From: Cherry, Brian K
Sent: 6/28/2012 8:46:53 AM
To: Cooke, Michelle (michelle.cooke@cpuc.ca.gov)
Cc:
Bcc:
Subject: FW: UBS Power & Utilities "California - Endless Summer"

FYI

From: Togneri, Gabriel
Sent: Thursday, June 28, 2012 6:33 AM
To: Earley Jr., Anthony; Johns, Christopher; Harvey, Kent M; Williams, Geisha; Bottorff, Thomas E; Stavropoulos, Nickolas
Cc: Cherry, Brian K; Investor Relations (list); Park, Hyun; Hayes, Kathleen (Law); Wan, Fong; Pruett, Greg S.; Frizzell, Roger
Subject: FW: UBS Power & Utilities "California - Endless Summer"

Here is JVR's write-up as a result of his visit to the CPUC and to us earlier this week. As I recall, we didn't confirm being in settlement discussions and I will call him. He was doing most of the talking about settlement discussions and we simply listened and then reiterated the same points that we've been making with investors for months.

In his note, he also covers commissioner terms, cost of capital, rate design, the SONGS outage, and renewables.

Gabe

Gabe Togneri I VP Investor Relations I PG&E Corporation I 415.267.7100

From: jim.vonriesemann@ubs.com [mailto:jim.vonriesemann@ubs.com]
Sent: Thursday, June 28, 2012 5:55 AM
Subject: UBS Power & Utilities "California - Endless Summer"

Good morning,

We thought you'd be interested in our comments following our Field Trip to San Francisco where we met with the CPUC and PCG management. We recognize many of you are traveling and have attached the entirety of our written comments below.

As always, please call us with any questions you may have.

Best,

The UBS Power & Utilities Team

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California – Endless Summer

- **Highlights of meetings with CPUC staff and PCG management**

Topics of interest include: 1) PCG settlement discussions; 2) water cost of capital proposed decision and implications for the electrics; 3) rate design; 4) resource planning, especially in Southern California and in light of ongoing SONGs outage; 5) CPUC Commission and forthcoming changes; 6) once through cooling; and, 7) status of renewable development.

6 ½ weeks – PCG in settlement discussions

The CPUC staff indicated that PCG is in active settlement discussions with key parties regarding the San Bruno pipeline explosion from September 2010. A global settlement including the OII and OIR is preferred and the next six weeks are critical in the negotiation process. Why? An ALJ recommendation in PCG's pipeline safety enhancement plan (PSEP) is due on August 6 and any agreement needs to be reached prior to this date to avoid the litigated route. It should be noted that PCG acknowledged that they were in discussions and that they would like a global settlement (this is not new), but the company would not comment beyond that. The key parties to the settlement discussion appear to be: the cities of San Bruno and San Francisco; the CPUC Consumer Protection and Safety Division (CPSD); the CPUC Department of Ratepayer Advocate (DRA); and The Utility Reform Network (TURN).

While we learned little on the specifics of the settlement discussion from the CPUC, our understanding is the overarching theme around the negotiations is that any "fine" will be used primarily to rebuild PCG's gas transmission infrastructure – the key task at hand, in our view – rather than feeding the state's coffers through some large monetary penalty followed by how much of the transmission infrastructure spend should be shareholder borne versus customer borne. The obvious issue is to separate the old ills from the new improvements and this is where the negotiation becomes challenging.

We believe the discussion will center around what constitutes the fine and how much of previously committed and unrecovered spend, *e.g.,* the $200MM per year for 2012 and 2013 plus certain PSEP costs, may be considered to be part of the fine. We think the range of potential outcomes is wide, but one issue we believe all sides will need to consider is what the financial ramifications to PCG are. The CPUC staff and other parties have engaged financial consultants to examine the potential financial ramifications of a settlement are to the company. Under consideration: lower returns, disallowances. Our unanswered question is whether a settlement will allow PCG to eventually recover on any of this spend.

The CPSD, in our view, is a critical component to the settlement process and it is clear to us the CPSD will need to be fully on board with any settlement, even if the others are not. That said, we believe a key issue will be getting the recently named head of the CPSD, General Jack Hagan, comfortable with the settlement agreement. This may be his first real decision and arguably, may be one of the more visible ones the CPSD division will make and one with lasting consequences. It should be noted that the state is serious about consumer safety and the pending budget bill has a rider adding 40 new staffers to the CPUC, 24 of which will be added to the safety division alone.

Presuming there is a settlement, a final decision is still unlikely before year end as there will be a commentary period and hearings before the CPUC renders a decision. While the significance of the two year anniversary is not an overarching consideration *per se*, the end of 2012 is. Any further delays beyond a settled resolution suggests a fully litigated proceeding that would last well into 2013. It is clear to us the company and the state want to put this issue behind them.

2013 expected to ring in more change at the CPUC

The term of the lone Republican Commissioner on the CPUC, Timothy Simon, expires at the end of the year. Gov Brown will have the opportunity to nominate a new commissioner or reappoint Simon to the five member panel. Without state statute requiring minority party representation, in this case Republican, it is highly probable that the Governor continues to move the CPUC towards a more consumer-centric commission, rather than the infrastructure development one of prior years.

Separately, President Peevey's term expires at the end of 2014 and he is expected to serve out his term. We view him as the ballast on the commission, having balanced both consumer and company interests. We also can envision a scenario where he is re-nominated to the CPUC. His wife, State Senator Carol Liu, is up for re-election this November. Previously, the widely held belief was Peevey would step down when his wife's term expired. The clear message we received was that this is not the case.

Cost of Capital – 10.5% still appears to be reasonable

On Monday, the proposed decision in the cost of capital proceeding for the State's water companies was in line with the settlement that was reached in November 2011. Our read-through for the electric's is that there is still a significant amount of work to be done by the electrics to justify their rates. Executive Director Paul Clannon suggested that allowed ROEs will come down from current levels "in terms of basis points" but not in "big drops." This implies to us that reasonable ranges around 10.5% appear to be still doable and the capital structures are largely intact.

Flawed rate design in need of repair

AB 1755 is under consideration by the CA Legislature to give the CPUC the authority to implement a fixed charge component to the consumer bill as a first step in fixing some of the discrepancies in the state's rate structure. California is essentially two states, the inland empire, which is air conditioner dependent, and along the coast, which is not. The result is essentially a *de facto* cross subsidization whereby the state's economically challenged central valley residents are paying the highest level, or $0.38 per kWh. We expect rate design to remain a topic of keen political interest.

SONGs outage means resource planning takes center stage

Our biggest surprise was that the CPUC and the state is only now considering the ramifications of a potential permanent shutdown of the San Onofre Nuclear Generating Station (SONGs) that is currently not operating. AES' Huntington station (previously mothballed) will be in operation only for the summer of 2012 as it doesn't have the necessary air permits to operate beyond this year as they've been transferred to another vendor whose new plant is scheduled to become operational in October 2013. Bottom line, more generation and transmission is needed in the southern California region and the LA basin in particular; key potential sites likely to see proposals to be repowered into CCGTs next year are AES, for Huntington Units 1 & 2 and NRG's Encina plant. The CPUC staff said that EIX has no prudency issues "at this time" with respect to the SONGs outage.

Once through cooling

Any OTC requirements could likely be delayed given reliability issues and the possibility of a permanent SONGs outage. This would have meaningful implications for most IPP portfolios in the state – AES, DYN, GEN, and NRG

Renewables appears to be on track

The state is well on its way to meeting its 33% renewable goal by 2020 provided the contracts that have been executed to provide renewable resources are seen through to completion. The CPUC and PCG each confirmed the end use rate impact is roughly a 5-7% increase, *ceteris paribus*, by 2020

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