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# **Report of Wells Fargo Securities Responding to:**

## **Overland Consulting's August 21, 2012 Report**

### **“Financial Analysis of PG&E Corporation”**

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Submitted on behalf of Pacific Gas and Electric Company  
in I.11-11-009, I.11-02-016 and I.12-01-007  
by Eric O. Fornell  
Wells Fargo Securities  
January 11, 2013



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**Background**

The California Public Utilities Commission (“CPUC”) has several dockets open to investigate pipeline safety in California and the rupture of a Pacific Gas and Electric Company (“PG&E”) gas transmission pipeline and subsequent explosion in San Bruno, California, on September 9, 2010. The CPUC’s Consumer Protection and Safety Division (“CPSD”) retained Overland Consulting (“Overland”) to examine the financial health of PG&E’s parent company, PG&E Corporation (“PCG” or the “Company”), and the ability of PCG to raise equity capital to fund a CPUC fine. Overland’s report was served on the parties to these proceedings on September 17, 2012. Wells Fargo Securities, LLC (“Wells Fargo”) has reviewed the Overland report and this response provides our evaluation of the report and its conclusions.<sup>1</sup>

While Overland focused on what it termed a “fine,” the investment community more generally refers to a “penalty.” To investors, the term “penalty” includes all the costs that PCG’s shareholders will have to bear as a result of the San Bruno accident -- whether they are unrecovered pipeline expenditures or a fine that may be paid to the State Treasury. What the investment community is interested in is the financial impact of the accident on the Company rather than the label applied to the cost. Consistent with this perspective, we use the term “penalty” throughout this report.

**Wells Fargo Securities, LLC**

Wells Fargo is in the business of underwriting, distributing and trading equity and debt securities of corporations in the U.S., and is one of the leading underwriters of utility equity and debt securities. <sup>2</sup>

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<sup>1</sup> This report reflects Wells Fargo’s professional views based on financial, market and other conditions as of the date hereof. This report does not purport to provide any guarantees or assurances as to any future capital raised by PG&E or PCG, the terms and success of which depend on a number of factors beyond the control of Wells Fargo.

<sup>2</sup> Since 2010, Wells Fargo is the #3 most active book-running manager of power and utility investment grade debt offerings, and the #3 most active book-running manager of power and utility equity offerings based on the total number of offerings, according to Dealogic. For reference, a book-running manager is one of the lead underwriters in the issuance of new equity or debt securities.



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Since the beginning of 2010, Wells Fargo has assisted investor owned utilities in raising \$3 5.6 billion in the debt capital markets and \$6.7 billion in the equity capital markets in a total of 1 10 securities transactions. In addition, Wells Fargo's research and economics groups maintain active coverage and publish research on the utility sector, including 127 utility companies under active fixed income coverage and 37 under active equity coverage.

**Executive Summary**

Wells Fargo believes Overland's approach to determining PCG's equity capacity is impractical and inappropriate for the issue they are analyzing. It fails to consider several factors that will influence the size of an equity offering PCG might be able to execute to fund a penalty. The first such factor is the use of proceeds. An equity offering to fund a penalty is not going to be as well received by investors as would an offering to fund capital expenditures or an acquisition that would add to the earnings of the company. The second is the role of investor expectations and the signal to investors that is sent by the size of the penalty. Research analysts have developed estimates of the likely level of a penalty on PG&E based largely on conversations with the CPUC and observations about the political and regulatory climate in California. These estimates already greatly exceed previous penalties for fatal pipeline accidents. A penalty that exceeds the estimates and deviates further from precedent penalties will cause investors to reassess negatively their view of the California regulatory climate and PG&E's business prospects. Raising equity to fund a penalty that exceeds expectations will become increasingly difficult as that penalty grows larger. Third, the Overland report considers only two equity offerings in judging the reasonableness of its equity sizing conclusions whereas there have been thirty utility equity offerings since January 1, 2008 that provide meaningful data for consideration.<sup>3</sup> Finally, the Overland report does not consider the market consequences of the fact that the offering will be followed by an expected

<sup>3</sup> This includes equity issuances by the sixty utilities listed in the Appendix as Electric & Gas Utility Industry Constituents, plus an issuance by Progress Energy Inc., which merged with Duke Energy Corporation in 2012.



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██████ in additional equity offerings by PCG to fund infrastructure investments in the subsequent four years.

As a result of having failed to consider these factors, ████████ Wells Fargo believes Overland's analysis significantly overestimates PCG's ability to issue equity to fund a penalty.

Wells Fargo's report is organized as follows:

1. Utility Industry Introduction
2. Discussion and Analysis of Overland's Report
3. Debt and Equity Market Expectations
4. Applying a Typical Professional Underwriters' Approach to Sizing a Utility Equity Offering
5. Conclusion

### **Utility Industry Introduction**

The U.S. electric and gas utility industry is comprised of companies that provide essential electric and gas services to residential, commercial and industrial customers. These utilities are primarily regulated entities. There are currently sixty publicly-traded electric and gas utilities in the U.S. with equity market capitalizations ranging from \$850 million to \$45.6 billion.<sup>4</sup> We have focused our analysis in this report on these sixty utilities.<sup>5</sup>

The utility industry requires significant ongoing capital investments to ensure quality, reliable service.

As shown in Figure 1, the sixty major utilities covered by this report spent \$80.8 billion on capital

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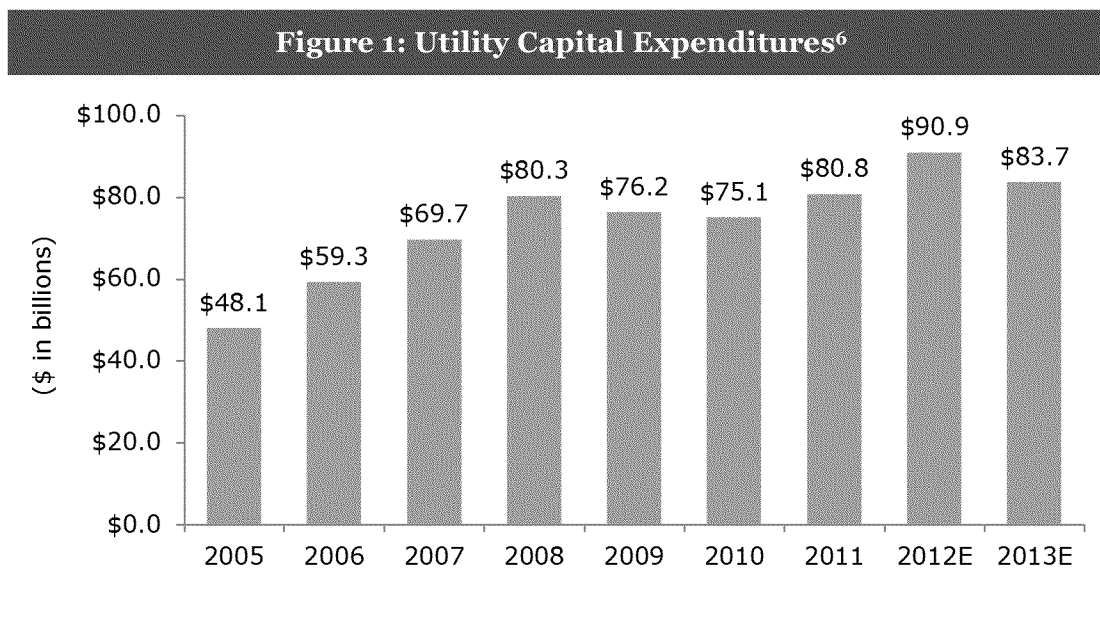
<sup>4</sup> Source: Capital IQ; Includes the sixty utilities listed in the Appendix as Electric & Gas Utility Industry Constituents; Data as of January 7, 2013.

<sup>5</sup> While there are many individual utility companies in the United States, our analysis will focus on the 60 utilities (including utility holding companies) with equity that is publicly traded and market capitalizations above \$850 million. These 60 utilities are listed in the Appendix as "Electric & Gas Utility Industry Constituents".



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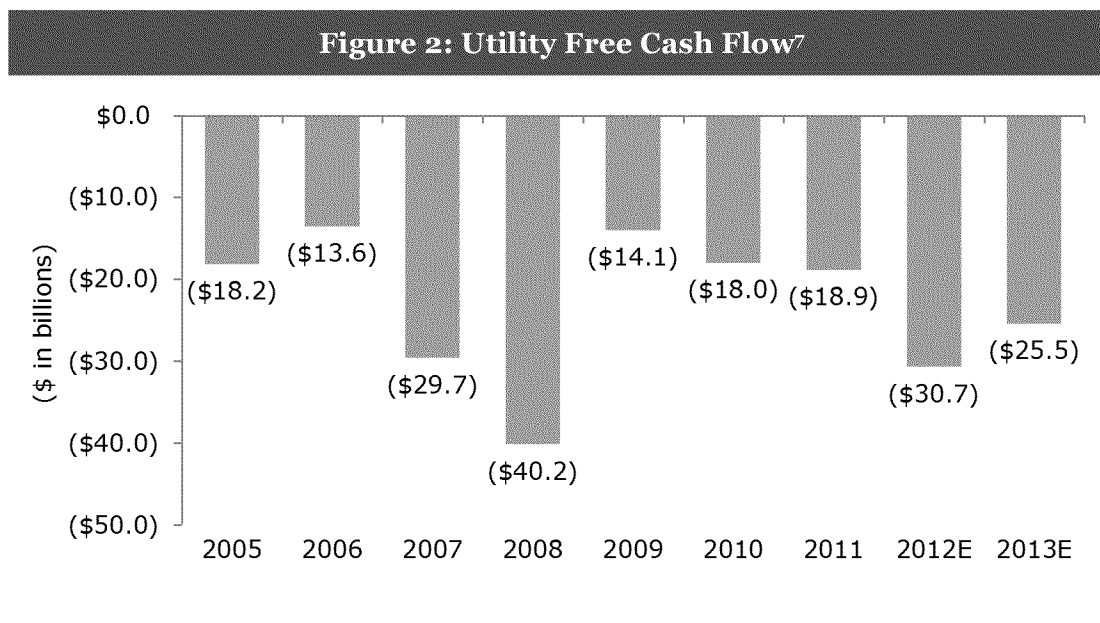
expenditures in 2011 and are expected to spend \$90.9 billion in 2012 and \$83.7 billion in 2013. These investments will replace and upgrade aging infrastructure, support growing customer demand and enable the utilities to comply with environmental regulations. A utility’s access to capital is fundamental to maintaining and improving its service. Utility capital investments are funded through a combination of internally generated cash flow and external financings such as bank borrowings and debt and equity securities offerings. A utility’s annual capital investment often exceeds the amount of cash flow generated by the company and results in negative cash flow. Negative cash flow must be financed externally with debt and/or equity securities offerings. Figure 2 shows the amount of negative cash flow annually in the utility sector from 2005 through 2011 and estimates for 2012 and 2013. This negative cash flow highlights the importance to utilities of access to the bank and capital markets.



<sup>6</sup> Source: Capital IQ; Includes the sixty utilities listed in the Appendix as Electric & Gas Utility Industry Constituents, adjusted for any predecessor companies acquired by the sixty utilities that were publicly traded at the time of the acquisition; Capital expenditure amounts for 2005 – 2011 based on actual results as presented in SEC filings, 2012E and 2013E based on equity analysts’ consensus estimates, or 3-year average for The Laclede Group, Inc. and South Jersey Industries, Inc., where consensus estimates are not available; Data as of January 7, 2013.



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Debt and equity capital is provided to the utility industry primarily by risk averse, income oriented investors who value stable, predictable returns with limited volatility and few surprises. The regulated nature of the utility business where companies earn reliable returns on invested capital and recover prudently incurred costs presents an attractive risk-return tradeoff for this type of investor. The perceived quality of the regulatory environment in which a utility operates is among the most important factors affecting the utility's ability to attract capital at reasonable rates.

***The utility industry requires ongoing access to capital. Providers of utility capital value stable, predictable returns, dividends and limited volatility.***

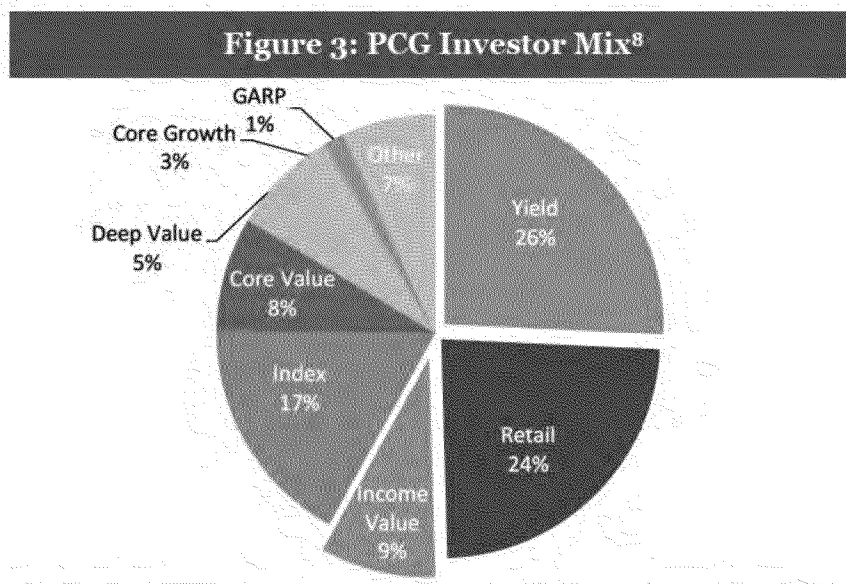
<sup>7</sup> Source: Capital IQ; Includes the sixty utilities listed in the Appendix as Electric & Gas Utility Industry Constituents, adjusted for any predecessor companies acquired by the sixty utilities that were publicly traded at the time of the acquisition; Free Cash Flow approximated as Cash Flow from Operations less Capital Expenditures and Common and Preferred Dividends; 2005 – 2011 based on actual results as presented in SEC filings, 2012E and 2013E based on equity analysts' consensus estimates, or 3-year average for Empire District Electric Company, The Laclede Group, Inc. and South Jersey Industries, Inc., where consensus estimates are not available; Data as of January 7, 2013.



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### Equity Investors

Utility stocks are owned by both retail (i.e., individuals) and institutional investors. Institutional investors can be categorized by their particular investment strategy. A list of these standard investor strategy definitions is provided in the Appendix for reference.



Investors in utility equity securities generally value both consistent earnings growth and a stable, reliable dividend. This is particularly true for the Retail, Yield and Income Value investors who, as shown in Figure 3, own 59% of PCG's outstanding stock. The combination of a utility's stock price growth and its dividend yield<sup>9</sup> is commonly referred to as its "total return." Dividends sustain utility valuations and signal management's confidence in the business and its prospects. A cut in a utility's dividend reduces the estimated total return while increasing investors' perception of the risk of investing in that utility. We would expect an unanticipated cut in a utility's dividend to lead many risk averse investors to sell

<sup>8</sup> Source: Thomson; Data as of September 30, 2012; See category definitions in Appendix; Other category includes growth, aggressive growth, insider holdings and other non-disclosed holdings.

<sup>9</sup> Dividend yield is calculated as the annualized dividend per share divided by the current price per share.

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thereby reducing the stock price and increasing the utility's cost of capital. 1. The cost of capital effect would be two-fold: first, a reduced dividend would provide a lower return, which is less attractive to investors; and second, a surprise dividend reduction would heighten the investment's perceived risk and volatility and therefore increase the return investors require. See Figure 4 for data on utility dividend cuts over the last five years and subsequent stock price consequences.

**Figure 4: Utility Dividend Cuts (Last five years)<sup>10</sup>**

<b>Company</b>	<b>Date of Dividend Cut</b>	<b>Dividend Cut Percentage</b>	<b>Stock Decline in 5 Days</b>	<b>Stock Decline in 15 Days</b>
Empire District Electric Co.	May 26, 2011	(100.0%)	(15.9%)	(15.3%)
Ameren Corporation	February 13, 2009	(39.4%)	(20.3%)	(35.1%)
Great Plains Energy Incorporated	February 10, 2009	(50.0%)	(27.3%)	(41.3%)
PNM Resources, Inc.	August 11, 2008	(45.7%)	(7.4%)	(6.8%)
<b>Average</b>		<b>(58.8%)</b>	<b>(17.7%)</b>	<b>(24.6%)</b>

As further examples, two large U.S. utilities, Exelon Corporation and Entergy Corporation, both recently suggested the possibility of a dividend cut. On November 1, 2012, Exelon Corporation's CEO stated that "revisiting our dividend policy will be in the range of options." That day, Exelon Corporation's share price fell 6.2% compared to a 0.6% decrease for the peer group. Similarly, on November 5, 2012, Entergy Corporation's CFO announced that in conjunction with a strategic transaction, a dividend cut may be required. That day, Entergy Corporation's share price fell 1.4% compared to a 0.1% decrease for the peer group. In the five trading days beginning the day before each announcement, Exelon and Entergy underperformed their peers by 5.9% and 3.0%, respectively.<sup>11</sup>

<sup>10</sup> Source: FactSet; Utility dividend cuts in the last five years, excluding dividend changes due to acquisition events; Includes the sixty utilities listed in the Appendix as Electric & Gas Utility Industry Constituents.

<sup>11</sup> Source: FactSet; Exelon Corporation Q3 2012 Conference Call, November 1, 2012; Entergy Corporation Q3 2012 Conference Call, November 5, 2012; Peers include AEE, AEP, CNP, D, DTE, DUK, EIX, (ETR), (EXC), FE, NEE, PCG, PPL, PEG, SO, WEC, XEL; ETR and EXC not included in comparison against self.





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PCG's dividend yield (annualized dividend per share divided by current share price) as of January 7, 2013 was 4.5% -- a level comparable to PCG's Selected Comparable Constituents<sup>12</sup> average dividend yield of 4.1%, a fact which suggests investors do not expect PCG to cut its dividend. If investors expected a dividend cut, PCG's stock would trade at a lower price and thus provide a higher current dividend yield. A reduction in the dividends paid by PCG, which we believe is not expected, would reduce the Company's perceived stability and would likely cause these conservative, income focused investors to increasingly sell the stock. This would reduce PCG's share price and increase the cost of equity capital.

Investors in utility equity securities also place a high degree of importance on the utility's regulatory environment when valuing and selecting utility securities for investment. A constructive regulatory environment which enables a utility to recover prudently incurred costs and allows for a fair return of and on capital investments is important to equity investors. Consistent and predictable regulatory treatment enables equity analysts to accurately forecast results and reduces adverse surprises. The following comments by utility equity analysts highlight the regulatory environment's importance to equity investors.

*"Electric utilities are governed by many regulatory bodies. Therefore, the regulatory environment a utility operates in and the relationship a utility has with its regulators are important drivers for this space." – Bank of America<sup>13</sup>*

*"Regulatory Environment – A key factor that determines a utility's ability to make new investments and earn a fair return." – Morgan Stanley<sup>14</sup>*

*"Should the CPUC ultimately award a ROE at or below the national average, we would view California as a less attractive jurisdiction in which to invest capital, and we would review our valuation of all three utilities." – Morgan Stanley<sup>15</sup>*

<sup>12</sup> PCG's Selected Comparable Constituents include ten utilities selected by Wells Fargo pursuant to the methodology set forth in Figure 13 in the Appendix.

<sup>13</sup> Bank of America "Electric Utilities Primer", Shelby G. Tucker, page 9, September 29, 2006.

<sup>14</sup> Morgan Stanley "Electric Utilities Investment Primer", Rudy Tolentino, page 8, July 14, 2008.

<sup>15</sup> Morgan Stanley "California Visit Takeaways", Stephen C. Byrd, page 4, October 4, 2012.



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***Utility equity investors value consistent earnings growth and the income provided by a predictable dividend. A dividend cut will drive down a utility's stock price and raise its cost of capital. A stable and predictable regulatory environment is very important for attracting investors to a utility's stock.***

Debt Investors

Credit ratings and the credit rating agencies' outlook are important factors influencing a utility's ability to raise debt capital and the cost of that capital. Credit rating agencies evaluate utilities using a methodology that includes both quantitative and qualitative factors. As reflected in the following comments by S&P, Moody's and Fitch, one of the most important factors affecting a utility's rating is the rating agency's judgment about the quality of the regulatory environment:

*"The assessment of regulatory risk is perhaps the most important factor in Standard & Poor's Ratings Services' analysis of a U.S. regulated, investor-owned utility's business risk. Each of the other four factors we examine --markets, operations, competitiveness, and management--can affect the quality of the regulation a utility experiences, but we believe the fundamental regulatory environment in the jurisdictions in which a utility operates often influences credit quality the most." – Standard & Poor's<sup>16</sup>*

*"The ability to recover prudently incurred costs in a timely manner is perhaps the single most important credit consideration for regulated utilities as the lack of timely recovery of such costs has caused financial stress for utilities on several occasions." – Moody's<sup>17</sup>*

*"The Comparative Operating Risk evaluation of utilities is strongly influenced by the legal framework and regulatory and political environment in the relevant jurisdiction." – Fitch<sup>18</sup>*

Moody's published ratings methodology for regulated electric and gas utilities numerically weights the factors considered when establishing a rating. See Figure 5. A utility's regulatory environment, inclusive

<sup>16</sup> Standard & Poor's "Assessing U.S. Utility Regulatory Environments", Todd A. Shipman, page 2, November 7, 2007 (OC365, Attachment 3).

<sup>17</sup> Moody's "Infrastructure Finance, Regulated Electric and Gas Utilities", Michael G. Haggarty, page 7, August 2009 (OC365, Attachment 1).

<sup>18</sup> Fitch's "Rating North American Utilities, Power, Gas, and Water Companies", Sharon Bonelli, page 10, May 16, 2011.

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of both the regulatory framework and the utility's ability to recover costs and earn returns, determines 50% of the rating.

**Figure 5: Moody's Rating Methodology<sup>19</sup>**

Broad Rating Factors	Broad Rating Factor Weighting	Rating Sub-Factor	Sub-Factor Weighting	Detailed Description
Regulatory Framework	25%		25%	<ul style="list-style-type: none"> <li>▪ Predictability and supportiveness of the regulatory framework</li> <li>▪ Establishment of rates and return of utility investment (shareholder return)</li> </ul>
Ability to Recover Costs and Earn Returns	25%		25%	<ul style="list-style-type: none"> <li>▪ Ability to timely recover prudently incurred costs</li> <li>▪ Lower ratings occur due to unfavorable rate decisions, politically charged regulatory environment or highly uncertain recovery</li> </ul>
Diversification	10%	Market Position	5%	<ul style="list-style-type: none"> <li>▪ Regional diversification in terms of market and/or regulatory regime</li> </ul>
		Generation and Fuel Diversity	5%	<ul style="list-style-type: none"> <li>▪ Diversification in terms of generation and/or fuel source</li> </ul>
Financial Strength, Liquidity and Key Financial Metrics	40%	Liquidity	10%	<ul style="list-style-type: none"> <li>▪ Ability to generate cash internally and availability externally (capital markets, credit)</li> </ul>
		CFO pre-WC + Interest / Interest	7.5%	<ul style="list-style-type: none"> <li>▪ Ability to cover the cost of its borrowed capital due to capital intensive industry</li> </ul>
		CFO pre-WC / Debt	7.5%	<ul style="list-style-type: none"> <li>▪ Measures cash generating ability of a utility compared to aggregate debt/obligations</li> </ul>
		CFO pre-WC - Dividends / Debt	7.5%	<ul style="list-style-type: none"> <li>▪ Measures financial leverage and strength of cash flow after dividend payments</li> </ul>
		Debt / Capitalization	7.5%	<ul style="list-style-type: none"> <li>▪ Traditional measure of leverage and can gauge utility's overall financial flexibility</li> </ul>
Total	100%		100%	

The credit rating of PCG is primarily determined by the credit rating of its major subsidiary PG&E, and while both PG&E and PCG have direct access to the debt capital markets, only PCG is able to raise equity. PG&E is currently rated A3 by Moody's and BBB by S&P. PCG is currently rated Baa1 by Moody's and BBB- (the lowest investment grade) by S&P and as a result is specifically vulnerable to a downgrade to non-investment grade.

<sup>19</sup> Moody's "Infrastructure Finance, Regulated Electric and Gas Utilities", Michael G. Haggarty, page 4, August 2009 (OC365, Attachment 1).



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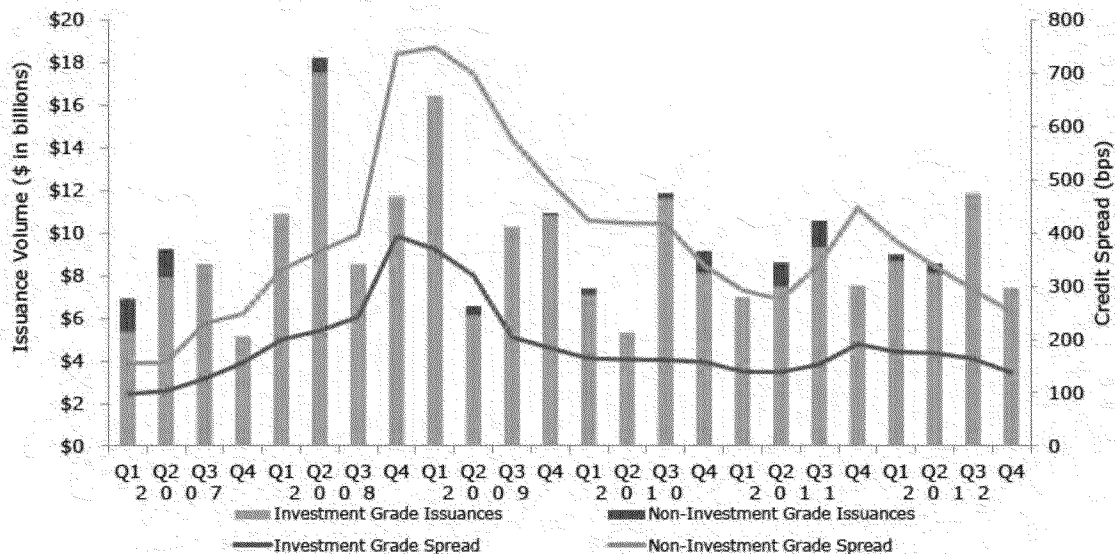
Maintaining investment grade credit ratings is important to ensuring that a utility maintains access to the capital markets at a reasonable cost. Since 2007, the debt of “BB” rated utility companies has required payment of a significantly higher interest rate, trading an average of 191 basis points (i.e. 1.91%) higher than the debt of “BBB” rated utility companies.<sup>20</sup> This premium fluctuates depending on external economic conditions and other factors. During difficult economic times, there may be little or no market for non-investment grade debt. Figure 6 displays utilities’ ability to access the debt capital markets during the last five years including the 2008-2009 financial crisis. Note that the cost of non-investment grade debt as measured by the credit spread in basis points versus the U.S. 10-Year Treasury increased significantly at the end of 2008 and into 2009 before returning to more traditional levels in recent quarters. During several quarters in this period of heightened market volatility, none of the utilities rated non-investment grade accessed the bond markets.

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<sup>20</sup> Source: Bloomberg Fair Market Curve Indices. Indices include companies with publicly traded bonds that have either publicly traded or private equity. “BB” includes bonds rated BB-, BB and BB+ by S&P and/or Ba1, Ba2 and Ba3 by Moody’s. “BBB” includes bonds rated BBB-, BBB and BBB+ by S&P and/or Baa1, Baa2 and Baa3 by Moody’s; Data as of January 7, 2013.



Figure 6: Domestic Utility Bond Issuances and Trading Levels<sup>21</sup>



An investment grade rating is not only important for PG&E to finance its large capital investment program, it is also important to PG&E's operations, specifically for PG&E's procurement of electricity and natural gas. In 2011, PG&E purchased \$3.7 billion of electricity and \$1.0 billion of natural gas.<sup>22</sup> PG&E's ability to retain access to the energy commodities it needs to serve its customers is predicated on suppliers' confidence in PG&E. PG&E's credit ratings are an important component of a counterparty's evaluation. In addition, PG&E's suppliers may be able to access financing based on the strength of PG&E as a counterparty and a reduction in PG&E's credit quality would likely increase their costs and potentially negatively affect PG&E's customers as those suppliers attempt to pass those costs along. According to PG&E, if PG&E is downgraded below investment grade by either S&P or Moody's it expects to have to post nearly \$1.0 billion in total collateral to support various purchase commitments, thereby

<sup>21</sup> Source: Bloomberg, Thomson Reuters IFR Markets; Spread data includes all utilities listed in Bloomberg's Fair Market Curve Indices for utility bonds rated A through BB and issuance data includes both public and private U.S. based electric and gas utilities. Investment Grade includes companies rated BBB- and above, Non-Investment Grade includes companies rated BB+ and below.

<sup>22</sup> PG&E Corporation 2011 10-K, filed February 16, 2012, page 11 and 12.



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increasing costs to PG&E's customers.<sup>23</sup> Further, as occurred during the 2001 California energy crisis, a credit rating downgrade or even the market's expectation of a negative credit trend may significantly impact PG&E's ability to procure electricity and gas on behalf of its customers, potentially limiting PG&E's ability to provide service.

***A utility's regulatory environment is important to preserving its credit rating. An investment grade credit rating is important for a utility to have access to energy commodity markets and to debt markets throughout the business cycle.***

**Discussion and Analysis of Overland's Report**

Overland's report estimates the equity capital PCG might raise to fund penalties, inclusive of both fines and cost disallowances, imposed by the CPUC. The methodologies Overland used to arrive at its equity capacity estimates are not only inconsistent with standard financial industry practices, but also ignore important factors relevant to this situation. Overland's approach is impractical and inappropriate for the issue analyzed as it evaluates two irrelevant financial metrics in isolation and fails to consider the collective implications of other relevant factors such as investors' expectations, the importance of PCG's dividend, the purpose of the equity offering, PCG's future equity requirements and the market's assessment of the California regulatory environment. To develop a reliable estimate of PCG's ability to raise equity capital to pay a potential penalty it is necessary to consider all these factors together. By failing to consider the effect of all of the relevant factors and focusing on only certain financial metrics in a vacuum, Overland's approach significantly overstates PCG's ability to raise equity, especially under circumstances where a penalty greatly exceeds investor expectations. We elaborate on these points in the following paragraphs.

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<sup>23</sup> Source: PG&E Corporation.



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Overland does not follow accepted methods used by equity underwriters . Overland's approach to estimating the maximum or "threshold" level of available equity is discussed on pages ten and eleven of their report. This approach concludes that PCG's equity market capacity can be determined by calculating the Company's price to book and dividend payout ratios after an offering and comparing those ratios to those of other utilities. Overland does not consider the widely accepted, market-based methodologies used by underwriters of utility equity offerings (which are discussed herein starting on page 22). PCG's equity market capacity must be determined by the amount of stock investors are willing to buy given the circumstances, and a utility's price to book and dividend payout ratios are not measures of market capacity. Rather, price to book is more commonly used as a measure of valuation indicating the extent to which the company's current market capitalization is more or less than the accounting value of its book equity, and a company's dividend payout ratio merely provides a benchmark of its dividend amount relative to the company's earnings. Neither the price to book nor dividend payout ratio is generally used by investment banks to determine the market's capacity for an equity offering.

Overland fails to consider the importance of the use of the funds in assessing a utility's ability to raise equity capital. In addition to the two metrics discussed above, Overland also judges the reasonableness of its "threshold" equity estimate by comparing the level of equity issuance, as measured by the percentage of the company sold, to two 2009 equity offerings which it considers precedents -- Northeast Utilities and Ameren. Overland's analysis in this regard fails to consider how the equity offering proceeds were used by the issuers. There have been thirty utility equity offerings since 2008 and Overland's limited selection fails to consider the full data set. More importantly, however, the two offerings Overland selected are not comparable to an equity offering by PCG to fund a penalty. The equity capital raised by Northeast Utilities and Ameren in the referenced offerings was primarily used to fund regulated capital investments. In contrast, the equity raised by PCG to pay a penalty would produce no economic return and would be evaluated more negatively by investors. As shown in Figure 11 on page



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25, equity offerings used to improve a utility's balance sheet (which still would be viewed more favorably than offerings to pay a penalty) have a higher All-in Cost than equity offerings used for more productive purposes (i.e., to fund growth and acquisitions). The "All -in Cost" is defined as the cumulative stock price change from deal announcement to pricing plus fees and expenses of the offering. We discuss the importance of the use of proceeds in greater detail beginning on page 23.

Overland fails to take into account how a penalty that is inconsistent with investor expectations would affect PCG's ability to raise equity capital. Overland's analysis does not consider the market reaction to a penalty that exceeds debt and equity investors' expectations. A penalty above expectations would signal to investors that the California regulatory environment is less constructive than currently believed and would likely cause investors to change their assessment of PG&E's investment risk profile and long-term growth outlook. The net result would be to increase PCG's cost of capital. A penalty above expectations also would potentially harm investors' opinion of the business and regulatory prospects for the other California state utilities. We discuss investor expectations about the size of any penalty in the section beginning on page 19.

Overland's analysis ignores the fact that PG&E must raise substantial capital for anticipated operational needs over the next few years. When considering the financial consequences of a penalty, it is important to consider not only the impact on the market capacity to absorb a one-time equity offering to fund a penalty, but also PCG's ongoing need to issue equity to support PG&E's capital expenditure program. As noted in Figure 7, PG&E expects to spend [REDACTED] on capital expenditures from 2013 through 2016. PCG and PG&E will need to maintain strong access to the debt and equity capital markets to fund this business plan. As shown in Figures 8 and 9, respectively, PG&E expects to raise a total of [REDACTED] in debt and PCG expects to raise a total of [REDACTED] in equity over the next four years to support PG&E's capital build out. A reduction in PCG's capital markets access would reduce its ability to

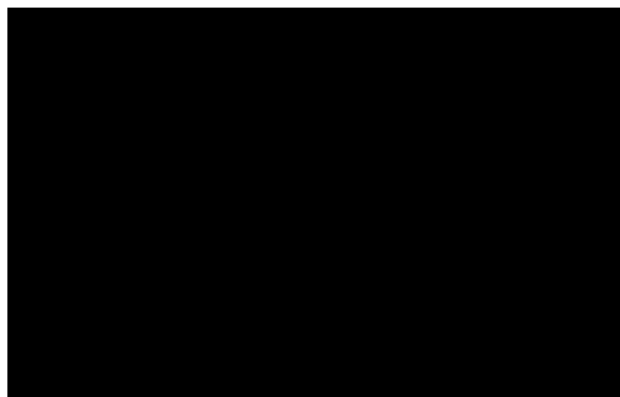




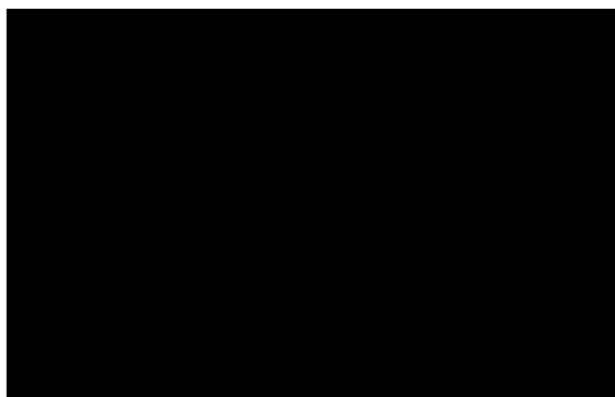
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invest in PG&E's utility system to continue to provide safe, reliable service. Overland's analysis unrealistically considers PG&E's ability to fund a penalty in isolation without taking into account its substantial ongoing equity needs.

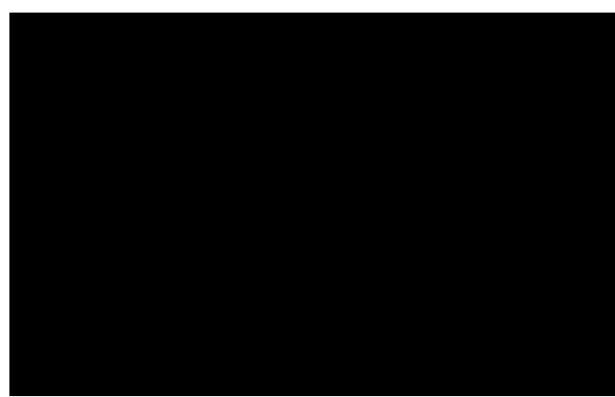
**Figure 7: PG&E Projected Capital Expenditures<sup>24</sup>**



**Figure 8: PG&E Projected Debt Issuances<sup>24</sup>**



**Figure 9: PCG Projected Equity Issuances<sup>24</sup>**



<sup>24</sup> Source: PG&E Corporation, [REDACTED].



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Overland's suggestion that PG &E could fund a penalty, at least in part, by reducing its dividend is impractical and ignores the likely repercussions of a dividend cut. On pages six and seven of the report, Overland suggests that PCG could cut its dividend as a source of equity capital. Overland, however, does not incorporate the repercussions of a dividend cut into the analysis. A dividend cut would reduce PCG's total return to equity investors while at the same time signaling instability and risk. As shown in Figure 4, a cut to PCG's dividend would likely produce a significant reduction in share price, increasing the utility's cost of equity capital. As discussed earlier, investors in utility stocks value the dividend. A cut would reduce PCG's ability to attract the investment capital PCG needs to fund its ongoing capital expenditure program. The market's negative reaction to PCG cutting its dividend would likely outweigh the benefit of any incremental cash savings and, furthermore, could put future equity market access at risk. Under the circumstances, we do not believe that cutting the dividend to raise equity is a viable alternative for PCG.

Overland's analysis is impractical and inappropriate for the additional reason that it fails to take into account the combined effect of all of these factors . Although we have discussed the issues above separately, the reality is that they would not operate in isolation -- they need to be considered in combination when assessing PCG's ability to raise equity to fund any potential penalty. Investors considering purchasing PCG's stock in an equity offering would certainly take this approach and consider all available information. Having focused on a few metrics in isolation without considering the overall context, Overland's conclusions are unreliable and lack the perspective of an experienced equity underwriter.



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The reaction by equity analysts to Overland's report is notable:

*"The analysis does not appear to address many salient issues pertaining to specific and non-specific capital markets risks that could impact the ability of PCG to finance such a large quantity of equity." – International Strategy & Investment<sup>25</sup>*

*"We view this analysis as flawed. We believe it would be difficult for a company to raise 12% of its market capitalization as equity to investors while offering a 0% return on that investment capital. Furthermore, it would be even more difficult to raise that said equity in an environment where the dividend is being cut." – Barclays<sup>26</sup>*

***Overland's approach to determining PCG's equity capacity is impractical, inappropriate and not based on accepted industry analytical methods. Overland's methodology fails to consider the collective implications of factors such as the use of proceeds, the importance of PCG's dividend, the market's perception of California's regulatory environment and the market reaction to a penalty that exceeds expectations.***

### **Debt and Equity Market Expectations**

Among other things, the stock market trades on investors' expectations. As we have discussed, any penalty that is larger than the market expects will hurt PCG's ability to raise equity by sending a signal that the regulatory climate in California has changed in such a manner as to hinder PG&E's long-term business prospects and increase the risk of investing in the Company.

Credit rating agencies and equity research analysts have closely monitored the proceedings related to the San Bruno accident and have expressed in their reports the market's expectations for penalties. Investors consider non-recovered expenses, non-recoverable capital expenditures and fines all to be "penalties" for the San Bruno accident. Disallowances, non-recoveries and cost of capital penalties that exceed investor

<sup>25</sup> International Strategy & Investment "'Capacity to Pay' Report Released by CPSD Appears Flawed", Greg Gordon, page 1, September 19, 2012.

<sup>26</sup> Barclays "CPSD Consultant Report Issued in San Bruno OIIs", Daniel Ford, page 1, September 18, 2012.



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expectations carry the same consequences as would a higher than expected fine. While credit and equity analysts are not always clear on terminology between a fine and penalty, where analysts specifically state their estimates of a fine, the mean expected fine appears to be \$477 million.<sup>27</sup> The analysts have based their estimates, in large part, on discussions with the CPUC, comparisons to the Rancho Cordova case and the consensus of other analysts. In other words, the analysts focused on anticipated outcomes, not on what, in their view, would be an appropriate fine.

*“Based on extensive media reports, it appears to us that the CPUC is under significant pressure to be seen as providing adequate oversight of PG&E. Accordingly, we believe public pressure and scrutiny could prompt the CPUC to be inclined to levy steeper fines than it otherwise might.” – JP Morgan<sup>28</sup>*

*“Last week we met with four of the five commissioners at the CPUC and various other staff...The CPUC is anxious to resolve the penalty phase of the San Bruno event and move on to focusing on improving the gas system and making it safer...Throughout our discussions, the commissioners mentioned wanting the fine to be big and memorable.” – Bank of America Merrill Lynch<sup>29</sup>*

*“The consensus seems to be \$500 million, which would result in a dollar for dollar equity issuance. How this consensus came to be is a total mystery to us. Such a penalty is not presently in our forecast but is starting to get baked into expectations of knowledgeable investors.” – FBR & Co.<sup>30</sup>*

*“Our \$500 million base case penalty is the mid-point of the \$200 million reserve established by the company (our bull case) and our bear case of \$800 million. The bear case is derived from previous CPUC commentary relating to the Rancho Cordova pipeline explosion that was resolved last year. In the case the CPUC noted a litigated outcome could have resulted in a cost of ~\$100 million for the single death, which compares to eight for San Bruno. Accordingly, we use a \$100 million per death figure despite the Commission ultimately approving a \$38 million penalty. We use a higher level due to the high profile nature and severity of the San Bruno incident.” – Morgan Stanley<sup>31</sup>*

<sup>27</sup> In instances where an analyst published a range of fine estimates, the midpoint was used for the purpose of calculating the mean.

<sup>28</sup> JP Morgan “Cutting 2012E EPS on Rising San Bruno Costs and Share Dilution”, Andrew Smith, page 4, November 21, 2011 (OC359, Attachment 189).

<sup>29</sup> Bank of America Merrill Lynch “Next steps for PCG: some resolution of San Bruno?”, Steve Fleishman, page 1, February 6, 2012 (OC359, Attachment 211).

<sup>30</sup> FBR & Co. “The Good, the Bad, and the Ugly at EEI”, Marc de Croisset, page 2, November 10, 2011 (OC359, Attachment 177).

<sup>31</sup> Morgan Stanley “California Visit Takeaways”, Stephen C. Byrd, page 6, October 4, 2012.



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These assessments pre-dated the ALJ's Proposed Decision ("PD") on October 12, 2012 and the CPUC's December 20, 2012 decision on the Pipeline Safety Enhancement Plan ("PSEP"). The CPUC's decision allowed recovery for 39% of PG&E's PSEP request and for PCG's shareholders to bear all cost overruns.<sup>32</sup> The CPUC's PSEP decision effectively imposes a \$1.015 billion<sup>33</sup> penalty on the Company, costs that will be borne by PCG shareholders.

The mean expected fine discussed above is already nearly five times the amount of the highest prior penalty for a fatal gas pipeline accident, that for the 2000 Carlsbad, NM, pipeline rupture and explosion that killed 12 people. Figure 10 summarizes the precedent penalties, including fines and other costs, in fatal gas pipeline accidents since 1999.

**Figure 10: Precedent Fines / Penalties<sup>34</sup>**

Event	Event Date	Total Penalties (\$MM)	Commentary
UGI Corporation Allentown, PA	February 9, 2011	\$0.4	Gas leak and explosion; loss of five lives and three serious injuries
Kleen Energy Plant Middletown, CT	February 7, 2010	16.0	Plant explosion during natural gas pipeline purging; loss of six lives and fifty injured
PG&E Corporation Rancho Cordova, CA	December 24, 2008	38.0	Natural gas leak and explosion; loss of one life and five injuries
Dominion Peoples Nat Gas Company Plum Borough, PA	March 5, 2008	0.1	Natural gas pipeline explosion; loss of one life and one serious injury
Public Service Enterprise Group Bergenfield, NJ	December 13, 2005	0.4	Pipeline rupture and explosion; loss of three lives and five people hospitalized
El Paso Corporation Carlsbad, NM	August 19, 2000	101.5	Natural gas pipeline rupture; loss of twelve lives
Olympic Pipeline Company Bellingham, WA	June 10, 1999	28.5	Pipeline rupture and ignition; loss of three lives

Once a fine is announced, investors will compare the amount of the fine plus all other penalties already borne by shareholders to their expectations of the total penalty. On top of the PSEP penalty, a fine which

<sup>32</sup> Source: D.12-12-030, page 3.

<sup>33</sup> Source: PG&E Corporation 8-K filed December 21, 2012, \$1.015 billion represents the total difference between the requested and authorized expenses (\$585.5 million, including \$220.7 million of 2011 expense PG&E did not request pursuant to direction from the CPUC to include sharing of costs by shareholders) and capital expenditures (\$429.6 million).

<sup>34</sup> Source: PG&E Corporation, press releases, OC367, Attachment 2; Total penalties include fines, restitution, civil and criminal damages.



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exceeds expectations will cause investors and ratings agencies to reassess negatively their judgment of PG&E's regulatory environment. Generally speaking, such a fine would increase PCG's cost of equity capital due to increased investor perception of business risk. Investors will judge that the California regulatory and business environment is not as constructive as they believed. This change in perception will reduce PCG's ability to attract capital at rates competitive with other utilities.

Given the substantial emphasis put on the regulatory environment by credit rating agencies, a credit rating downgrade is possible in response to a fine or penalty in excess of expectations. A credit rating downgrade by S&P would push PCG below investment-grade, which would increase its cost of capital and put PCG's access to capital at risk.

***A fine or penalty in excess of investors' expectations will cause investors to conclude that PG&E's regulatory environment is worse than they anticipated. This would reduce PCG's and PG&E's access to the capital markets and raise their cost of capital.***

**Applying a Typical Professional Underwriters' Approach to Sizing a Utility Equity Offering**

In Wells Fargo's experience, determining market capacity for an equity offering is based on the fundamental attractiveness of a utility's investment proposition and the stock's liquidity. Demand for a utility's equity depends on a compelling thesis to invest in a company's shares. A number of factors contribute to the attractiveness of a utility equity offering, including but not limited to:

- Constructive regulatory and business environment
- Attractive total return potential
- Visible, predictable earnings growth



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- Stable, growing dividend
- Experienced management team
- High quality business operations
- Profitable use of proceeds

The use of proceeds is often a leading factor in establishing the market capacity and demand for an equity offering. Investors buy a company's stock to earn a return on their investment. The most common use of proceeds for utility equity offerings is to fund growth initiatives, including regulated capital expenditures and acquisitions. Equity raised to pay a fine or penalty will not provide a return on investment. A use of proceeds that provides a return to investors will serve to expand an issuer's capacity to raise equity while a use of proceeds that detracts from value such as to fund a fine or penalty will reduce market capacity.

An evaluation of equity capacity also commonly includes an analysis of the issuer's trading liquidity as measured by a stock's Average Daily Trading Volume ("ADTV") and the percentage of the company's market capitalization being offered compared to those metrics for precedent transactions. ADTV calculates the mean number of shares traded per trading day over a specified time period and is used to analyze the size of an offering the market might absorb without undue price pressure. The percentage of market capitalization is also a benchmark for assessing contemplated offerings against industry historical precedents. Contemplated offering sizes are usually expressed as a multiple of ADTV and as a percentage of market capitalization. However, while ADTV and percentage of market capitalization provide general parameters in a normal situation, an equity offering to fund a fine or penalty merits additional consideration. These two metrics are not reliable in this situation because the historical ranges observed are based on precedents not comparable to PCG's issuance to pay a penalty.



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In assessing the market for a particular equity offering, it is necessary to consider the track record for recent equity offerings by comparable companies in similar circumstances. The equity offerings used as precedents should be for companies in the same industry as the issuer, of a similar size and for a similar purpose. Important factors to consider include the size of the offerings and the intended use of the proceeds. Since 2008, there have been thirty equity offerings by Electric & Gas Utility Industry Constituents with total proceeds raised ranging from \$97 .0 million to \$2.5 billion.<sup>35</sup> The proceeds from twenty-three of those equity offerings were primarily used to fund growth initiatives (regulated capital investments or acquisitions). Investors would evaluate these offerings more favorably than a PCG offering to fund a fine or penalty. As a result, those equity offerings are not directly comparable. The proceeds from the remaining seven utility equity offerings were primarily used to repay debt. While equity offerings to repay debt are viewed more negatively by investors than offerings to fund growth, they do serve to reduce a utility's financial risk, increase future investment flexibility and reduce interest expense -- factors that are viewed favorably by investors. An equity issuance for the purpose of funding a fine or penalty lacks those debt repayment investor benefits and would be viewed even less favorably by investors.

Organized by date and grouped by the primary use of proceeds, the thirty utility equity offerings since 2008 are provided in Figure 11. The total equity proceeds raised as well as the corresponding percentage of market capitalization and multiple of ADTV are provided for reference. The "All -in Cost" is defined as the cumulative stock price change (generally a decline, due to expected dilution) from deal announcement to pricing plus fees and expenses of the offering. In practice, this approximates the total cost a company incurred to raise the desired amount of equity. The average All-in Cost for issuances to repay debt was 12.7%, more than twice the 5.9% cost to fund growth investments and acquisitions. A s

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<sup>35</sup> See Figure 11. Includes the sixty utilities listed in the Appendix as Electric & Gas Utility Industry Constituents plus Progress Energy Inc. ("PGN"), which merged with Duke Energy Corporation in 2012.





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discussed above, an equity issuance to repay debt, while not creating any additional return on investment, improves a utility's balance sheet and thus benefits equity holders. An equity issuance to pay a fine or penalty would prevent deterioration of the balance sheet, but provide no tangible benefit to equity holders. Thus, the likely cost of such an issuance would be even higher than for the precedent transactions where debt was repaid.

Figure 11: Precedent Utility Equity Offerings<sup>36</sup>

(\$ in millions)							
Pricing Date	Issuer	Total Proceeds	Market Cap	% of Mkt Cap	Mult. of ADTV	All-in Cost	Use of Proceeds
Primary Purpose of Follow On Offering: Acquisition Related / Capital Investment							
04/10/12	PPL Corp	\$285	\$15,756	1.8%	2.2x	(2.3%)	Regulated Investments, Repay Short-term Indebtedness, GCP
03/15/12	PG&E	254	17,792	1.4%	2.1x	(0.2%)	Regulated Investments
03/05/12	Pepco Holdings Inc	345	4,454	7.7%	9.5x	(4.7%)	Regulated Investments, Repay Short-term Indebtedness, WC, GCP
04/11/11	PPL Corp	2,328	12,462	18.7%	17.0x	(5.1%)	Acquisition of Central Networks
11/10/10	Black Hills Corp	131	1,217	10.8%	18.1x	(10.3%)	Repay Short-term indebtedness, Non-regulated Investments, CAPEX, GCP
11/04/10	Westar Energy Inc	217	2,831	7.7%	10.8x	(2.5%)	Repay Short-term Indebtedness, CAPEX, GCP
09/28/10	Consolidated Edison Inc	307	13,834	2.2%	3.2x	(0.4%)	Regulated Investments, CAPEX, GCP
09/16/10	UHL Holdings Corp	524	798	65.6%	106.4x	(9.1%)	Acquisit on of Southern CT Gas, CTG Resources, Berkshire Energy Resources
09/08/10	NISource Inc	400	4,710	8.5%	8.2x	(9.3%)	GCP, Investment Growth Opportunities
08/03/10	Xcel Energy Inc	470	10,166	4.6%	8.0x	(6.6%)	Regulated Investments, Repay Short-term Indebtedness
06/22/10	PPL Corp	2,484	9,179	27.1%	27.8x	(10.7%)	Acquisition of Louisville Gas & Electric and Kentucky Utilities Company
06/09/10	CenterPoint Energy Inc	326	5,100	6.4%	6.9x	(6.6%)	GCP, Loans to Subsidiaries for Investment Projects
05/11/10	SCANA Corp	304	4,635	6.6%	12.7x	(6.6%)	CAPEX, GCP
04/08/10	Pinnacle West Capital Corp	262	3,910	6.7%	7.0x	(5.0%)	Regulated Investments, Repay Short-term Indebtedness, GCP
12/01/09	Consolidated Edison Inc	214	11,826	1.8%	2.7x	(0.7%)	Regulated Investments, CAPEX, GCP
09/10/09	CenterPoint Energy Inc	290	4,436	6.5%	6.6x	(5.2%)	GCP, Loans to Subsidiaries for Investment Projects
09/09/09	Ameren Corp	552	5,598	9.9%	15.0x	(7.0%)	Regulated Investments, GCP
03/16/09	Northeast Utilities	383	3,161	12.1%	11.1x	(1.8%)	Regulated Investments, CAPEX, GCP
12/31/08	SCANA Corp	102	4,195	2.4%	2.5x	(1.3%)	CAPEX, GCP
09/18/08	Otter Tail Corp	155	994	15.6%	23.7x	(27.6%)	Non-regulated Investments, WC
09/09/08	Xcel Energy Inc	348	8,991	3.9%	6.3x	(3.4%)	Regulated Investments, Repay Short-term Indebtedness
05/29/08	Westar Energy Inc	146	2,231	6.5%	5.7x	(0.3%)	Repay Short-term Indebtedness, CAPEX, GCP
01/17/08	ITC Holdings Corp	280	2,152	13.0%	12.8x	(8.1%)	Acquisition of Electric Transmission Assets of Interstate Power & Light
<b># of Transactions: 23</b>	Average:	\$483	\$6,540	10.8%	14.2x	(5.9%)	
Primary Purpose of Follow On Offering: Balance Sheet Repair (Repay Indebtedness)							
05/20/09	UHL Holdings Corp	\$97	\$545	17.7%	25.2x	(16.9%)	Repay Short-term Indebtedness, GCP
05/12/09	Great Plains Energy Inc	161	1,735	9.3%	6.7x	(10.9%)	Repay Short-term Indebtedness, GCP
04/01/09	American Electric Power Co Inc	1,691	10,318	16.4%	19.2x	(5.3%)	Repay Indebtedness
03/05/09	Portland General Electric Co	176	900	19.5%	21.4x	(10.5%)	Repay Short-term Indebtedness, CAPEX, GCP
01/07/09	Progress Energy Inc	539	10,018	5.4%	7.0x	(9.0%)	Repay Short-term Indebtedness, GCP
12/02/08	Hawaiian Electric Industries In	115	2,203	5.2%	7.1x	(14.4%)	Repay Short-term Indebtedness, CAPEX, WC, GCP
11/06/08	Pepco Holdings Inc	266	3,553	7.5%	8.5x	(22.1%)	Repay Short-term Indebtedness, GCP
<b># of Transactions: 7</b>	Average:	\$435	\$4,182	11.6%	13.6x	(12.7%)	

Of the thirty precedent transactions in Figure 11, it is important to note that only eight were for proceeds of \$400 million or greater and only three exceeded \$600 million. PPL Corporation issued over \$4.8

<sup>36</sup> Source: Public company filings, FactSet, Dealogic. The following abbreviations are used in the "Use of Proceeds" column: GCP = General Corporate Purposes, WC = Working Capital, CAPEX = Capital Expenditures. Includes offerings by the sixty utilities listed in the Appendix as Electric & Gas Utility Industry Constituents plus Progress Energy Inc. ("PGN"), which merged with Duke Energy Corporation in 2012.



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billion of equity in two separate transactions in 2010 and 2011 to fund two corporate acquisitions.

American Electric Power Company raised \$1.7 billion in April 2009 to repay debt incurred for capital expended during the financial crisis, strengthen its financial flexibility and pre-fund some additional growth capital spending.

Figure 11 shows that an equity offering greater than \$500 million in the utility sector is unusual, and will attract heightened investor scrutiny and attention. PG&E plans to spend [REDACTED] in California on infrastructure and capital improvements between 2013 and 2016. <sup>37</sup> [REDACTED]

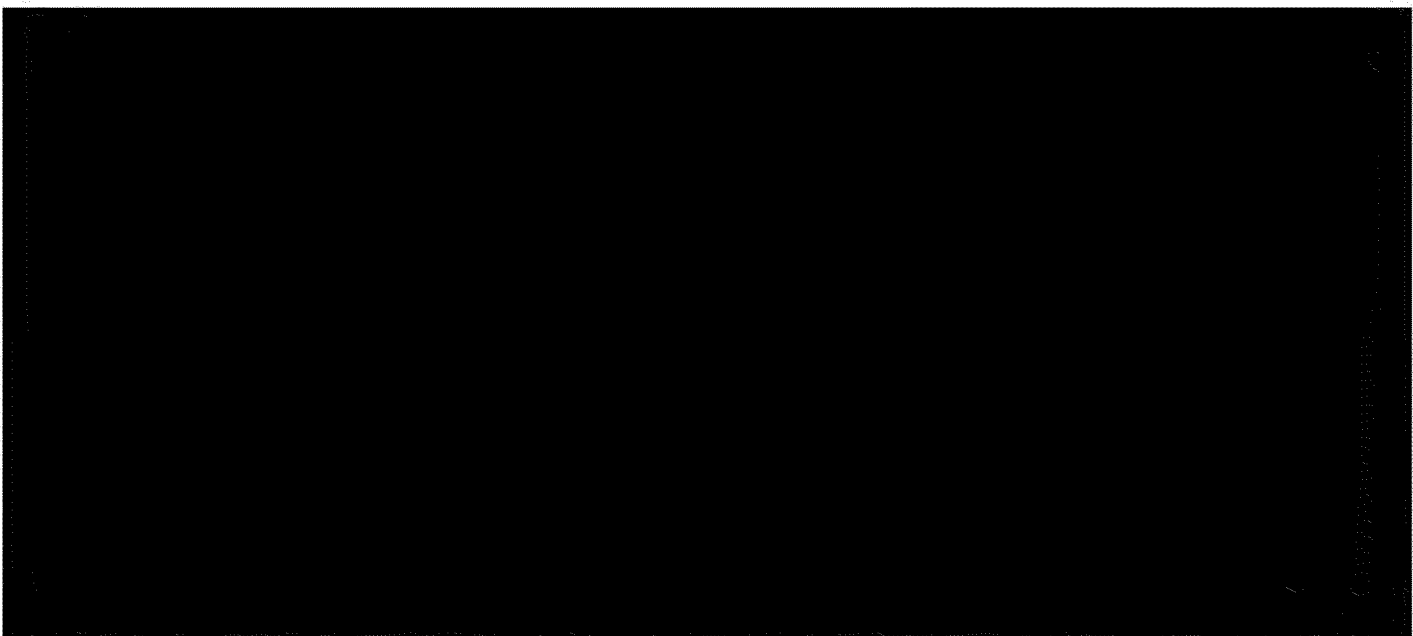
[REDACTED].<sup>38</sup> Given PG&E's expected large capital expenditure requirements (see Figure 7), additional equity needs due to unrecoverable expenses and fines would serve to push PCG's required equity issuances [REDACTED]

[REDACTED]. Figure 12 shows how PCG's currently anticipated future equity offerings to fund capital expenditures -- not including an offering to fund a penalty -- compare as a percentage of equity market capitalization with the percentage for those utilities that offered stock over the last four years. PCG's expected need to access the equity market is [REDACTED] compared with the utility industry's most active recent issuers. [REDACTED]

<sup>37</sup> Source: PG&E Corporation, [REDACTED].  
<sup>38</sup> Source: PG&E Corporation, [REDACTED].



**Figure 12: Utility Equity Offerings as a Percentage of Market Capitalization since 2009<sup>39</sup>**



In addition, we believe that an appropriate assessment of PCG's ability to issue equity to fund a fine or penalty needs to consider the size of that fine or penalty relative to market expectations. As we discussed above, the mean expected fine is in the range of \$475 million. Any fine or penalty significantly larger than expectations, taking into account both the \$1 billion PSEP penalty and prior industry penalties, will have a detrimental effect on PCG's ability to attract investors because, as discussed above, investors will conclude that PCG's business and regulatory environment is more difficult and its stock riskier than they anticipated. This will increase the cost of raising equity and will reduce the investor demand for an equity offering.

<sup>39</sup> Source: Public company filings, FactSet, Dealogic, Capital IQ. Includes the sixty utilities listed in the Appendix as Electric & Gas Utility Industry Constituents plus Progress Energy Inc. ("PGN"), which merged with Duke Energy Corporation in 2012. Peer group issuances include only discrete follow-on equity offerings, does not include internal programs that may be used to issue equity such as a Dividend Reinvestment Program ("DRIP"). PCG has historically been able to raise approximately \$250 million per year by issuing equity through internal programs such as the Company's 401k and DRIP. PCG current market capitalization data as of January 7, 2013; Historical issuance market capitalizations as of January 1, 2009.

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***In Wells Fargo's view, any analysis of PCG's ability to fund a penalty with equity capital must take into account relevant factors such as the use of the equity, market expectations about the size of the penalty and PG&E's ongoing capital needs. Our analysis indicates that, all things considered, Overland's analysis that PCG could issue \$2.25 billion in equity to fund a penalty is both impractical and unrealistic.***

**Conclusion**

Wells Fargo's major disagreement with the Overland report is that Overland's analysis does not use standard equity capital markets industry practices and is inconsistent with those practices. Overland's focus on selected metrics ignores the fact that PCG will have to sell the additional equity to investors, who must be willing to buy it. The size of an equity offering PCG can achieve is influenced by the use of proceeds and investors' perception of PCG's business prospects. A high fine or penalty in excess of investor expectations will not instill confidence in the risk averse majority of utility investors to whom PCG shares must be marketed and may put PCG's access to the capital markets at risk at a time when the Company needs to raise a substantial amount of equity in the near future. An equity offering to fund a fine or penalty, unrecovered expenses or unrecoverable capital expenditures will not be nearly as attractive to investors as an offering to fund investments that earn a return. An offering to fund a fine or penalty which exceeds investor expectations will be further challenged, since it will signal that PG&E's regulatory climate and business prospects are more difficult and risky than investors have judged.



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Appendix

Electric & Gas Utility Industry Constituents<sup>40</sup>

Ticker	Company Name	Ticker	Company Name	Ticker	Company Name
GAS	AGL Resources Inc.	FE	FirstEnergy Corp.	PNW	Pinnacle West Capital Corporation
ALE	ALLETE, Inc.	GXP	Great Plains Energy Incorporated	PNM	PNM Resources, Inc.
LNT	Alliant Energy Corporation	HE	Hawaiian Electric Industries Inc.	POR	Portland General Electric Company
AEE	Ameren Corporation	IDA	IdaCorp, Inc.	PPL	PPL Corporation
AEP	American Electric Power Co., Inc.	TEG	Integrus Energy Group, Inc.	PEG	Public Service Enterprise Group Inc.
ATO	Atmos Energy Corporation	ITC	ITC Holdings Corp.	SCG	SCANA Corp.
AVA	Avista Corp.	MDU	MDU Resources Group Inc.	SRE	Sempra Energy
BKH	Black Hills Corporation	MGEE	MGE Energy Inc.	SJI	South Jersey Industries, Inc.
CNP	CenterPoint Energy, Inc.	NJR	New Jersey Resources Corp.	SO	Southern Company
CNL	Cleco Corporation	NEE	NextEra Energy, Inc.	SWX	Southwest Gas Corporation
CMS	CMS Energy Corp.	NI	NiSource Inc.	TE	TECO Energy, Inc.
ED	Consolidated Edison Inc.	NU	Northeast Utilities	LG	The Laclede Group, Inc.
D	Dominion Resources, Inc.	NWN	Northwest Natural Gas Company	UGI	UGI Corp.
DTE	DTE Energy Co.	NWE	Northwestern Corporation	UIL	UIL Holdings Corporation
DUK	Duke Energy Corporation	NVE	NV Energy, Inc.	UNS	UNS Energy Corporation
EIX	Edison International	OGE	OGE Energy Corp.	VVC	Vectren Corporation
EE	El Paso Electric Co.	OTTR	Otter Tail Corporation	WR	Westar Energy, Inc.
EDE	Empire District Electric Co.	POM	Pepco Holdings, Inc.	WGL	WGL Holdings Inc.
ETR	Entergy Corporation	PCG	PG&E Corp.	WEC	Wisconsin Energy Corp.
EXC	Exelon Corporation	PNY	Piedmont Natural Gas Co. Inc.	XEL	Xcel Energy Inc.

PCG Selected Comparable Constituents

Ticker	Company Name
AEP	American Electric Power Co., Inc.
CMS	CMS Energy Corp.
ED	Consolidated Edison Inc.
DTE	DTE Energy Co.
DUK	Duke Energy Corporation
NU	Northeast Utilities
SCG	SCANA Corp.
SO	Southern Company
WEC	Wisconsin Energy Corp.
XEL	Xcel Energy Inc.

<sup>40</sup> Includes all utilities (including utility holding companies) with publicly traded equity excluding utilities with market capitalizations below \$850 million.



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Analysis of PCG Selected Comparable Constituents

In Overland's assessment of PCG's equity capacity, Overland utilizes a comparable set that is too broad because it includes all electric and gas utilities without regard for size or business profile (both of which are key trading characteristics). Based on Wells Fargo's experience and consistent with equity research analysts' approach, development of a focused peer set is more appropriate. To arrive at an appropriate group of comparable companies to PCG, Wells Fargo eliminated individual utilities for the following reasons:

1. Acquired utilities: These utilities are either in the process of, or have been acquired.
2. Pure-play gas utilities: Utilities that predominately focus on gas distribution rather than diversified electric and gas operations similar to PCG.
3. Pure-play transmission: Utilities focused solely on electric transmission.
4. Size: Utilities with market capitalizations below \$6 billion.
5. Merchant generation/retail operations: Utilities with significant merchant generation or retail operations.
6. Midstream operations: Utilities with significant gas midstream businesses.

See Figure 13 on the following page for additional information regarding PCG's Selected Comparable Constituents.



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Figure 13: PCG Selected Comparable Constituents Selection Methodology<sup>41</sup>

Universe of U.S. Utilities with Publicly Traded Equity (>\$850 million)		Subject Company	Pure Play Gas Utilities	Pure Play Transmission	Utilities < \$6 billion Market Capitalization	Significant Midstream Operations	Merchant Generation / Retail Operations	PCG Selected Comparable Constituents	
AEE	NJR	PCG	ATO	ITC	ALE	CNP	AEE	AEP	
AEP	NU		GAS		AVA	NI	D	CMS	
ALE	NVE		LG		BKH	SRE	EIX	DTE	
ATO	NWE		NJR		CNL		ETR	DUK	
AVA	NWN		NWN		EDE		EXC	ED	
BKH	OGF		PNY		EE		FE	NU	
CMS	OTTR		SJI		GXP		NEE	SCG	
CNL	PCG		SWX		HE		PEG	SO	
CNP	PEG		UGI		IDA		PPL	WEC	
D	PNM		WGL		LNT			XEL	
DTE	PNW				MDU				
DUK	PNY				MGEE				
ED	POM				NVE				
EDE	POR				NWE				
EE	PPL				OGF				
EIX	SCG				OTTR				
ETR	SJI				PNM				
EXC	SO				PNW				
FE	SRE				POM				
GAS	SWX				POR				
GXP	TE				TE				
HE	TEG				TEG				
IDA	UGI				UIL				
ITC	UIL				UNS				
LG	UNS				VVC				
LNT	VVC				WR				
MDU	WEC								
MGEE	WGL								
NEE	WR								
NI	XEL								
<b>60</b>			<b>1</b>	<b>10</b>	<b>1</b>	<b>26</b>	<b>3</b>	<b>9</b>	<b>10</b>

<sup>41</sup> Source: Public company filings



## Investor Mix Definitions<sup>42</sup>

### **Aggressive Growth**

Aggressive growth investors employ an extreme version of the growth style. Their aggressiveness may be defined primarily by holding stocks in companies that are growing extremely quickly, are in an early stage of their life cycle, and/or have minimal or no current earnings.

### **Core Growth**

These institutions invest in companies with above-average earnings growth rates. Core Growth investors are often willing to pay up for blue chip companies that trade at higher price-to-earnings and price-to-book multiples because of strong management and the solid competitive position within their industry. Like Core Value investors, they tend to focus on blue chip companies and have long-term investment horizons.

### **Core Value**

The focus of these investors is on buying securities at relatively low valuations on an absolute basis or in relation to the market or historical levels. Value portfolios typically exhibit below-average price-to-earnings, price-to-book and price-to-cash flow multiples. In addition, growth and profitability characteristics are frequently below market averages, but with an expectation for improved future performance. Similar to Core Growth, these investors focus on blue chip stocks and employ a buy-and-hold strategy.

### **Deep Value**

This style is a more extreme version of value investing that is characterized by holding the stocks of companies with extremely low valuation measures. Often these companies are particularly out of favor or in industries that are out of favor. Some investors in this category are known for agitating for changes such as new management, the sale of assets or a spin-off. This group of investors is sometimes categorized as "contrarian," as they usually invest in companies when the rest of the market is negative on the company's prospects.

### **GARP (Growth at a Reasonable Price)**

GARP investors hold securities that are trading at a discount to the market, but are expected to grow at higher than the market or industry average. These companies are typically out of favor either systematically or temporarily. This is a more conservative investment style compared to an outright growth-oriented strategy. Dividend yield is generally not a concern of GARP investors.

### **Growth**

Growth investors bridge the gap between the Aggressive Growth and Core Growth investment styles. They look for companies growing at rates greater than those of the general marketplace, but are unwilling to pay for extremely high multiples.

### **Income Value**

These investors are similar to those in the Core Value category except they place an importance on dividend yield equal to the importance placed on low valuation measures. As a result, Income Value portfolios exhibit above average current income.

### **Index**

These investors generally create portfolios which are designed to match the composition of a broad-based index such as the S&P 500, the Wilshire Small Cap, and the Russell 3000. Therefore, the performance and risk of the portfolio mirrors the general market. Their investment decisions are driven by the indices, not by an evaluation of the companies or their securities. TF/Carson categorizes these funds based on its specific knowledge of the firm's historical investment behavior.

### **Yield**

These investors focus on companies with yields that are well above average and the ability to continue making or increasing dividend payments. Investors that fall into this category tend to focus on income and safety more than on capital appreciation.

### **Retail**

The excess shares outstanding after accounting for all of the publicly available information on share holdings.

<sup>42</sup> Source: Thomson.



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## **Vice Chairman, Investment Banking, Wells Fargo Securities, February 2012 to date**

Responsible for senior client coverage in energy, utility, pipeline, and energy focused private equity sectors. Advise clients on M&A, divestitures, and capital raising.

## **Vice Chairman, Investment Banking, JPMorgan, 2007-2011**

Responsible for senior client coverage in energy, utility, pipeline, and energy focused private equity sectors. Advise clients on M&A, divestitures, and capital raising.

- Initiated and led JPMorgan's MLP Practice, 2008-2011
- Co-ordinated JPMorgan's New Renewable Energy Coverage, 2008-2010
- Led JPMorgan's negotiations in 2008 with Environmental Defense Fund, National Resources Defense Council, other banks and clients to establish the industry standard "Carbon Principles" guidelines for the financing of companies or projects constructing coal fired power plants

## **Managing Director, Global Head of Natural Resources, JPMorgan, 2002-2006**

Responsible for leading coverage practice for power, pipelines, oil & gas, chemicals and mining.

## **Managing Director, Head of Power and Pipeline Group, Chase then JPMorgan, 1999-2001**

Responsible for leading coverage practice for power and pipeline group.

## **Managing Director, Goldman Sachs & Co., 1997-1999**

Responsible for investment banking client coverage of power and pipeline clients.

## **Vice President, Goldman Sachs & Co., 1992-1996**

Responsible for investment banking client coverage of power and pipeline clients.

## **President, CMS Enterprises Company, Dearborn, MI, 1988-1992**

Managed CMS Energy's non-utility business activities: oil & gas exploration and production, independent power generation, gas gathering and marketing, and renewable energy. Board member of 50% owned, ASE listed renewable energy subsidiary, Oxford Energy.

## **Vice President, Goldman Sachs & Co., NY and Chicago, 1986-1988**

Responsible for investment banking client coverage of general industrial accounts in the Midwest.

## **Vice President, Marketing and Transportation, American Natural Resources Company, Detroit, MI, 1980-1986**

Responsible for gas marketing and transportation on newly deregulated natural gas pipeline system.

- Roles included Vice President, Corporate Development, 1984-1985. Reported to CEO of energy holding company on corporate development. Subsidiaries included oil & gas exploration and production and interstate trucking
- Twelve month leave of absence to serve as Deputy Director of the Detroit-Wayne County Port Authority, 1981-1982

## **Education**

BA Magdalen College, Oxford University, 1978-1980

- Rhodes Scholar studying Philosophy, Politics and Economics

BA Amherst College, 1974-1978

- Summa cum Laude, Economics and English