Merchant Utilities

FYI

From: Lam, Lisa [mailto:LxLy@pge.com]
Sent: Tuesday, July 26, 2011 8:04 AM
To: Officers of PG&E Corporation; Officers of Pacific Gas and Electric
Cc: Investor Relations (list)
Subject: Analyst Report: BofA-ML – Upgrading Diversified and Merchant Utilities

In what amounts to a significant market call, Steve Fleishman of Bank of America – Merrill Lynch issued a report yesterday that upgraded diversified and merchant utilities. His report states that the sector has “bottomed out” and that there are increasing signs of long-term recovery, suggesting it is the right time to buy. He notes that the regulated utilities have high valuations which reflect lower interest rates and investor defensiveness but that they still provide safe dividends for those seeking income and see limited upside opportunity with this sector at current valuations.

Fleishman notes that a number of events that occurred in 2011 that now provide a bullish outlook for the power sector. The final rule issued by the EPA in early July to reduce sulfur and nitrogen oxides – Cross State Air Pollution Rule (CSAPR) will be effective in 2012. The rule will price the return of emission allowances into power and cause coal plants to shut down in certain regions. The proposal issued by the EPA to reduce mercury and acid gases – HAPS MACT, to be implemented in 2015, requires most if not all coal generators to review their fleet and either shut down or retrofit all of their plants with the exception of the cleanest coal plants. The implementation of both rules is expected to result in a decreased supply of power and a corresponding price increase for the plants that continue operating.

The report cites three main risks to this positive outlook for the sector: (1) the 2012 election will be a critical event to watch, as the Republican Party has been in opposition of the CSAPR and HAPS MACT rules, and a Republican win could extend the implementation timelines for the EPA rules; (2) a continued weak economy will negatively impact natural gases and may increase political pressure to delay EPA rules on coal plants; and (3) an oversupply of shale gas in the near-term could suppress natural gas prices if more Marcellus gas gets access to the market.

The full report is attached for your reference.

Lisa

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Lisa Lam

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