MOODY'S
INVESTORS SERVICE

PG&E's Pipeline Safety Regulatory Proposal Is Credit Negative

From Credit Outlook

Analyst Contacts:

NEW YORK +1.212.553.1653

Toby Shea +1.212.553.1779
Vice President - Senior Analyst
toby.shea@moodys.com

A.J. Sabatelle +1.212.553.4136
Senior Vice President
angelo.sabatelle@moodys.co

Last Friday, the California Public Utilities Commission (CPUC) issued a proposed decision that, if enacted, would prevent Pacific Gas and Electric Company (PG&E, A3 stable) from recovering roughly $1 billion of its $2.18 billion expenditure on its pipeline modernization program and a pipeline records integration program. The CPUC also proposed a 6.05% return on equity (ROE) on the recoverable portion of the investment for five years, as compared with the current ROE of 11.35%. Both aspects of the proposal are credit negative for PG&E.

How adverse the credit effects are will largely depend on how much of the unrecoverable costs, which also include yet-to-be-determined fines, are financed with equity as opposed to debt. The company's recent actions suggest a commitment to allocate the burden largely onto shareholders, mitigating the effect on credit quality.

The CPUC's administrative law judge (ALJ) proposed decision follows PG&E's August 2011 filing with the CPUC of its pipeline safety enhancement plan (PSEP) to address several pipeline deficiencies that led to the San Bruno, California, natural gas pipeline explosion more than two years ago. In the filing, PG&E forecast that its total plan-related costs over the first phase of the PSEP would approximate $2.18 billion, including $750 million in operating expenses and $1.4 billion in capital expenditures.

Of the $750 million in operating expenses, PG&E did not seek recovery of its 2011 related expenses of around $220.7 million. The company does not have a regulatory mechanism that allows recovery of its 2012 estimated $231.1 million of expenses. Of the remaining $300 million of future PSEP operating expense, the ALJ proposed decision contemplates recovery of 56%, or $166.6 million, according to an 8-K that PG&E filed on Monday.

The two primary areas of disallowance for the capital expenditure portion are recovery of the capital costs associated with the company's pipeline records integration program, and the capital costs for potential contingencies concerning the plan. We are not surprised that the proposed decision would exclude recovery of PG&E's planned records-integration program given the substantial criticism of the company for past record keeping. However, the authorized ROE that will accompany the recoverable portion of the company's capital investment was more of a surprise, because the proposed authorized ROE is equivalent to the company's current cost of debt for the first five years of depreciable life.

What is Moody's Credit Outlook?

Published every Monday and Thursday morning, Moody's Credit Outlook informs our research clients of the credit implications of current events.

While ALJ-proposed decisions in California often differ materially from the final decision, the existence and timing of this proposed decision and its stark differentiation from the company's request, along with the negative public sentiment toward PG&E around the San Bruno incident, increases the probability that the final CPUC decision will end up similar to the proposed decision. The total effect on PG&E's credit quality would depend upon the final details of the PSEP decision, the size of the expected fine, and most importantly, the manner in which the company intends to finance these future obligations.

Report Number: 146537

Authors
Toby Shea
A.J. Sabatelle

Production Associate
David Dombrovskis

MOODY'S
INVESTORS SERVICE