From: Greg Gordon
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To: Investor Relations (mailbox) (InvestorRelations2@pge-corp.com)
Cc:
Bcc:
Subject: ISI Utilities: PCG - Proposed Decision on Pipeline Safety Plan Issued; Settlement Talks Continue

PG&E Corp (PCG)

Proposed Decision on Pipeline Safety Plan Issued; Settlement Talks Continue

- **What's New:** On Friday (10/12/12) an Administrative Law Judge (ALJ) issued a proposed decision (PD) in PCG's Pipeline Safety Enhancement Plan (PSEP) case. Of the $768m of revenue sought, by the company for the period of 2012-2014 (for both O&M and recovery of/on on $1.4 Bn of Capex), the ALJ PD proposes allowing $277m. The key differences between the companies request and the PD are denial of PCG's request to include the costs of pressure testing post 1955 pipelines and costs for gas system records integration, denial of recovery of $400m in capital expenditures and recommending an equity return of 6.05% (the incremental cost of debt) for a period of five years. The ALJ PD disallows recovery for any PSEP related expense incurred in 2011 and the first 10 months of 2012 and assigns the risk of any cost overruns to shareholders

- **PSEP Filing Background:** The PSEP, filed by the Company on August 26, 2011, calls for pressure testing of 783 miles of pipeline, replacing 185.5 miles of pipeline, retrofitting 199 miles of pipeline for in-line inspection, inspecting 234 miles of pipe with in-line inspection tools, and the replacing, automating and upgrading of 228 gas shut-off valves. The filing covers the period from 2012-2014 and asks for recovery of $536m in O&M costs and $1.4 Bn of capital investment. It includes a contingency for cost overruns, which may not occur.

- **EPS and Valuation Impact:** PCG already assumes expenditures incurred in 2012 (~$247m) would not be recovered, recording these expenses as items impacting comparability. We estimate that the ALJ PD, if approved, would lead to additional, un-recoverable O&M expenses of ~$80m & 50m in 2013 & 2014 (a non-recurring EPS impact of ~$0.11 and $0.07 respectively). Our model currently includes $150m of unrecoverable costs in 2013. The impact to our '14 estimate of additional unrecoverable costs would be equity dilution associated with replacing lost retained earnings. Around $100m of capex for its records integration program would not be recoverable in rates. Both these factors would be modesty dilutive. The EPS impact of a 6.05% ROE on authorized, pre-contingency capital spending of $1.032 Bn would be around $25m a year (~$0.05 / sh) once the spending is fully in rates in 2015. Barring cost overruns, the impact to our valuation if the PD is approved (all else equal) is <$1 / share.

▪· . **What's Next**: The CPUC will consider the PD no sooner than 30 days from the date of the PD. The three outstanding OII's that will culminate in a ruling on fines and penalties have been suspended by the CPUC until 11/1/12 to allow parties to pursue settlement negotiations. In our view one aspect of the PSEP PD that appears unreasonable is the proposal of a modified equity return, given the fact that the OII's/settlement talks will address the issue of fines and penalties. We don't know whether or not the CPUC will consider the impacts of the PSEP decision and the OII's holistically.

To read the complete report, please click on the link below:
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If you are unable to open the link above, please copy this address and paste into your web browser: https://www.isihmail.com/distribution.ashx?f=lI-CZnN0otvm6uB3vY7DIB5kLFs6_D8ZZOBdvJR8cmQ1&c=T3Np9iWyEp4F94tn0QLJhA2&b

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