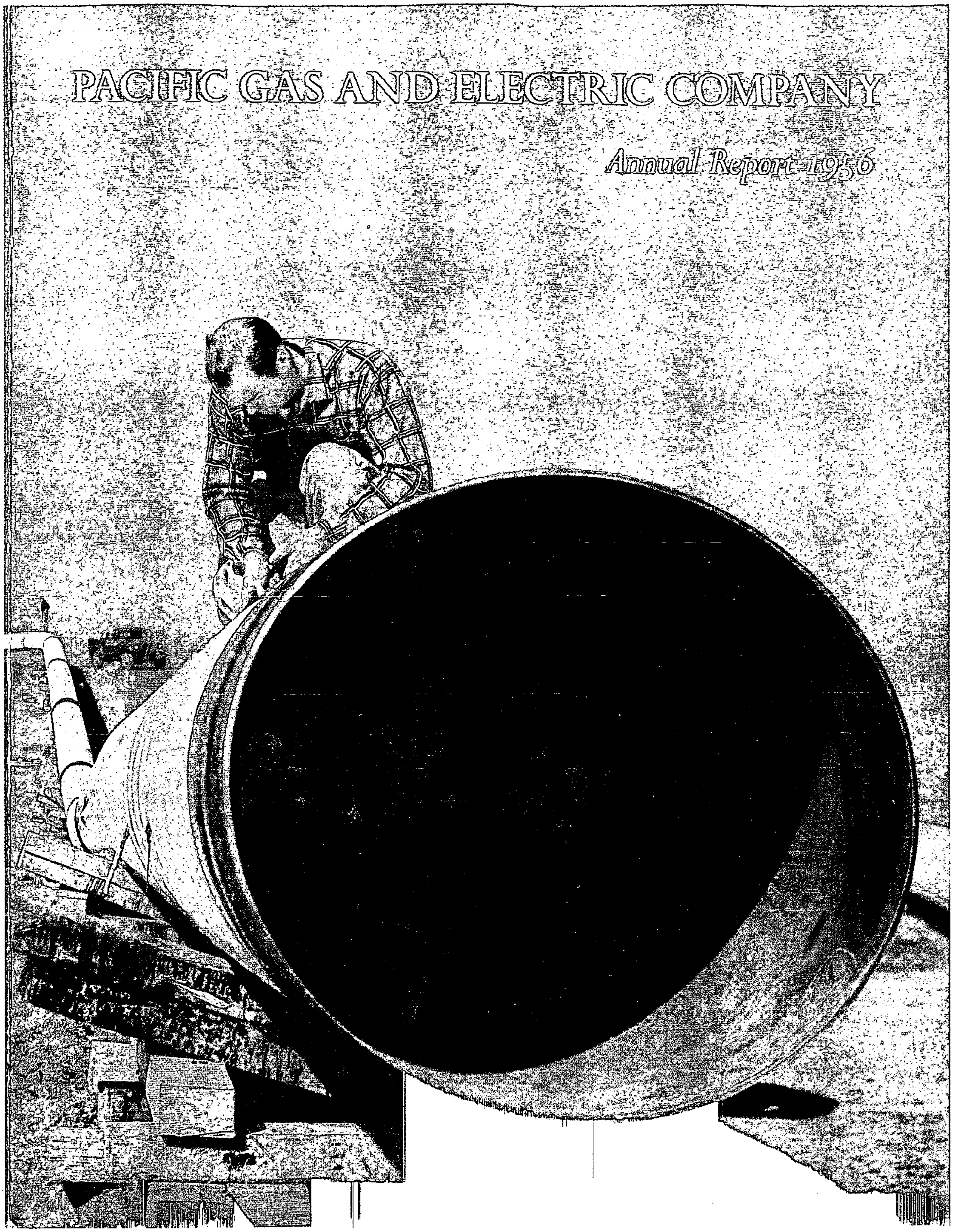
PACIFIC GAS AND ELECTRIC COMPANY

Annual Report 1956



PACIFIC
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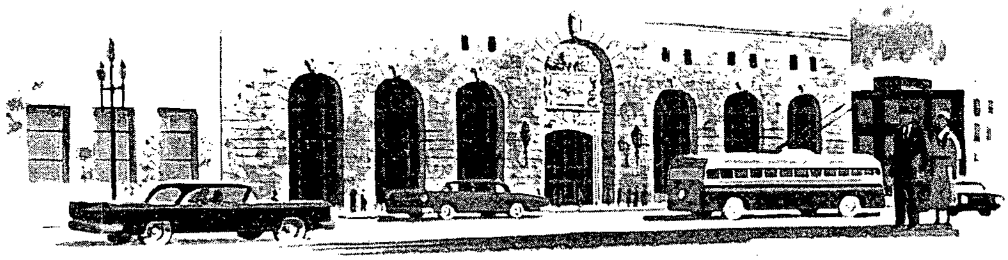
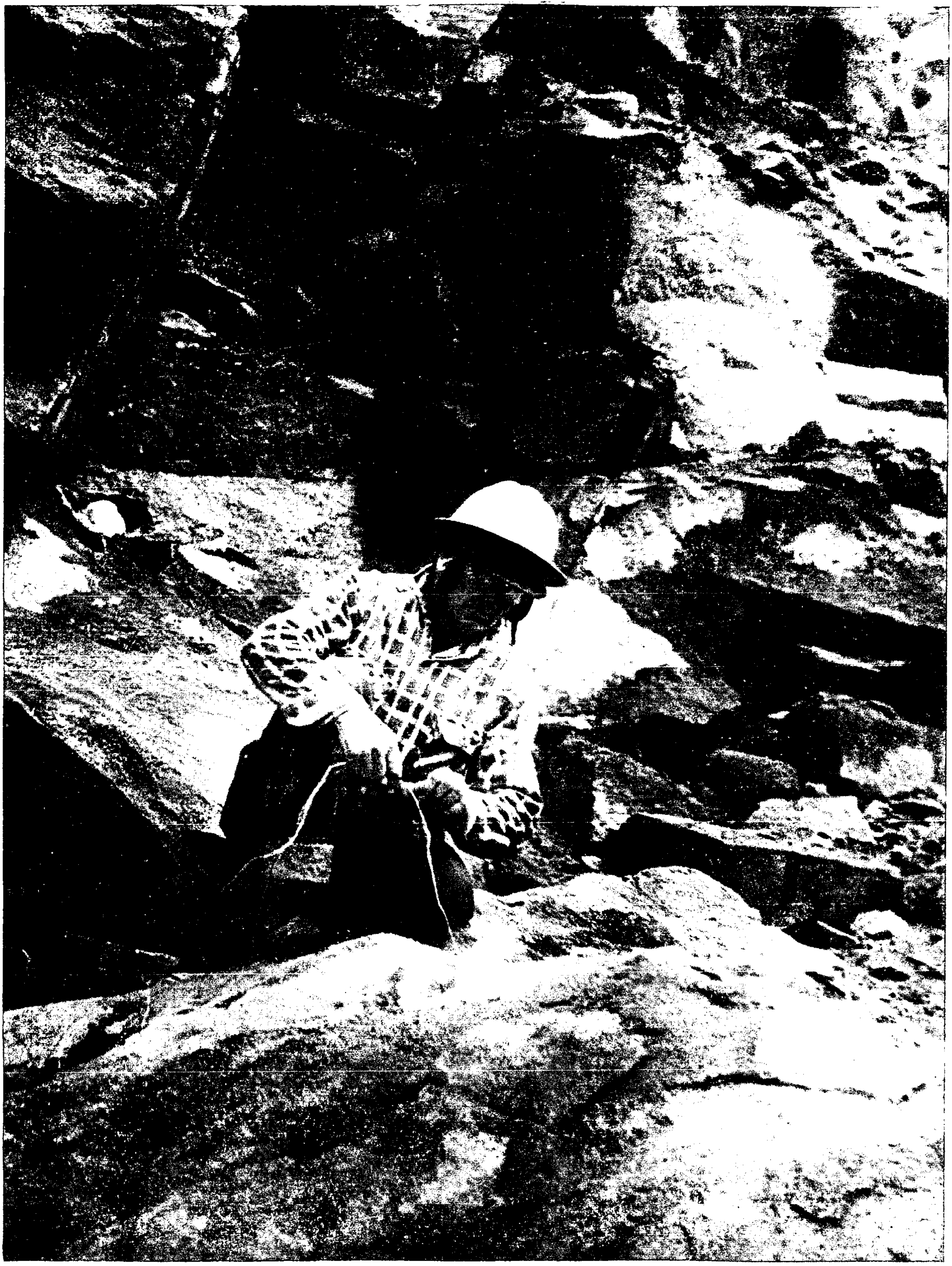
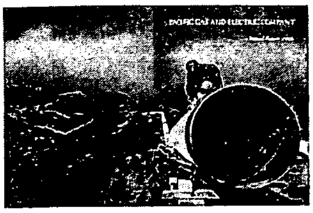
COMPANY



FIFTY-FIRST ANNUAL REPORT FOR THE YEAR ENDED DECEMBER 31, 1956





Contents

←"Powder monkey" prepares dynamite charge to blast granite at Kings River hydro development.

PACIFIC GAS AND ELECTRIC COMPANY, 245 Market Street, San Francisco 6

Board of Directors

James B. Black *Chairman of the Board*	San Francisco
Allen L. Chickering	San Francisco
James F. Crafts	San Francisco
William W. Crocker	San Francisco
Paul L. Davies	San Jose
Robert H. Gerdes	San Francisco
Walter A. Haas	San Francisco
James K. Lochead	San Francisco
Elliott McAllister	San Francisco
Henry D. Nichols	San Francisco
Silas H. Palmer	San Francisco
Porter Sesnon	San Francisco
Walter H. Sullivan	San Francisco
N. R. Sutherland	San Francisco
Carl F. Wente	San Francisco

Executive Committee

James B. Black
Allen L. Chickering
William W. Crocker
Henry D. Nichols
Silas H. Palmer
N. R. Sutherland

Executive Officers

N. R. Sutherland	*President and General Manager*
Robert H. Gerdes	*Executive Vice-President*
L. Harold Anderson	*Vice-President and Assistant General Manager*
S. L. Sibley	*Vice-President and Assistant General Manager*
Walter Dreyer	*Vice-President and Chief Engineer*
J. S. Moulton	*Vice-President and Executive Engineer*
O. R. Doerr	*Vice-President in Charge of Sales*
G. A. Peers	*Vice-President in Charge of Electric Operations*
P. E. Beckman	*Vice-President in Charge of Gas Operations*
A. J. Swank	*Vice-President in Charge of General Construction*
J. K. Horton	*Vice-President*
Robert R. Gros	*Vice-President*
K. C. Christensen	*Treasurer*
E. E. Manhard	*Secretary*
L. W. Coughlan	*Comptroller*
R. H. Peterson	*General Counsel*

H. C. Nelson	*Assistant Treasurer and Assistant Secretary*
V. D. Vincent	*Assistant Treasurer*
D. L. Bell	*Assistant Treasurer*
J. F. Taylor	*Assistant Secretary*
A. H. Catherall	*Assistant Secretary*

Stock Transfer Agencies

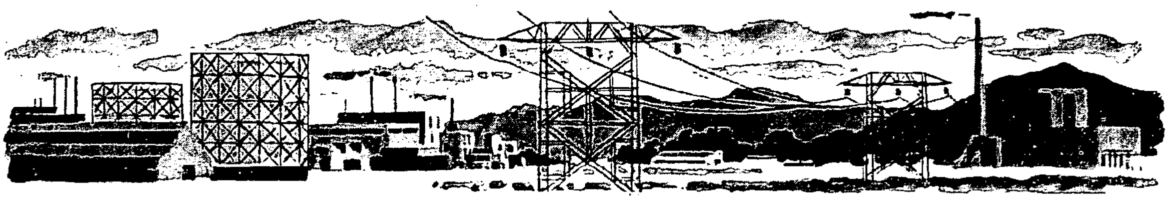
Office of the Company (E. F. Hall, Transfer Agent), San Francisco; Bankers Trust Company, New York.

Registrars of Stock

American Trust Company, San Francisco; The New York Trust Company, New York.

This Company makes no charge for stock transfers except as to documentary stamps or other charges that may be required by law.

Report of the Directors of Pacific Gas and Electric Company



To Our Stockholders:

San Francisco, California, February 15, 1957

The year 1956 was another year of growth and progress for your Company.

The continuously growing demands for electric and gas service in Northern and Central California were met promptly and in full, with adequate margins of reserve capacity.

The overall increase in sales volume and revenues in 1956, however, fell short of measuring our underlying growth trend, as several important classes of service were adversely affected by climatic conditions.

Net earnings for the common stock amounted to $57,582,000, equivalent to $3.46 a share on an average of 16,662,129 shares outstanding during the year and to $3.37 a share based on the 17,068,524 shares outstanding at the close of 1956. These results compare with earnings of $3.32 a share in 1955, based on the 16,255,733 shares outstanding throughout that year.

The indicated gain in share earnings, however, is subject to some qualification. The adverse effect of climatic conditions upon our earnings was more than offset by an exceptionally favorable water year for hydro generation, and by a change in the method of charging property taxes to income from a calendar to a fiscal year basis. But when consideration is given to the further fact that the Company was required to absorb substantial increases in operating expenses as the year progressed, which were largely beyond the control of the management, we believe that the year's results can be considered quite satisfactory from an earnings standpoint.

After a careful appraisal of the outlook for the Company's earnings, the Board of Directors, on March 21, 1956, increased the quarterly dividend rate on the common stock applicable to the first quarter of the year from 55 to 60 cents a share. Quarterly dividends have been continued at the latter rate since that time.

The Company is taking steps to deal promptly with the increases in operating expenses referred to above. Successive increases in prices for fuel oil used in our steam-electric generating plants and for natural gas purchased from California fields occurred during the year, and again early in 1957. Prices for these important elements in the cost of providing utility service have now risen to such an extent that we can no longer absorb the increases and maintain our earnings at satisfactory levels, and our most immediate problem is to obtain rate adjustments to offset them.

To this end, an application was filed late in December with the California Public Utilities Commission for authorization to increase our natural gas rates for industrial use. On February 8, 1957, another application was filed for authorization to increase electric rates and to establish an equitable automatic fuel adjustment clause.

Almost $148 million was spent on our construction program in 1956, and it is now estimated that expenditures for this purpose will be in the range of $175 to $190 million annually over the next two years. The principal reason for the higher level of expenditures is that we have recently embarked upon a major program of hydro-electric construction. The cost per kilowatt of installed capacity in hydro plants is two to three times greater than for steam plants. This higher initial capital outlay for hydro plants is justified because no fuel costs are associated with their operation and their labor and maintenance costs are lower than those for steam plants. Other factors contributing to the greater amount of construction expenditures include higher wage scales and increased prices for materials and equipment.

Our large construction program, which will increase requirements for new money, makes it imperative that our earnings be kept at satisfactory levels in order to maintain our competitive position in the capital markets. Adequate earnings provide the best assurance that we can obtain capital at a reasonable cost. The recent increase in the cost of borrowed funds is of great significance to utility companies. If this situation continues, the regulatory bodies must face the situation with realism and adjust upward the rates of return that customarily have been allowed utility companies in recent years, which rates of return were based largely upon money conditions which prevailed during and for a considerable period after World War II.

Long-range planning of the highest competency is essential to the successful conduct of a utility business. Commitments for facilities and equipment must be made years in advance of the time they can be brought into actual operation. Our confidence in the continued growth of this area was reaffirmed recently when we ordered two 325,000 kilowatt steam units for installation at our Pittsburg Power Plant in 1960 and 1961. These units are about twice the size of the largest steam units we now have in operation. The new Pittsburg units will bring capacity now under construction or scheduled for completion during the next five years to 1,495,500 kilowatts, of which 625,500 kilowatts will be in hydro plants and 870,000 kilowatts in steam plants.

Also looking well ahead, another matter to which the Company is giving its closest attention is the problem of its natural gas supply. Existing contractual obligations appear adequate to meet the anticipated growth in demand for gas service in this area through 1960 and we are now devoting our efforts toward securing additional supplies for the period after that date.

Our activities in the field of nuclear electric power were expanded during the year, as detailed later in the report. Unfortunately, however, some are urging that government build and operate commercial nuclear power facilities. Large sums are now being spent for nuclear research and development by investor-owned utility companies, including our own, as well as by industrial firms, and there is no need for government agencies to enter the field of nuclear power production for commercial purposes.

A more detailed review of our operations in 1956 will be found on the pages following. Certified financial statements appear commencing on page 28 of the report.

On behalf of the Board of Directors we wish to express our deep appreciation to employees in all ranks who made possible another year of splendid progress. Challenging years lie ahead, but we feel confident that we have the organization and the personnel to discharge competently our public utility obligation in the highest sense of that term.

This fifty-first annual report of the Company will be submitted at the annual meeting of stockholders to be held at the office of the Company, 245 Market Street, San Francisco, California, on Tuesday, April 9, 1957.

For the Board of Directors

Chairman of the Board

N. R. Sutherland

President and General Manager

The management will solicit proxies for the annual meeting. In connection with such solicitation, it is expected that the proxy statement and a form of proxy will be mailed to stockholders on or about March 7, 1957.

HIGHLIGHTS

of the Year's Operations

AT THE YEAR-END we were supplying utility service to 3,247,929 customers in all branches of our operations. The gain was 123,181, which is below the record established in the previous year, but above the average gain over the past decade.

GROSS OPERATING REVENUES reached an all-time high of $470,744,000, exceeding those of the previous year by $27,244,000, or 6.1%. Climatic conditions adversely affected the growth in revenues for several major classes of service.

PROCEEDS FROM SECURITIES sold to finance our construction program totaled $62 million, the smallest amount sold for this purpose since 1946. Rights were issued to our common stockholders entitling them to subscribe for additional common stock for the first time since 1953.

SALES OF ELECTRICITY TO CUSTOMERS totaled 17.2 billion kilowatt-hours, a 4.8% increase over the previous year. In addition, we accepted for delivery 1.2 billion kilowatt-hours for the account of others.

THE COMPANY greatly expanded its activities in the field of nuclear electric power. Through an arrangement with the General Electric Company, the nation's first privately financed nuclear power will be flowing into our system before the close of 1957.

SALES OF GAS TO CUSTOMERS totaled 304 billion cubic feet, a gain of 5.8% over the previous year. Warmer-than-normal weather which prevailed during most of the year retarded sales in this department.

THE NUMBER OF STOCKHOLDERS participating in our ownership reached 221,328 at the year-end, a gratifying gain of 3,507. Of the total, 85,874 were preferred stockholders and 135,454 were common stockholders.

CONSTRUCTION EXPENDITURES totaled $148 million, an increase of about $15 million over the prior year. The cost of our construction program is increasing, and we expect that expenditures for this purpose will range from $175 to $190 million annually over the next two years.

NET EARNINGS FOR THE COMMON STOCK were $3.46 a share based on the average number of shares outstanding, and $3.37 a share based on end-of-period shares. This compares with earnings of $3.32 a share based on the lesser number of shares outstanding in 1955.

Revenues and Sales—Electric and Gas Departments by Classes of Service

ELECTRIC DEPARTMENT	1956	1955	Increase Amount	Increase Per Cent
Electric Revenues				
Residential or Domestic Sales	$ 103,393,858	$ 96,002,090	$ 7,391,768	7.7%
Small Light and Power Sales	59,185,703	56,559,250	2,626,453	4.6
Large Light and Power Sales	80,281,261	72,527,448	7,753,813	10.7
Agricultural Power Sales	36,912,761	39,510,469	* 2,597,708	* 6.6
Public Street and Highway Lighting	4,359,662	4,026,389	333,273	8.3
Sales to Railroads and Railways	289,746	302,242	* 12,496	* 4.1
Sales to Other Electric Utilities	13,845,766	13,378,470	467,296	3.5
Company Use (Construction)	208,215	197,031	11,184	5.7
Other Miscellaneous Revenue	7,377,612	7,206,575	171,037	2.4
Totals	$ 305,854,584	$ 289,709,964	$ 16,144,620	5.6%
Electric Sales—Kilowatt-Hours				
Residential or Domestic Sales	3,836,376,061	3,500,458,987	335,917,074	9.6%
Small Light and Power Sales	1,929,311,851	1,843,979,710	85,332,141	4.6
Large Light and Power Sales	6,785,393,112	6,156,236,698	629,156,414	10.2
Agricultural Power Sales	2,826,509,164	3,115,675,037	*289,165,873	* 9.3
Public Street and Highway Lighting	119,117,255	108,113,707	11,003,548	10.2
Sales to Railroads and Railways	19,834,757	20,552,528	* 717,771	* 3.5
Sales to Other Electric Utilities	1,668,044,640	1,644,621,097	23,423,543	1.4
Company Use (Construction)	10,122,410	9,723,076	399,334	4.1
Total Sales to Customers	17,194,709,250	16,399,360,840	795,348,410	4.8
Delivered for the account of others	1,188,505,543	1,391,746,350	*203,240,807	*14.6
Totals	18,383,214,793	17,791,107,190	592,107,603	3.3%

*Denotes decrease

GAS DEPARTMENT	1956	1955	Increase Amount	Increase Per Cent
Gas Revenues				
Residential or Domestic Sales	$ 89,579,470	$ 85,718,355	$ 3,861,115	4.5%
Commercial Sales	22,619,592	22,378,074	241,518	1.1
Industrial Sales	48,612,154	41,965,863	6,646,291	15.8
Sales to Other Gas Utilities	1,483,828	1,251,649	232,179	18.5
Company Use (Construction)	43,063	38,114	4,949	13.0
Other Miscellaneous Revenue	221,956	156,101	65,855	42.2
Totals	$ 162,560,063	$ 151,508,156	$ 11,051,907	7.3%
Gas Sales—Thousands of Cubic Feet				
Residential or Domestic Sales	128,996,060	127,658,779	1,337,281	1.0%
Commercial Sales	39,497,149	40,507,826	* 1,010,677	* 2.5
Industrial Sales	131,198,241	115,295,247	15,902,994	13.8
Sales to Other Gas Utilities	3,803,246	3,367,885	435,361	12.9
Company Use (Construction)	90,851	87,462	3,389	3.9
Total Sales to Customers	303,585,547	286,917,199	16,668,348	5.8
Company Use (Steam-electric plants, etc.)	58,881,119	95,231,999	* 36,350,880	*38.2
Totals	362,466,666	382,149,198	* 19,682,532	* 5.2%

*Denotes decrease

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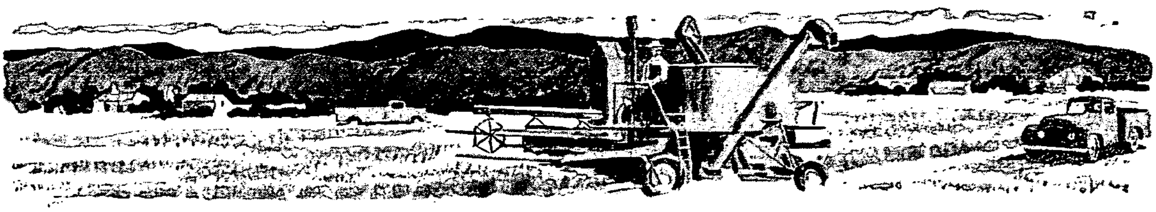
The Year in Review



Revenues and Sales

Gross operating revenues from all sources reached an all-time high of $470,744,000 for the year, an increase of $27,244,000, or 6.1%. In addition we had miscellaneous income of $1,187,000, principally dividends from subsidiary companies.

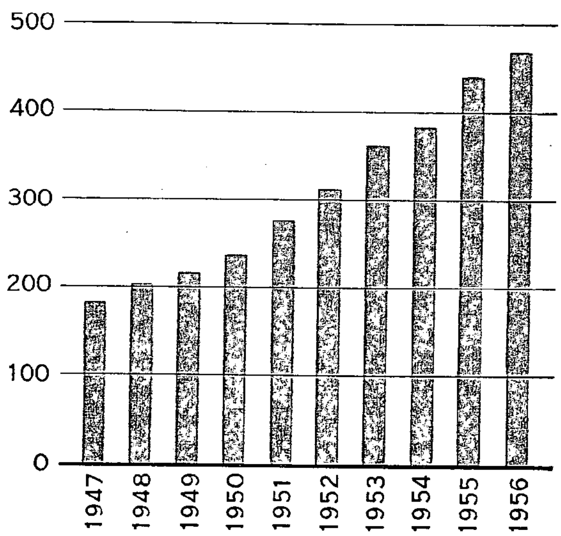
Gratifying gains in revenues and sales were registered in electric residential service and in the industrial classifications for both gas and electricity (see table on opposite page for details). Since these classes of service are largely unaffected by variations in temperature and precipitation they provide a good yardstick for measuring the trend of revenues and sales volume from one year to the next.

Climatic conditions, however, do have a considerable influence on sales and related revenues in other important classes of service. The extremely heavy precipitation in the 1955–56 winter season had an adverse effect on agricultural power sales. The heavy spring and summer river flow reduced the need for agricultural pumping and was largely responsible for the 9.3% decline in sales for this purpose.

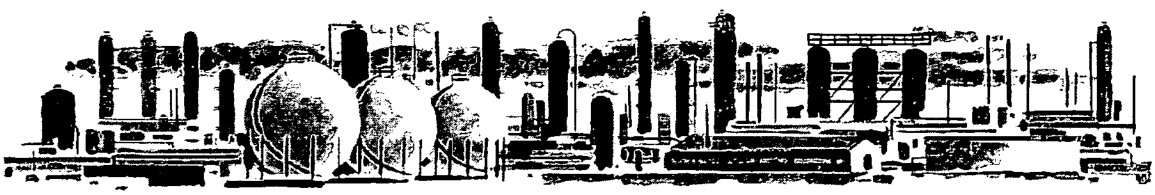
The warmer-than-normal weather which prevailed during most of the year had a depressing effect on both domestic and commercial gas sales. The effect of temperature variations on system gas sales is illustrated by the fact that for every degree that average daily temperatures depart from normal during the heating season, gas sales are increased or decreased by 35 to 40 million cubic feet per day. In 1956 the cumulative daily average temperatures were 120 degree days warmer than normal, whereas in 1955 temperatures were 398 degree days colder than normal.

This explains the relatively minor gain recorded for residential gas sales and the slight decrease in commercial gas sales. Revenues for these two classes of service showed up slightly better because of higher rates which were placed in effect about the middle of 1955 to offset the higher cost of gas purchased from out-of-state sources.

GROSS OPERATING REVENUES
Millions of Dollars



The substantial gains in industrial sales in both the Gas and Electric Departments reflect a continuation of the high level of business activity as well as the establishment of many new industrial plants in our service area.



Operating Expenses

Despite the continuation of our intensive efforts to improve our procedures and to reduce costs, substantial increases in operating expenses occurred in 1956. These were largely beyond the control of the management.

Wages and salaries paid operating employees amounted to $57,146,000, an increase of $3,534,000 over the previous year. The major portion of this increase resulted from wage adjustments placed in effect about the middle of the year, as more fully described in the section on Personnel.

Prices of both natural gas produced in California fields and fuel oil increased substantially during the year. Fuel oil for our steam-electric generating plants was increased 55 cents per barrel, or by 27%, in three steps during the year, following an increase of 15 cents per barrel late in 1955. In January 1957, still another increase of 15 cents per barrel took place. Since the price of most of the natural gas which we purchase from California fields is tied to the price of fuel oil, the increased prices for the latter have resulted in proportional increases in the price paid for such natural gas.

The cumulative effect of these increases in prices of natural gas and fuel oil is too great for the Company to absorb, and steps are being taken, as discussed elsewhere in this report, to adjust our rates to offset these higher prices.

As a result of an excellent year for hydro generation, the cost of power purchased by us from other producers was more than double that of the previous year, increasing from $2,917,000 to $6,190,000. Most of this was attributable to the increased availability of power produced in plants of the Central Valley Project of the United States Bureau of Reclamation.

As a further step in the Company's effort to reduce operating costs, an IBM 705 electronic data processing system will be delivered to the Company in November 1957. Initial use, estimated to produce savings in excess of one million dollars annually, will be for billing and related accounting for P G & E's more than three and one-quarter million customers. It is expected that our present billing systems will be fully supplanted by computer operations by the middle of 1960. Eventually computer operations will be extended to include plant, stores and payroll accounting and other applications from which additional savings will be realized. An eight-story office building located about two blocks from the Company's general offices has been purchased and will be rehabilitated to house the computer system and for other uses.

Taxes

As has been the case for many years past, taxes in 1956 continued to be the largest single element of cost in supplying service to our customers. Taxes and franchise payments totaled $125,910,000, or $5,496,000 more than in the previous year. As shown on the table on page 12, $121,988,000 of the total was charged against income and the balance was charged against capital and other accounts.

Taxes charged against income absorbed 25.3% of our gross operating revenues. This is one measure of the subsidy now given government-owned utilities which pay little or no taxes in the conduct of their operations. Rate comparisons between investor-owned and government-owned utilities therefore have little meaning unless this subsidy and others are taken into account.

Ad valorem taxes continued their upward trend, totaling $46,274,000, or $1,372,000 more than in the previous year. Pursuant to an order issued by the California Public Utilities Commission on May 8, 1956, the Company was authorized to change its method of charging income for ad valorem taxes from a calendar to a fiscal year basis as of January 1, 1956, to conform with the accounting practice generally followed by other major utilities. Under this order ad valorem taxes payable during the fiscal year July 1, 1956 to June 30, 1957 were charged against income during that fiscal period instead of during the calendar year 1956 as under our prior practice. Under this revised practice income for the year 1956 was charged with an amount which reflected only one-half of the increase in ad valorem taxes over the previous fiscal year instead of the entire increase under our former method. Similar benefits will accrue to the income account for 1957 and subsequent years. The change from a calendar to a fiscal year basis made avail-

Summary Showing Sources and Disposition of Income

Years 1952–1956 Inclusive

	1956	1955	1954	1953	1952
Sources of Income:					
Electric Department revenues	$305,855,000	$289,710,000	$265,419,000	$252,664,000	$205,643,000
Gas Department revenues	162,560,000	151,508,000	118,846,000	109,732,000	106,781,000
Revenues from other operating departments	2,329,000	2,282,000	1,979,000	1,709,000	1,561,000
Miscellaneous income	1,187,000	804,000	1,035,000	208,000	429,000
Totals	$471,931,000	$444,304,000	$387,279,000	$364,313,000	$314,414,000
Disposition of Income:					
Wages and salaries of operating employees	$ 57,146,000	$ 53,612,000	$ 50,994,000	$ 49,066,000	$ 46,688,000
Power purchased from wholesale producers	6,190,000	2,917,000	6,377,000	7,011,000	10,166,000
Natural gas purchased	98,808,000	94,947,000	73,980,000	65,503,000	54,957,000
Oil and other fuel purchased	15,309,000	12,222,000	8,442,000	10,968,000	8,497,000
Material and supplies, services from others, etc.	22,165,000	19,143,000	20,345,000	22,179,000	20,537,000
Provision for pensions, insurance, etc.	7,516,000	9,114,000	7,776,000	5,629,000	3,805,000
Provision for depreciation and amortization	44,964,000	43,372,000	39,090,000	35,172,000	32,700,000
Taxes, including provision for federal taxes on income	110,526,000	108,264,000	93,186,000	91,309,000	73,324,000
Special charges in lieu of and for deferred federal and state taxes on income	8,746,000	6,284,000	4,504,000	—	—
Bond interest and other income deductions	24,787,000	23,394,000	19,546,000	17,783,000	16,740,000
Dividends declared on preferred stock	18,192,000	17,102,000	16,266,000	15,722,000	15,530,000
Dividends declared on common stock	39,989,000	35,763,000	35,553,000	29,689,000	24,984,000
Balance retained in the business	17,593,000	18,170,000	11,220,000	14,282,000	6,486,000
Totals	$471,931,000	$444,304,000	$387,279,000	$364,313,000	$314,414,000
Average Number of Shares of Common Stock Outstanding	16,662,129	16,255,733	16,160,533	14,114,427	12,492,070
Earnings Per Share on Average Number of Shares Outstanding	$3.46	$3.32	$2.89	$3.12	$2.52
Dividends Declared Per Share of Common Stock	$2.40	$2.20	$2.20	$2.10	$2.00
Retained in the Business, Per Share of Common Stock	$1.06	$1.12	$0.69	$1.02	$0.52

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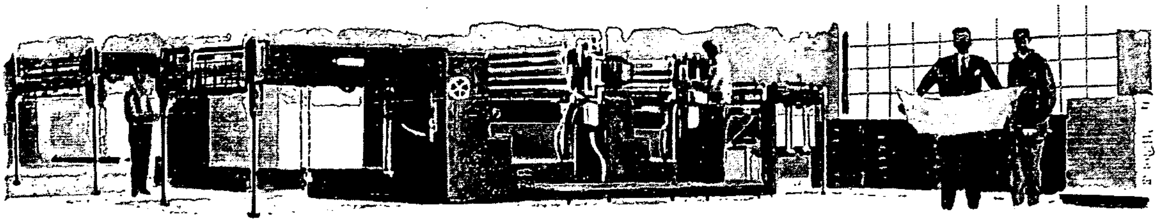
Taxes and Franchise Payments

	1956	1955	Increase
LOCAL TAXES AND FRANCHISE PAYMENTS:			
Ad valorem property taxes	$ 46,274,000	$ 44,902,000	$1,372,000
Franchise payments	2,716,000	2,369,000	347,000
Total local taxes and franchise payments	48,990,000	47,271,000	1,719,000
STATE TAXES:			
Bank and corporation franchise	4,829,000	4,035,000	794,000
Provision for state income taxes payable following period of accelerated amortization	480,000	200,000	280,000
Special charges in lieu of state income taxes	—	145,000	* 145,000
Unemployment insurance	282,000	276,000	6,000
Other	397,000	374,000	23,000
Total state taxes	5,988,000	5,030,000	958,000
CITY AND STATE TAXES:			
Sales and use	2,530,000	1,832,000	698,000
FEDERAL TAXES:			
Corporation income	58,408,000	58,657,000	* 249,000
Provision for federal income taxes payable following period of accelerated amortization	8,266,000	6,014,000	2,252,000
Special charges in lieu of federal income taxes	—	* 75,000	75,000
Unemployment insurance	171,000	167,000	4,000
Old age benefits	1,498,000	1,435,000	63,000
Other	59,000	83,000	* 24,000
Total federal taxes	68,402,000	66,281,000	2,121,000
TOTAL TAXES AND FRANCHISE PAYMENTS	$125,910,000	$120,414,000	$5,496,000
CHARGED TO:			
Income account as taxes	$119,272,000	$114,478,000	$4,794,000
Income account as franchise payments	2,716,000	2,369,000	347,000
Income deductions	—	70,000	* 70,000
Capital and other accounts	3,922,000	3,497,000	425,000
TOTAL TAXES AND FRANCHISE PAYMENTS	$125,910,000	$120,414,000	$5,496,000

*Denotes decrease

able for disposition a credit of approximately $22,000,000, which was equivalent to one-half the 1955–56 tax liability that had been charged to income under the former practice. After applying about $10,400,000 of this credit to write off Plant Acquisition Adjustments accounts and other items, the remaining balance of about $11,600,000 is being amortized as a credit to ad valorem tax expense over a period of ten years, as more fully described in the Notes to Financial Statements.

The Company has elected to adopt accelerated depreciation, as permitted by the Internal Revenue Code of 1954, in determining its federal income tax liability for the years 1954 and 1955, and



intends to so elect for 1956. Late in 1956 an application was filed with the California Public Utilities Commission for an order authorizing the Company to normalize taxes in its accounts by charging expense with an amount equal to the taxes deferred as a result of using accelerated depreciation and concurrently crediting a corresponding amount to restricted surplus. The accounting treatment requested is the same as that previously authorized by the Commission with respect to deferral of taxes arising from accelerated amortization. Pending a decision on its application, the Company shows its income tax liability just as if it had not elected to adopt accelerated depreciation, the deferred credit to tax expense being reflected in the accrued tax account in the balance sheet.

Depreciation and Amortization

The Company provides for depreciation on its properties under a method known as the remaining-life sinking fund basis. Under this method appropriate interest and annuity rates are applied to the several classes of utility property which are calculated to provide adequately for recovering the remaining cost of depreciable assets over their estimated remaining lives.

On May 15, 1956 the California Public Utilities Commission authorized the Company, effective as of January 1, 1956, to change the rate of interest on its depreciation reserve balance from 4% to 2% and to adopt certain changes in lives and annuity rates. In total, however, the provision made for depreciation for the year 1956 in the amount of $44,964,000 was not appreciably different from what it would have been under the former rates.

As already discussed under the section on Taxes, the balance remaining in the Plant Acquisition Adjustments accounts was disposed of as of the beginning of the year, and as a consequence no amortization for this item was charged against income in 1956.

Financing

Proceeds from securities issued for new money approximated $62 million in 1956, the smallest amount issued for this purpose since 1946. Because of the Company's expanding construction program, it is anticipated that the Company's new money requirements will be greater over the next several years.

The Company started the year with $18 million of short-term bank loans outstanding. In March 1956 we sold at competitive bidding $25 million of First and Refunding Mortgage Bonds, Series Z, 3⅜%, due December 1, 1988. The major portion of the proceeds was used to retire bank loans.

To provide additional funds for its construction program and in order to maintain its capital structure in favorable balance, the Company issued rights to its common stockholders of record on June 12, 1956, entitling them to subscribe pro rata for 812,791 shares of common stock, in the ratio of one share for each twenty shares then held, at a subscription price of $45 a share. Subscriptions were received for 791,858 shares, or 97.4% of the total shares offered. This included stock subscribed for by the underwriters upon the exercise of rights purchased by them in the open market during the subscription period. The small remaining balance of unsubscribed shares was purchased by the underwriters at the subscription price in accordance with the terms of the underwriting agreement, the Company sharing in the profits upon resale of this stock to the public. Net proceeds after underwriting and corporate costs totaled almost $36 million.

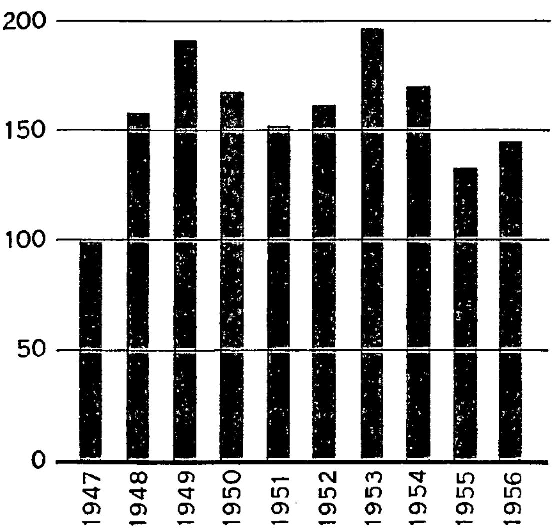
This was the first offering to our common stockholders since 1953, although approximately 700,000 shares of common stock were issued in 1954 in exchange for securities of acquired companies.

On November 1, 1956, 127,426 shares of 4.50% Redeemable First Preferred Stock were issued pursuant to the terms of an Employees' Stock Purchase Plan inaugurated in 1954. Almost 4,700 employees participated in the plan. This was the third offering of stock made to employees in the postwar period in accordance with the Company's policy of encouraging employee stock ownership.

To meet its cash requirements the Company borrowed $25 million from banks early in December and closed the year with that amount of short-term bank loans outstanding. These loans were retired on February 1, 1957 from the proceeds from an issue of $35 million of First and Refunding Mortgage Bonds, Series AA, 4½%, due December 1, 1986, sold at competitive bidding late in January 1957. The cost to the Company was the highest paid for bond money in almost thirty years, reflecting the extraordinary demand for investment funds.

At the year-end the Company's total capitalization, exclusive of short-term bank loans, amounted to $1,798 million, consisting of 45.7% bonds, all outstanding under the Company's First and Refunding Mortgage, 19.5% preferred stock, and 34.8% common stock equity.

CONSTRUCTION EXPENDITURES
Millions of Dollars



Construction Program

Capital expenditures for extending and enlarging our facilities amounted to almost $148 million in 1956. This was somewhat greater than anticipated at the beginning of the year, partly because of higher wage rates and material prices that became effective as the year progressed and also because of our decision to expedite certain phases of our construction program in the last quarter of the year.

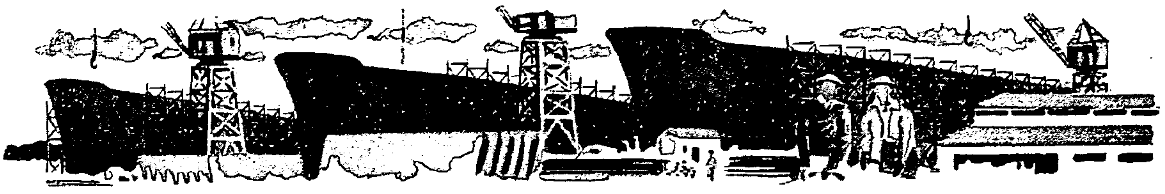
During the year we added 215,000 kilowatts to our system resources. A second steam unit of 165,000 kilowatts capacity was placed in operation at our Morro Bay Power Plant in July. The first unit of 50,000 kilowatts capacity at our new Humboldt Bay Power Plant was placed in commercial operation in December.

We now have 4,528,500 kilowatts of generating capacity in service, of which 68% is in steam plants and 32% in hydro plants. System electric capacity is now almost treble that in operation at the close of World War II.

Construction continued on a 165,000 kilowatt addition to our Hunters Point Power Plant in San Francisco which we expect to complete about the middle of 1958. Work was also started on a second 50,000 kilowatt steam unit at our Humboldt Bay Power Plant.

Construction on our large hydro plant program gained momentum as the year progressed. On the Feather River work continued on the Poe Powerhouse of 106,000 kilowatts capacity, and construction was commenced on the Caribou 2 and Butt Valley Powerhouses, which will have a combined generating capacity of 145,000 kilowatts.

Good progress was made on the Company's hydro development on the North Fork of the Kings River, which will add 261,500 kilowatts to our system resources. One of the features of this development will be the first large underground powerhouse in the United States, designed to house the turbines at the Haas Powerhouse unit of the



project. Other major features include the construction of two large dams, the Kings River Powerhouse, and enlargement of our existing Balch Powerhouse.

Concurrently with the construction of the major units of plant described above, extensive additions were made to both our gas and electric transmission and distribution systems. In the Gas Department alone approximately $40 million was spent for this purpose.

Nuclear Energy

During the year the Company took another important step to gain experience and knowledge in the challenging field of nuclear electric power generation. Through an arrangement with the General Electric Company we are installing a 5,000 kilowatt turbine-generator to operate with steam produced from a nuclear reactor of the boiling-water type, now under construction by General Electric at its Vallecitos Atomic Laboratory located near Pleasanton, about forty miles southeast of San Francisco. The plant, scheduled for operation in the fall of 1957, will produce the nation's first all-privately financed nuclear electric power.

Modern commercial offices provide a pleasant atmosphere for customers and employees.

In previous annual reports mention has been made of the Company's activities in connection with the Nuclear Power Group, Inc. In association with seven other companies we are continuing as an active co-sponsor of a 180,000 kilowatt all-nuclear electric plant, which will be located near Chicago and is planned for completion in 1960.

Our contribution to the developmental expense of the Chicago plant and other expenditures for nuclear research amounted to approximately $600,000 in 1956, all of which was charged against current income.

It should again be emphasized that, at the present state of the art, nuclear plants cannot produce power at a cost competitive with conventional plants in our area. However, as the result of the tremendous amount of research and developmental work that is now being carried on, it is hoped that one or more types of reactors will be developed which can produce power at a cost competitive with conventional plants in the United States. When this occurs nuclear electric plants will be integrated with existing power sources, but will not supplant them.

Business Development

Through its industrial development department P G & E actively promotes the location of new industries in its service area. A combination of increased promotional effort and favorable economic conditions produced a record year for industrial expansion. Commitments of capital expenditures for new manufacturing plants and additions to existing plants within our territory exceeded $425 million, more than 50% over the previous high established in 1953.

As a part of our increased promotional effort we produced a full-color motion picture, "Golden Horizons," covering Northern California's industrial opportunities. This film was made available to firms considering California locations. Late in the year a national advertising campaign was launched to stimulate interest in locating industrial facilities in the territory served by the Company.

Our residential sales activities continued to stress the importance of raising the general wiring standards in new homes and to promote adequate wiring in older residences, tying in with the national "Live Better Electrically" and "Housepower" campaigns. Adequate wiring is extremely important in order to expand the market for modern heavy-duty electrical appliances.

To augment its residential sales promotion P G & E entered the television program field for the first time in January 1957 with a weekly dramatic series, "O. Henry Playhouse," starring Thomas Mitchell. The series is being presented on stations throughout our service area, and commercial time is devoted to promoting adequate wiring, modern home lighting and new gas and electric household appliances.

As an indication of the trend toward greater use of electric appliances in the household, annual average residential electric use reached 2,747 kilowatt-hours in 1956, an increase of 131 kilowatt-hours over the previous year, and nearly twice the consumption only ten years ago.

Over the past eighteen months contracts have been entered into for supplying gas service to industrial plants in San Bernardino and eastern Kern Counties along the route of our Topock-Milpitas gas transmission line which will produce annual revenues in excess of ten million dollars.

Customers

At the year-end we were supplying utility service to 3,247,929 customers in all branches of our operations. This represents a gain of 123,181 customers for the year.

Principally because of a decline in new housing starts in our territory, the number of new customers connected fell short of the record established in the previous year. The gain, however, exceeded the average number of customers connected over the past ten years.

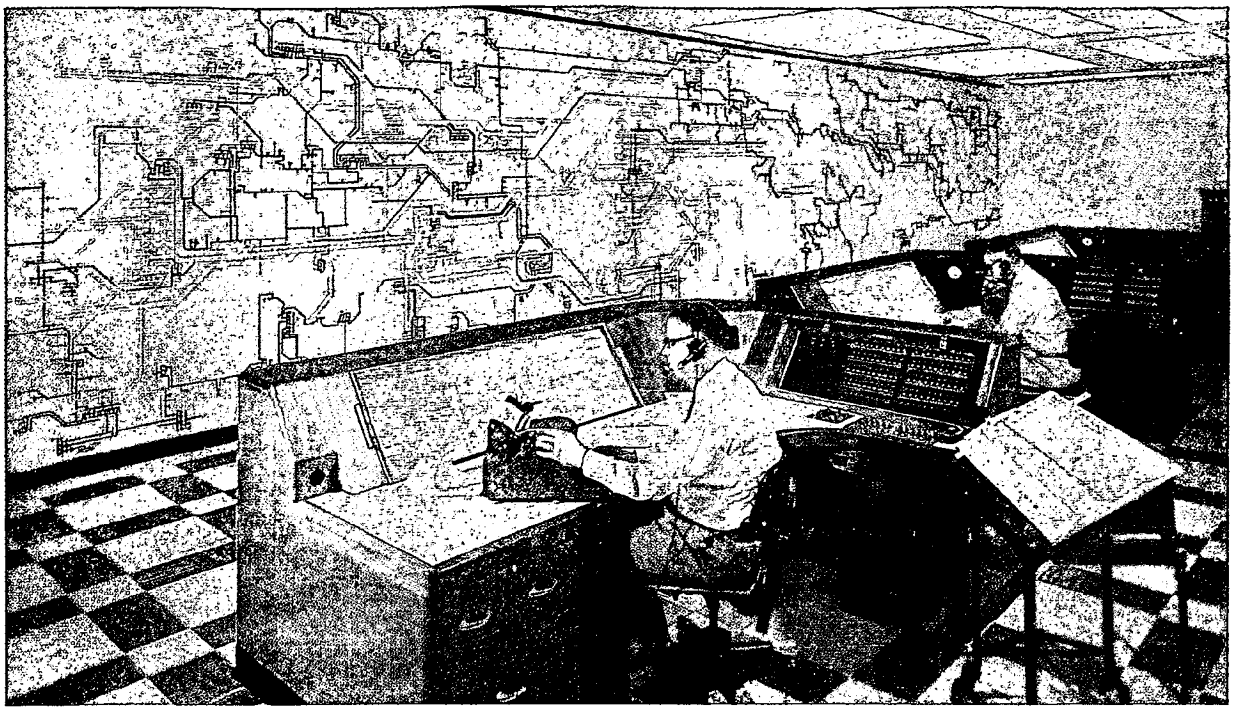
There is a close correlation between customer and population growth. Recent forecasts of the Bureau of the Census indicate that California may become the most populous state in the nation by 1965. Barring unforeseen developments, it appears that the large expansion of our facilities to meet customer growth must continue.

The table at the bottom of the page shows the departmental breakdown of customers served at the year-end and the increases during the year.

Customers—By Departments and Increase During Year

	December 31		
	1956	1955	Increase during 1956
Electric Department	1,753,278	1,692,997	60,281
Gas Department	1,468,779	1,406,722	62,057
Water Department	25,194	24,335	859
Steam Sales Department	678	694	* 16
TOTALS	3,247,929	3,124,748	123,181

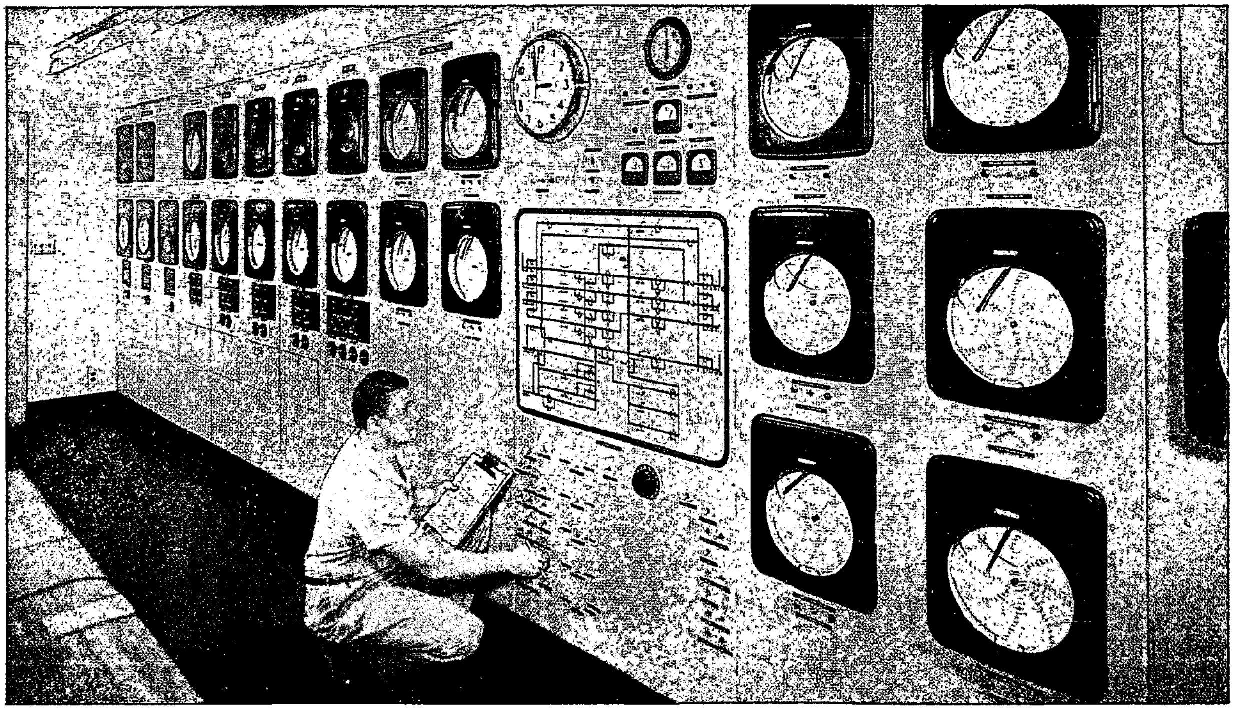
*Denotes decrease

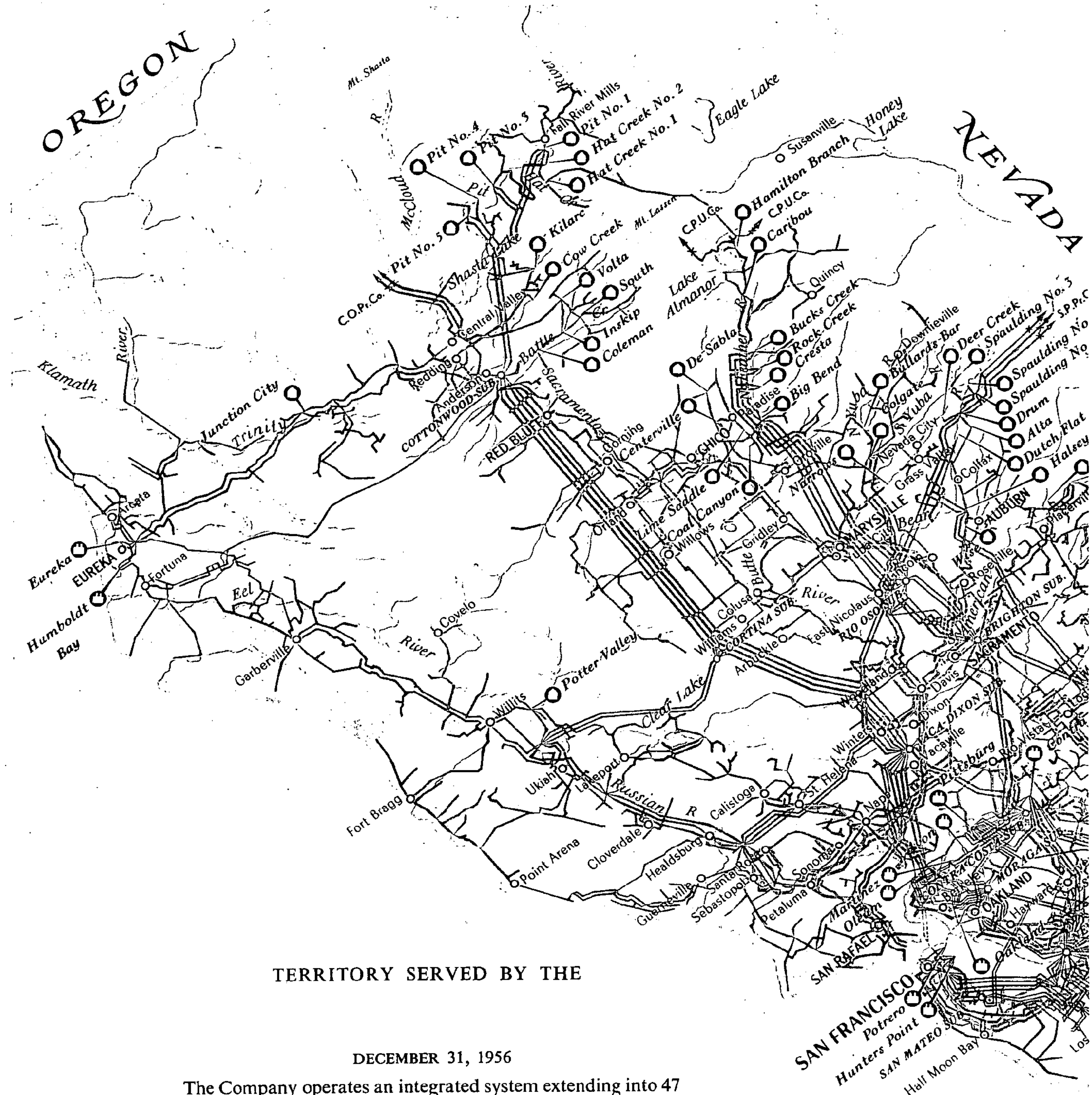


Above: System Dispatchers Office in Oakland where the flow of power is controlled for the entire electric network serving Northern and Central California. Power lines controlled from this point could encircle the earth nearly three times.

Nerve Centers of the System

Below: Control panel at Milpitas Terminal where the flow of gas from out-of-state and major California sources is directed to the San Francisco Bay Area. Diagram of station piping and controls is shown in the center of the panel.





TERRITORY SERVED BY THE

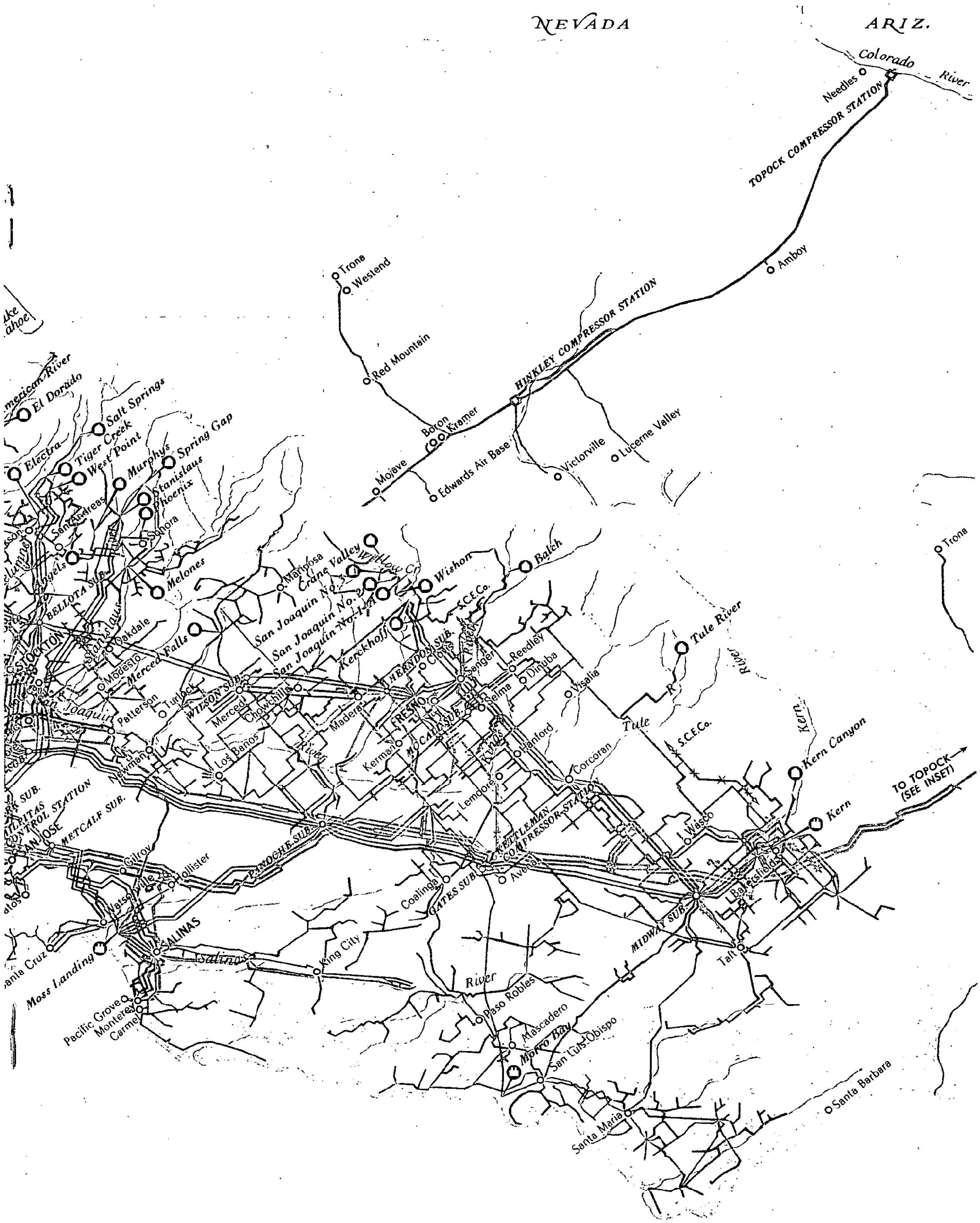
DECEMBER 31, 1956

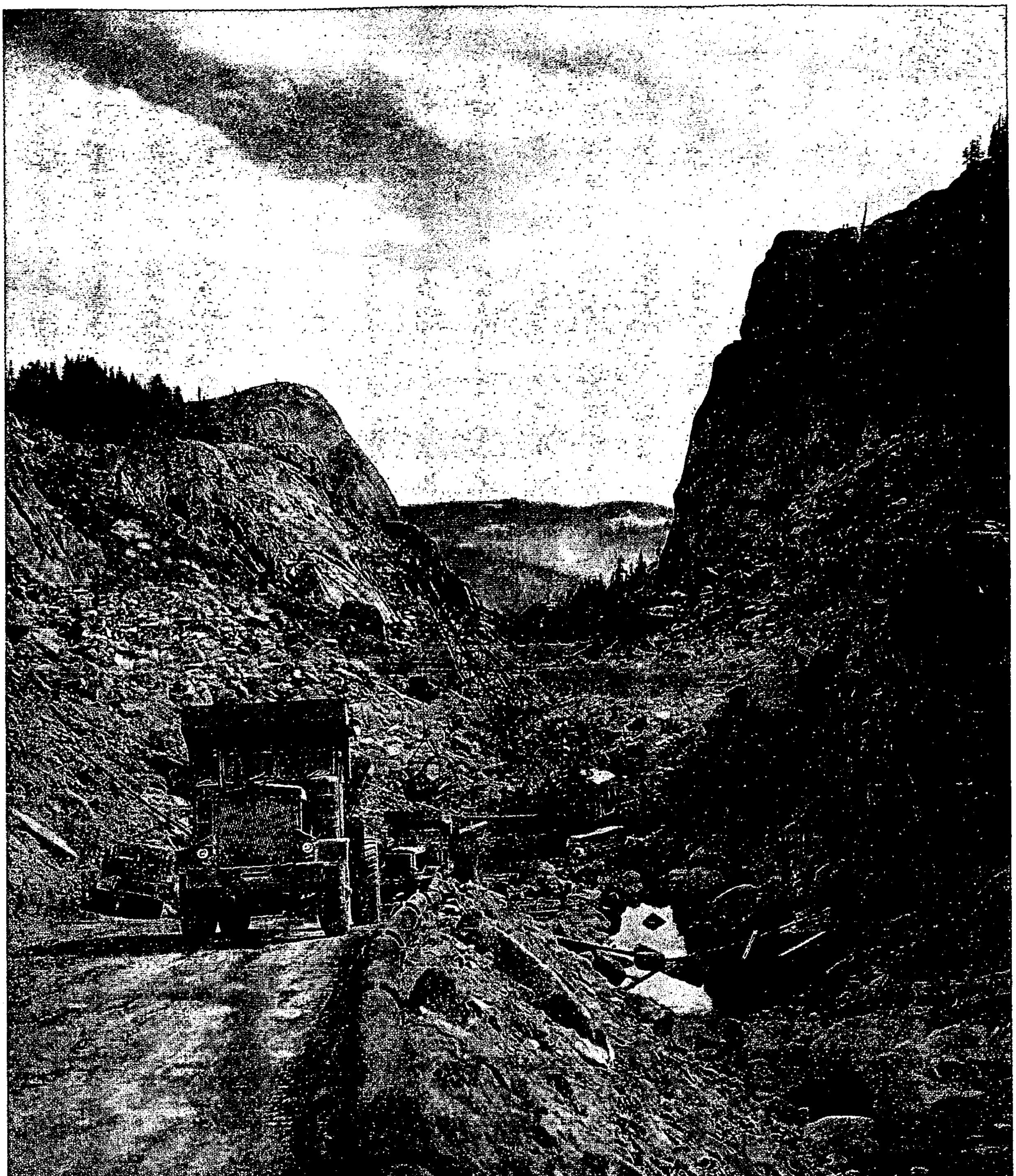
The Company operates an integrated system extending into 47 California counties with an estimated population of 6,250,000

ELECTRIC SYSTEM	GAS SYSTEM
Generating Plants—Steam-electric	Generating Plants
Generating Plants—Hydro-electric	Major Gas Lines
Major Electric Lines	Connecting Companies
Connecting Companies	Standard Pacific Gas Line, Inc.

58 Hydro-electric Plants	1,452,000 Kw.	3,200	miles gas transmission lines
13 Steam-electric Plants	3,076,500 Kw.	16,200	miles gas distribution lines
71 Plants Capacity . .	4,528,500 Kw.	19,400	miles of gas pipe lines
Capacity from others .	500,000 Kw.		

68,500 miles of electric power lines


NEVADA
ARIZ.
Colorado
River
Needles
TOPOCK COMPRESSOR STATION
Amboy
Trone
Westend
HINKLEY COMPRESSOR STATION
Red Mountain
Boron
Kramer
Mojave
Edwards Air Base
Victorville
Lucerne Valley
Trona
Lake Tahoe
American River
El Dorado
Salt Springs
Tiger Creek
Electra
West Point
Spring Gap
Murphys
Stanislaus
Phoenix
San Andreas
Sonora
Angels
Melones
BELLOTA SUB.
STOCKTON
Oakdale
Stanislaus
Modesto
Merced Falls
Mariposa
Crane Valley
Willow Cr.
San Joaquin No. 3
San Joaquin No. 2
San Joaquin No. 1-A
Wishon
Balch
Kerckhoff
S.C.E.Co.
HERNDON SUB.
Clovis
Sanger
Reedley
Dinuba
Tule River
Visalia
WILSON SUB.
Merced
Chowchilla
Madera
FRESNO
Selma
Turlock
Patterson
San Joaquin
Newman
Los Banos
Kerman
Hanford
Lemoore
Corcoran
Tule
S.C.E.Co.
Kern
Kern Canyon
TO TOPOCK (SEE INSET)
Kern
MILPITAS CONTROL STATION
SAN JOSE
METCALF SUB.
PANOCHE SUB.
KETTLEMAN COMPRESSOR STATION
Avenal
Coalinga
GATES SUB.
Wasco
Bakersfield
Gilroy
Hollister
Watsonville
SALINAS
Santa Cruz
Moss Landing
King City
Salinas
MIDWAY SUB.
Taft
River
Paso Robles
Atascadero
Morro Bay
San Luis Obispo
Pacific Grove
Monterey
Carmel
Santa Maria
Santa Barbara



Foundation work in progress at the site of Courtright Dam, at an elevation of 8,000 feet, on the $80 million Kings River Development in the rugged High Sierra. Two dams, two new powerhouses, and the enlargement of existing facilities along the river will add 261,500 kilowatts of electric generating capacity to our system resources by the close of 1958.

Operations

Gross system electric output reached a new peak of 22.2 billion kilowatt-hours in 1956. Of the total output 9.0 billion, or 40.7%, was produced in our steam plants, 10.0 billion, or 44.8%, in our hydro plants, and 3.2 billion, or 14.5%, was delivered into our system from other producers.

The extraordinary series of warm rain storms during the latter part of 1955 resulted in an unseasonal runoff which filled our reservoirs to about 61% of capacity by the beginning of the year. During the balance of the winter season there were heavy deposits of snow in the mountain areas. The result was the most favorable year we have ever experienced for hydro-electric generation. The output of our hydro plants was approximately 50% greater than that of the previous year, when production was only about 90% of normal. This, coupled with the greater output from hydro plants of other suppliers, resulted in a reduction in the output of our steam plants of about 3.3 billion kilowatt-hours, with accompanying substantial savings in fuel costs.

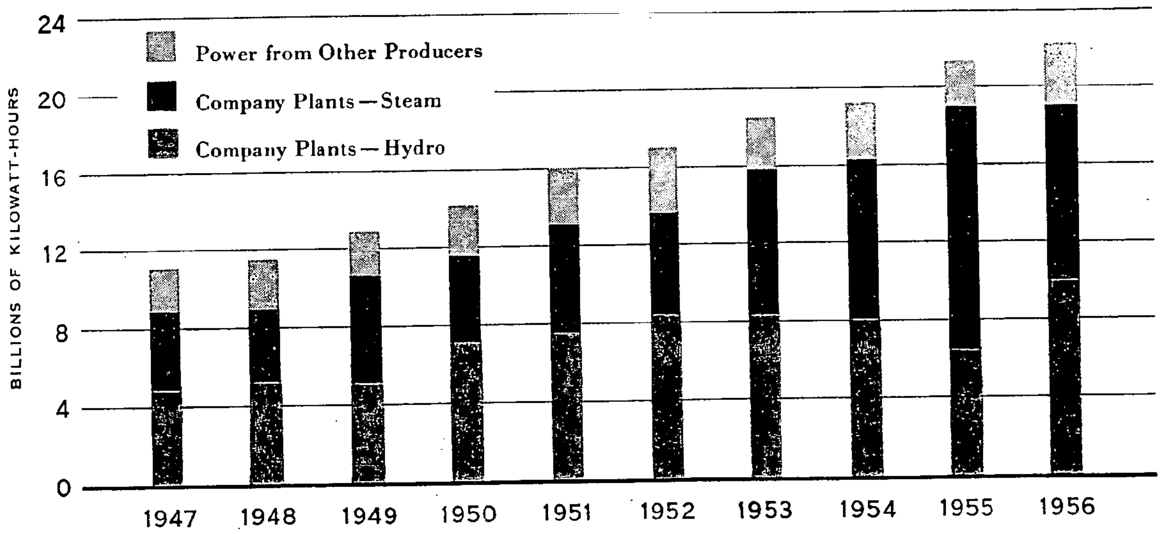
We closed the year with the equivalent of approximately one billion kilowatt-hours in the form of stored water, a much greater carry-over than normal.

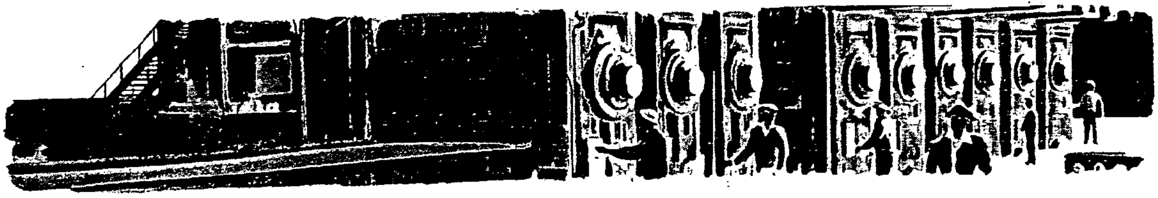
The peak demand on our electric facilities reached 4,025,300 kilowatts on June 28. We estimate that our peak would have occurred somewhat later in the year and would have been perhaps 200,000 kilowatts higher were it not for the unusual amount of gravity water which reduced the demand for irrigation pumping.

Our natural gas transmission system operated satisfactorily throughout the year. The maximum day sendout for the year occurred on February 17, and amounted to 1,487 million cubic feet.

During the year initial steps were taken to convert a partially depleted gas field in Yolo County, about sixty miles north of San Francisco, into the Company's first natural gas underground storage area. Three wells are now operative in the field, six additional wells will be drilled, and a compressor station connecting each well will be installed. When completed the compressor will be able to inject gas at a rate of 36 million cubic feet per day during periods when supply exceeds demand. During periods of peak demand the project

ELECTRIC SYSTEM OUTPUT—KILOWATT-HOURS (*By Sources*)





will be able to deliver a maximum of 80 million cubic feet a day into our gas transmission system. We estimate that the project will be in operation before the end of the 1957–58 heating season.

Gas Supply

Natural gas purchased for sale to our customers and for use in our steam-electric generating plants totaled 384 billion cubic feet, or 3.4% less than in the previous year. About 17 billion cubic feet more gas was purchased during the year for sale to our customers, but this was more than offset by a reduction of 36 billion cubic feet of gas consumed in our steam-electric generating plants.

Out-of-state sources continued to provide the major portion of our gas supply, 69% of our total requirements last year having been delivered into our system at the California-Arizona border through the facilities of El Paso Natural Gas Company.

In last year's annual report stockholders were advised that the Federal Power Commission had authorized the El Paso Company to increase deliveries into our system, in increments, from 700 to 875 million cubic feet a day. In order to provide the capacity to handle the first increment of 50 million cubic feet per day, we paralleled our Topock-Milpitas 34-inch transmission line for an additional 85 miles. Additional facilities required to increase the capacity of the line to 875 million cubic feet will be completed in 1957.

To further augment our gas supply, in January 1956 a new agreement was entered into between the Company and El Paso for an additional 150 million cubic feet of gas a day, with the last increment scheduled for delivery in 1959, at which time deliveries of out-of-state gas into our system will aggregate 1,025 million cubic feet a day. Regulatory approval has already been obtained to construct the facilities required to bring the capacity of the line to 875 million cubic feet per day, and an application has been filed for the balance.

As the result of considerable exploration and development work in the last three years in Northern California substantial new reserves of natural gas have been discovered. This has permitted the Company to begin tying the new discoveries into its system, thereby providing it with greater operating flexibility and capacity. Work has already started on an 83-mile line in a southerly direction to Sacramento. It is also planned to construct another line about 175 miles northwesterly into the Humboldt County area, which has not been interconnected with our main gas transmission system, and which at present is inadequately supplied with natural gas service from rapidly depleting local wells.

Natural Gas Corporation of California, a wholly-owned subsidiary, is participating in the exploration work in the northern Sacramento Valley. Two productive wells have been drilled recently as joint ventures with other operators, each of which has an indicated initial producibility of about 7,500,000 cubic feet a day. Plans are being formulated for additional drilling in 1957 on leaseholds adjacent to the successful wells.

Rate Matters

In previous annual reports stockholders have been advised of the increased rates charged for out-of-state gas purchased by the Company from El Paso Natural Gas Company. Over the past four years two substantial increases in the cost of out-of-state gas have been placed in effect; the first became effective on January 1, 1953 and the second on April 15, 1955. Both of these increases were made subject to possible refund upon review by the Federal Power Commission.

On July 20, 1956 the Commission approved a settlement of the proceedings arising out of the first increase. Under this settlement El Paso refunded to the Company $1,232,000 including interest, with respect to gas purchased for the year 1953. Since this refund represented a portion of the increase which the Company had absorbed in 1953, we were not required to refund any portion of this amount to our customers.

This settlement terminated all proceedings before the Federal Power Commission with respect to El Paso's rates prior to April 15, 1955. Hearings to review the El Paso increase which became effective on the latter date were concluded in December 1956. As of the date of this report the Commission had not rendered its decision.

Since May 1955, pursuant to authorization of the California Public Utilities Commission, the Company has included contingent offset charges in its gas rates to recover a major part of the El Paso rate increases. If the offset charges collected exceed the increase in El Paso rates as finally fixed by the Federal Power Commission, the excess will be refunded to our customers.

In the section on Operating Expenses we referred to the substantial increases in fuel oil prices and the accompanying increases in prices for a large portion of the natural gas we purchase from California fields. In order to obtain relief from the burden of these increases in the price of gas the Company, on December 17, 1956, filed an application with the California Public Utilities Commission for authority to increase gas rates to customers served on an interruptible basis. This service is supplied at lower rates than other classes of service and is largely confined to industrial uses. The present tariffs for this service vary with the price of fuel oil between the limits of $1.00 and $2.00 per barrel. Since the price of fuel oil has been above $2.00 per barrel for over a year and is $2.75 per barrel as of the date of this report, the Company has requested authorization to adjust its interruptible gas rates in accordance with current fuel oil prices without regard to the existing ceiling on adjustment at the level of $2.00 per barrel. This will enable the Company to recover a substantial part of the increased cost of California gas and will bring industrial gas rates closer to (though still well below) the price of competitive fuels.

For the purpose of offsetting higher prices for fuel used in our steam-electric generating plants, an application was filed with the Commission on February 8, 1957 for authority to increase customer charges for electric service, with certain exceptions, by about 6%. Authority was also requested to include an automatic fuel adjustment clause in the rate schedules.

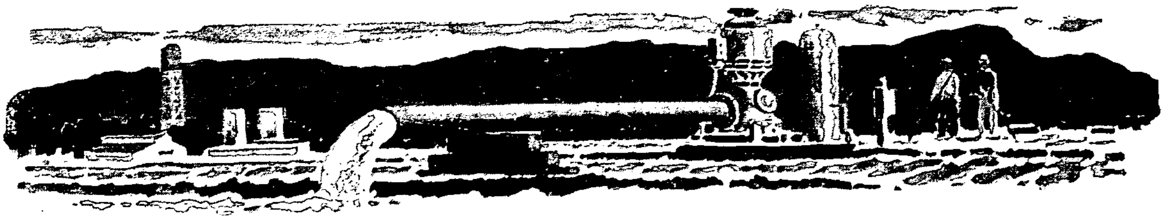
Thousands of man hours are consumed in the planning stages for new electric generating plants.

Personnel

At the year-end we had 18,370 employees, compared with 17,387 at the close of the previous year. The greater number of employees resulted from the increase in the size of our operations and our construction activities.

Additional employment was provided by contractors engaged on P G & E construction projects, an average of about 2,000 being employed on these projects during the year.

Wages and salaries of both operating and construction employees totaled $97,593,000, an increase of $6,830,000. The largest portion, $57,146,-000, was paid to operating employees and charged



against income. The remainder, $40,447,000, represented payments to construction employees and was charged to capital accounts.

Other direct employee benefits paid by the Company amounted to $9,807,000, with over two-thirds of this sum representing contributions to our Retirement Plan. During the year 203 employees retired under the plan, and at the end of the year 2,091 former employees were receiving retirement benefits.

Our labor agreements with the International Brotherhood of Electrical Workers (A. F. of L.–C. I. O.), which represents the majority of our employees, were amended as of July 1, 1956, and extended for a period of one year. The amended agreements provided for a wage increase of 7½% plus a four to five cents per hour adjustment in certain classifications. Similar adjustments were made for employees represented by the Engineers and Scientists of California and for employees not represented by a union. The last general wage increase prior to this was granted in September 1954.

Through an arrangement with the Stanford University Graduate School of Business, which trained the conference leaders, our supervisory training program was greatly expanded during the year. We continued to devote our closest attention to management development, a program which we believe is vital to the efficient conduct of our business.

Pacific Service Employees Association, with a membership of about 17,000, is a voluntary organization operated and managed entirely by its members. It conducts an extensive program of educational, social and recreational activities, operates a Credit Union and several welfare programs for its members. Its Hospitalization Plan was liberalized as of January 1, 1957, to include major medical or catastrophic coverage, the Company assuming the cost of the additional coverage.

SUMMARY OF PAYROLLS AND OTHER EMPLOYEE BENEFITS, YEAR 1956

Payrolls:	
Operating employees	$ 57,146,000
Construction employees	40,447,000
Sub-total	$ 97,593,000
Other Employee Benefits Paid By Company:	
Retirement Plan payments	$ 6,662,000
Other pension payments made by Trustee	855,000
State unemployment insurance tax	232,000
Federal unemployment insurance tax	171,000
Federal old-age insurance tax	1,493,000
Group Life Insurance Plan payments	184,000
Contributions to employee association	155,000
Sub-total	$ 9,807,000
Total Payrolls and Other Employee Benefits	$107,400,000

Stock Ownership

A major source of satisfaction to the management is the widespread ownership of P G & E stock. At the year-end we had 221,328 stockholders of record, a gratifying gain of 3,507.

Of the total at the end of the year, 85,874 were preferred stockholders and 135,454 were common stockholders.

The Company enjoys the distinction of being one of the most widely-owned corporations in the United States, ranking seventh in this respect according to the most recent information available.

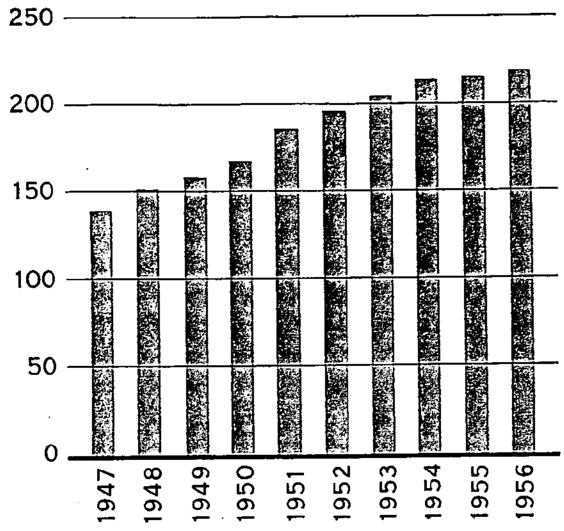
It should not be overlooked, however, that the number of stockholders of record falls short of measuring the actual number of beneficial owners of our stock. For example, it does not reflect

DISTRIBUTION OF STOCK OWNERSHIP BY CLASS OF INVESTOR, DECEMBER 31, 1956*

Class of Investor	Number of Stockholders	Number of Shares Owned
Women stockholders	87,209	7,134,523
Joint and other tenancies	60,977	4,785,329
Men stockholders	51,226	4,625,518
Trustees, guardians and other fiduciaries	14,352	1,838,202
Nominees	2,213	6,020,676
Corporations, partnerships and proprietorships	1,600	701,783
Charitable and fraternal organizations and foundations	1,286	284,907
Banks, investment companies and security dealers	893	1,429,899
Insurance companies	669	3,764,199
Religious institutions	480	91,325
Educational institutions	423	274,726
Totals	221,328	30,951,037

*These statistics exclude the effect of the issuance of 127,426 shares of 4.50% Redeemable First Preferred Stock late in 1956, the first dividend on which was not paid until February 15, 1957.

NUMBER OF STOCKHOLDERS
Thousands of Stockholders



the large number of owners whose shares are held in broker or nominee names, each of these latter appearing as only one stockholder of record on our books. Beyond this, literally millions have an indirect financial interest in the Company because of the substantial investment in our stocks by institutional investors, including investment trusts, pension funds, insurance companies and other similar organizations.

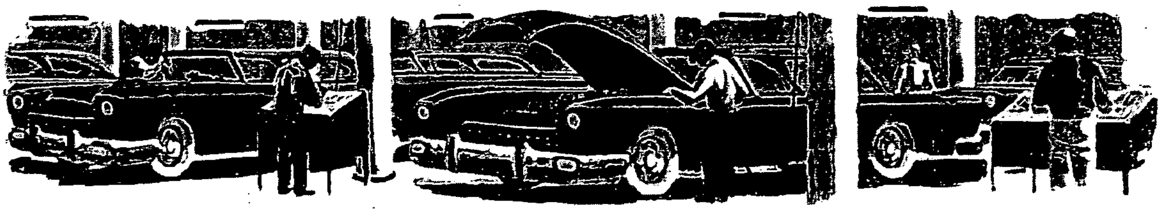
Another gratifying aspect of our stock ownership is the high degree of local ownership. About 65% of our stockholders have California addresses and own about 46% of the outstanding stock. It has been the Company's policy over a long period of years to encourage ownership of its stock by local residents, including its employees.

The gain in stockholders during 1956, the seventeenth consecutive year in which we have experienced a gain in the number of those participating in our ownership, is indicative of a nationwide trend toward a wider ownership of American business. According to the most recent Census of Shareowners conducted by the New York Stock Exchange, it is estimated that one out of every twelve adults in the United States is now a stockholder in publicly-held corporations. This is an entirely voluntary participation and is a reflection of their faith in our free institutions and economic system, which have provided us with the world's highest standard of living.

Central Valley Power

Under the terms of our contracts for the disposition of Central Valley power we accepted delivery of about 930 million kilowatt-hours for transmission to sixteen federal establishments and nine other customers entitled to preference under the Reclamation Law. The remainder of the commercial power produced by the project, exclusive of direct sales, was purchased by the Company.

During 1956 the Sacramento Municipal Utility District installed facilities which enable it to accept delivery of power directly from the project



transmission facilities. By the end of the year virtually all of the conversion had been completed and only a very small amount of power was being transported to the District over Company lines.

In last year's report we outlined the Company's proposal to the Bureau of Reclamation in connection with the construction of the Trinity River Project. This project was authorized by an Act of Congress in 1955 as an addition to the Central Valley Project, and is designed to store and divert waters of the Trinity River to the Sacramento River Basin for irrigation use. Under the terms of the Company's proposal we offered to install plants with a capacity of 384,600 kilowatts, provide transmission facilities and pay an average of $4,600,000 per year for use of the falling water. This would save the federal government approximately $56 million in construction costs, would save the Central Valley Project $165 million during the project repayment period, and would provide tax revenues of $145 million for local, state and federal governments which would otherwise be lost under federal development of the power facilities.

The authorizing Act directed the Secretary of the Interior to negotiate for non-federal development of the power facilities of the project subject to Congressional approval. Negotiations between the Company and the Secretary for a contract embodying the features outlined above were completed at the end of 1956. In February 1957 the Secretary found the Company's proposal to be acceptable generally and recommended its approval by Congress.

Directors and Officers

Mr. Paul L. Davies was elected a member of our Board of Directors on July 18, 1956. He replaced Mr. John P. Coghlan who resigned after twenty-five years of outstanding service on the Board. Mr. Davies is Chairman of the Board and Chief Executive Officer of Food Machinery and Chemical Corporation, San Jose. He is a director of American Trust Company, California Water Service Company, National Distillers Products Corporation and Caterpillar Tractor Co., and is active in civic affairs.

There were no changes in the staff of Executive Officers during the year.

HASKINS & SELLS
CERTIFIED PUBLIC ACCOUNTANTS

120 MONTGOMERY STREET
SAN FRANCISCO 4

ACCOUNTANTS' CERTIFICATE

The Board of Directors of
Pacific Gas and Electric Company:

We have examined the balance sheet of Pacific Gas and Electric Company as of December 31, 1956 and the related statements of net income and earned surplus for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. Previously we made a similar examination for the preceding year.

In our opinion, the accompanying balance sheet and statements of net income and earned surplus present fairly the financial position of the Company at December 31, 1956 and the results of its operations for the year then ended, in conformity with generally accepted accounting principles applied, except for the change in depreciation practice and the change in method of charging income for ad valorem taxes as explained in Notes 3 and 5 to Financial Statements, on a basis consistent with that of the preceding year.

Haskins & Sells

February 18, 1957.

PACIFIC GAS AND ELECTRIC COMPANY

Statement of Net Income for the Years Ended December 31, 1956 and 1955

	1956	1955
GROSS OPERATING REVENUES:		
Electric department	$305,854,584	$289,709,964
Gas department	162,560,063	151,508,156
Other	2,329,517	2,281,435
Total	$470,744,164	$443,499,555
OPERATING EXPENSES:		
Maintenance and repairs	$ 15,180,661	$ 13,220,482
Production expenses:		
Power purchased	6,189,929	2,917,500
Natural gas purchased	98,808,459	94,946,851
Oil and other fuel	15,309,290	12,222,397
Other	9,860,314	8,878,963
Transmission expenses	4,227,342	4,285,929
Distribution expenses	19,922,736	18,768,896
Customers' accounting and collecting expenses	15,711,937	14,865,406
Sales promotion expenses	3,572,165	3,340,303
Provision for depreciation and amortization (Notes 2 and 3)	44,963,968	43,372,342
Taxes:		
Provision for Federal income tax (Note 5)	66,673,897	64,671,843
Other taxes	52,597,731	49,806,596
Administrative and general expenses	17,882,946	15,809,518
Provision for doubtful accounts	960,000	960,000
Provision for casualty losses from storm damage (1956 credit represents excess of 1955 estimate over actual expenditures)	*491,150	1,738,200
Total	$371,370,225	$349,805,226
NET OPERATING REVENUES	$ 99,373,939	$ 93,694,329
MISCELLANEOUS INCOME:		
Dividends from subsidiaries	$ 700,000	$ 729,650
Other (net)	487,151	74,459
Total	$ 1,187,151	$ 804,109
Total	$100,561,090	$ 94,498,438
INCOME DEDUCTIONS:		
Interest on funded debt	$ 25,149,505	$ 24,462,946
Amortization of net bond discount and expense	416,358	417,310
Miscellaneous interest	835,111	1,001,561
Interest charged to construction	*2,661,395	*3,676,852
Other	1,047,246	1,258,659
Total	$ 24,786,825	$ 23,463,624
NET INCOME	$ 75,774,265	$ 71,034,814

*Denotes red figure.

The accompanying Notes to Financial Statements are an integral part of this statement.

PACIFIC GAS AND ELECTRIC COMPANY

Statement of Earned Surplus for the Years Ended December 31, 1956 and 1955

	1956	1955
BALANCE, JANUARY 1	$105,853,828	$ 81,711,345
NET INCOME	75,774,265	71,034,814
OTHER ADDITIONS:		
Additions to restricted surplus for income taxes payable following period of accelerated amortization (Note 5)	8,867,166	6,288,409
Credit arising from deferment of ad valorem tax expense (see contra) (Note 5)	9,455,025	
Estimated excess of sales price over net depreciated cost of electrical properties transferred to the United States Bureau of Reclamation pursuant to condemnation proceedings	932,685	
Refund of excess cost of natural gas purchased in prior years (less related income tax expense, $565,567)	483,334	
Purchase discount (* premium) on bonds reacquired, and unamortized net discount and expense applicable thereto	363,677	*276,075
Surplus from merger of subsidiary	224,401	
Miscellaneous—net (includes $459,668 profit on sales of properties in 1955)	28,204	511,048
Total	$201,982,585	$159,269,541
DEDUCTIONS:		
Dividends—Cash:		
First preferred—various series	$ 18,192,322	$ 17,102,301
Common	39,989,108	35,762,613
Write-off of plant acquisition adjustments (see contra) (Note 5)	9,455,025	
Provision for contingent electric rate refund	108,932	550,799
Total deductions	$ 67,745,387	$ 53,415,713
BALANCE, DECEMBER 31 (restricted for income taxes payable following period of accelerated amortization: 1956, $18,291,195; 1955, $9,424,029—Note 5)	$134,237,198	$105,853,828

*Denotes red figure.

The accompanying Notes to Financial Statements are an integral part of this statement.

PACIFIC GAS AND ELECTRIC COMPANY

Balance Sheet, December 31, 1956 and 1955

ASSETS

	1956	1955
Utility Plant (Note 2):		
Tangible plant	$2,277,395,844	$2,148,456,204
Intangible plant	1,341,089	1,265,238
Plant acquisition adjustments (Notes 2 and 5)		15,544,051
Total utility plant	$2,278,736,933	$2,165,265,493
Less reserves for depreciation and amortization	438,780,844	411,934,726
Utility plant—net	$1,839,956,089	$1,753,330,767
Investments and Non-Current Receivables:		
Capital stock of subsidiaries—at cost (Notes 1 and 4)	$ 14,865,747	$ 15,953,928
Investment in other physical property—at cost	4,405,600	4,244,585
Other investments and non-current receivables	1,758,558	1,865,821
Total investments and non-current receivables	$ 21,029,905	$ 22,064,334
Current Assets:		
Cash	$ 26,691,922	$ 26,498,828
Miscellaneous special deposits	62,867	437,314
Accounts receivable (less reserve for doubtful accounts: 1956, $1,678,798; 1955, $1,635,973)	38,205,187	32,771,692
Materials and supplies (for operations and construction)—at average cost	16,354,101	14,911,602
Prepaid taxes and insurance (Note 5)	25,411,640	1,494,643
Total current assets	$ 106,725,717	$ 76,114,079
Deferred Charges:		
Unamortized bond discount and expense (Note 4)	$ 10,009,073	$ 10,505,220
Other	813,434	2,173,125
Total deferred charges	$ 10,822,507	$ 12,678,345
Total	$1,978,534,218	$1,864,187,525

The accompanying Notes to Financial Statements are an integral part of this statement.

PACIFIC GAS AND ELECTRIC COMPANY

Balance Sheet, December 31, 1956 and 1955

LIABILITIES	1956	1955
CAPITALIZATION:		
Capital stock and surplus:		
Capital stock (Schedule 1):		
First preferred	$ 350,249,775	$ 347,064,125
Common	426,715,050	406,395,275
Excess of premiums received over discount and expense on outstanding shares	64,489,173	48,962,647
Instalments received on employees' preferred stock purchase agreements		1,802,210
Total capital stock	$ 841,453,998	$ 804,224,257
Surplus:		
Capital surplus	$ 627,217	$ 627,217
Earned surplus (including restricted surplus: 1956, $18,291,195; 1955, $9,424,029—Note 5)	134,237,198	105,853,828
Total surplus	$ 134,864,415	$ 106,481,045
Total capital stock and surplus	$ 976,318,413	$ 910,705,302
Mortgage bonds (less sinking-fund requirements) (Schedule 2)	821,864,340	805,135,320
Total capitalization	$1,798,182,753	$1,715,840,622
CURRENT LIABILITIES:		
Bank loans	$ 25,000,000	$ 18,000,000
Accounts payable	25,221,310	17,802,822
Drafts outstanding	1,402,518	1,439,466
Dividends payable	10,243,346	8,947,117
Current sinking-fund requirements (Note 4)	4,594,660	4,932,680
Accrued interest	2,394,082	2,362,922
Customers' meter and line deposits	5,724,638	5,360,449
Accrued taxes	78,420,751	75,922,959
Total current liabilities	$ 153,001,305	$ 134,768,415
DEFERRED CREDITS:		
Unamortized ad valorem tax credits (Note 5)	$ 10,498,876	
Unamortized premium on bonds	1,733,361	$ 1,794,187
Other	239,129	1,237
Total deferred credits	$ 12,471,366	$ 1,795,424
RESERVES:		
For insurance and casualties	$ 2,661,012	$ 1,946,558
For contingent electric rate refund	1,383,255	1,117,807
For adjustment of plant accounts	926,577	
Total reserves	$ 4,970,844	$ 3,064,365
CONTRIBUTIONS IN AID OF CONSTRUCTION	$ 9,907,950	$ 8,718,699
TOTAL	$1,978,534,218	$1,864,187,525

The accompanying Notes to Financial Statements are an integral part of this statement.

Capital Stock, December 31, 1956

SCHEDULE 1

Description	Shares Authorized	Issued and Outstanding —Held by Public: Shares	Issued and Outstanding —Held by Public: Amount
FIRST PREFERRED, CUMULATIVE, PAR VALUE $25 PER SHARE			
6%	4,211,662	4,211,662	$105,291,550
5½%	1,173,163	1,173,163	29,329,075
5%	400,000	400,000	10,000,000
5% redeemable	2,860,977	2,860,977	71,524,425
5% redeemable—Series A	1,750,000	1,719,388	42,984,700
4.80% redeemable	1,517,375	1,517,375	37,934,375
4.50% redeemable	1,127,426	1,127,426	28,185,650
4.36% redeemable	1,000,000	1,000,000	25,000,000
Redeemable (unclassified in series)	5,959,397	—	—
TOTAL	20,000,000	14,009,991	$350,249,775
COMMON, PAR VALUE $25 PER SHARE	20,000,000	17,068,602	426,715,050
TOTAL	40,000,000	31,078,593	$776,964,825
EXCESS OF PREMIUMS RECEIVED OVER DISCOUNT AND EXPENSE ON OUTSTANDING SHARES			64,489,173
TOTAL			$841,453,998

Mortgage Bonds, December 31, 1956

SCHEDULE 2

Title of Issue	Interest Rate %	Maturity	Amount Outstanding —Held by Public	Amount Held in Treasury
FIRST AND REFUNDING MORTGAGE (See Note):				
Series I	3½	June 1, 1966	$ 927,000	
Series J	3	Dec. 1, 1970	18,669,000	
Series K	3	June 1, 1971	23,839,000	
Series L	3	June 1, 1974	109,423,000	$ 125,000
Series M	3	Dec. 1, 1979	77,975,000	
Series N	3	Dec. 1, 1977	48,182,000	
Series O	3	Dec. 1, 1975	9,100,000	250,000
Series P	2¾	June 1, 1981	24,088,000	
Series Q	2⅞	Dec. 1, 1980	66,034,000	1,400,000
Series R	3⅛	June 1, 1982	69,113,000	22,000
Series S	3	June 1, 1983	73,174,000	1,600,000
Series T	2⅞	June 1, 1976	77,225,000	250,000
Series U	3⅜	Dec. 1, 1985	46,211,000	
Series W	3⅛	Dec. 1, 1984	55,742,000	
Series X	3⅛	June 1, 1984	60,887,000	
Series Y	3⅜	Dec. 1, 1987	44,200,000	60,000
Series Z	3⅜	Dec. 1, 1988	21,670,000	
TOTAL			$826,459,000	$3,707,000
CLASSIFICATION IN BALANCE SHEET OF MORTGAGE BONDS:				
SHOWN UNDER CURRENT LIABILITIES—Current sinking-fund requirements (See Note 4 to the financial statements)			$ 4,594,660	
SHOWN AS MORTGAGE BONDS			821,864,340	
TOTAL			$826,459,000	

NOTE: Additional amounts may be issued under the terms of the indentures relating to these bonds. In January 1957 the Company sold $35,000,000 face amount of first and refunding mortgage bonds.

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NOTE 1—Financial Statements; Subsidiary Companies:

In this report the financial statements presented relate to the Company only, by reason of the fact that the net assets and earnings of the subsidiaries are relatively insignificant. As of December 31, 1956 and 1955 the Company's investment in subsidiaries ($14,865,747 and $15,953,928 at the respective dates) exceeded its equities in the net assets of the subsidiaries by $12,289,047 and $13,065,035 respectively. The excess represents principally the investment in Natural Gas Corporation of California as to which it is believed, based on engineering estimates, that the earnings of this subsidiary will be adequate to amortize the Company's investment over the life of the gas reserve.

NOTE 2—Utility Plant:

The major portion of the Company's utility plant consists of plant constructed by the Company and is recorded in the accounts at cost to the Company (such cost includes interest and taxes during construction, direct engineering and supervision expenses, and proportions of administrative and general expenses determined by the Company to be applicable to construction). The remainder of its utility plant, consisting of acquisitions of operating units or systems, is recorded at "original cost" (defined as cost to the person first devoting the property to public service) except an amount of $15,544,051 charged to utility plant acquisition adjustments, representing the excess of cost to the Company over "original cost," which from January 1, 1950 through December 31, 1955 was being amortized out of earnings over the fifteen-year period commenced January 1, 1950. See Note 5 regarding change in 1956 in the method of disposition of the unamortized balances of plant acquisition adjustments.

NOTE 3—Depreciation:

The principal accruals to the reserves are computed on the sinking-fund method. Effective January 1, 1956, the Public Utilities Commission of the State of California authorized the Company to change the rate of interest on its depreciation reserve balance from 4% to 2%, and to change lives and annuities as determined to be appropriate with respect to the Company's depreciable properties. The revised provision for the year 1956 is not appreciably different from what it would have been under the former rates. In the opinion of Company engineers, application of the authorized interest and annuity rates to their respective bases will adequately provide for recovering the remaining cost of depreciable assets over their estimated remaining lives.

NOTE 4—Mortgage Bonds:

Under the terms of the first and refunding mortgage, the Company is required to make semi-annual sinking-fund payments based upon the aggregate bonded indebtedness outstanding; such sinking-fund payments due during the year ending December 31, 1957 are shown among the current liabilities net of the treasury bonds held by the Company at December 31, 1956.

In general, bond discount and expense, redemption premiums on refunded issues, and sale premiums are being written off over the lives of the various issues to which they pertain, or refunding issues, and such items applicable to bonds reacquired other than through refunding operations are cleared to earned surplus at time of reacquisition.

All fixed properties and certain personal property of the Company are subject to the lien of the mortgage bonds. The capital stocks of subsidiaries are on deposit and pledged with the California trustee of the first and refunding mortgage.

NOTE 5—Federal Income and other Taxes:

The cost of plant construction completed under Certificates of Necessity is being amortized on a five-year basis for income tax purposes whereas for general accounting purposes such cost is being depreciated at normal rates. Because the benefits produced by the deferral of taxes are temporary, the Company has offset the effect on income by recording in its accounts provisions for deferred income taxes and an earned surplus account restricted for income taxes payable following the period of accelerated amortization.

The Company has elected to use accelerated depreciation, as permitted by the Internal Revenue Code of 1954, in determining its taxable net income for the years

1954 and 1955. Through exercise of this election, the Company's federal income tax liability for the years 1954 and 1955 was less than it would otherwise have been by $731,700 and $2,488,200 respectively. Pending action by the Public Utilities Commission of the State of California on an application filed for an accounting order authorizing the Company to normalize taxes in its accounts by charging expense with a provision for deferred income taxes and concurrently crediting restricted surplus, the credit applicable to the years 1954 and 1955 is being carried in the "Accrued Taxes" account in the balance sheet.

Effective January 1, 1956, the Company was authorized by the Public Utilities Commission of the State of California to change its method of charging income for ad valorem taxes from a calendar to a fiscal year basis. On the revised basis ad valorem tax expense in the amount of $25,123,091, applying to the year 1957, is included in the prepaid tax account in the balance sheet as of December 31, 1956. The related credit arising because of the change in method has been applied to write off the unamortized balance of Plant Acquisition Adjustments accounts and other items aggregating about $10,400,000, leaving a deferred credit of about $11,600,000 which is being amortized as a credit to ad valorem tax expense over a ten-year period. The effect of the above is to reduce charges to income by about $2,200,000 annually. Also, the Company anticipates that tax expense will be less than it would otherwise have been because of the deferment of one-half of any ad valorem tax increases which may occur from year to year.

NOTE 6—Commitments and Contingent Liabilities:

At December 31, 1956 the Company had firm commitments in the aggregate amount of about $110,005,000 in connection with its plant construction program.

The Company closes its accounts promptly as of the end of each month, with the result that there are always unrecorded items of expense from month to month and year to year; at December 31, 1956 the unrecorded liabilities and accruals for expenses were more than offset by the unrecorded and unbilled revenues accrued at that date.

The Company, its wholly-owned subsidiary, Natural Gas Corporation, and various producers of gas at the Rio Vista gas field have been named as defendants in three lawsuits arising from the production and sale of gas from the Rio Vista field. In two of these suits, in which damages totaling $39,500,000 are sought, it is charged that the producers at the Rio Vista field have wrongfully sold to this Company gas belonging to the plaintiffs. In the third suit, in which damages of $150,000,000 are sought, it is alleged that activities of the several defendants in connection with the Company's purchase of gas at the Rio Vista field violate the California anti-trust laws. In the opinion of counsel for the Company, none of these suits is meritorious.

Except as to the above mentioned litigation and certain other litigation which is considered routine to the Company's operations and certain indemnities given in the normal course of business, there are no known contingent liabilities not provided for by reserves or insurance.

Departmental Organization

DEPARTMENT OF ELECTRIC OPERATION

I. W. Collins, *Assistant to Vice-President in Charge of Electric Operations*

General Superintendents: J. H. Martin, *Power Control;* V. F. Estcourt, *Steam Generation;* J. N. Spaulding, *Water Systems;* W. H. Herbeck, *Hydro Generation;* H. T. Sutcliffe, *Substations;* T. B. Copeland,* *Transmission and Distribution;* R. L. Brinton, *Communications;* Earl Whiteley, *System Protection*

DEPARTMENT OF GAS OPERATION

General Superintendents: R. D. Smith, *Transmission and Distribution;* M. A. Richford, *Production and Utilization;* R. T. Peterson, *Gas Control;* K. B. Anderson, *Technical Services;* E. H. Fisher, *Pipe Line Operations*

DEPARTMENT OF GENERAL CONSTRUCTION

H. W. Haberkorn, *Manager of Hydroelectric Construction*
Charles H. Sedam, *Manager of Station Construction*
H. D. Wright, *Manager of Line Construction*
J. A. Love, *Manager of Gas Construction*
George C. Grubb, *Superintendent of Office and Service Group Construction*

DEPARTMENT OF EXECUTIVE ENGINEER

Emil J. Lage, *Manager Valuation Department*
B. K. Dunshee,* *Manager Land Department*
Rudolph Jenny, *Manager Rate Department*

ACCOUNTING AND TAX DEPARTMENTS

R. N. Dreiman, *Assistant Comptroller*
T. R. Salm, *General Auditor*
Harry McGann, *Auditor of Division Accounts*
D. J. Beaudet, *Auditor of Plant Accounts*
Francis J. Carr, *Manager Tax Department*

DEPARTMENT OF ENGINEERING

C. C. Whelchel, *Chief Mechanical Engineer*
Carl W. Appleford, *Chief Civil Engineer*
W. R. Johnson, *Chief Electric Generation and Transmission Engineer*
C. E. Baugh, *Chief Electric Distribution Engineer*
E. V. Noe, *Chief of Bureau of Specifications and Estimates*
W. N. Lindblad,* *Chief of Bureau of Tests and Inspections*
John F. Bonner, *Assistant to Vice-President and Chief Engineer*

SALES AND COMMERCIAL DEPARTMENT

R. W. Joyce, *Manager Commercial Department*
J. H. Gumz, *Manager Commercial and Industrial Sales*
Walter D. Howell, *Manager Agricultural Sales*
J. S. C. Ross, *Manager Residential Sales*
R. I. Mendes, *Manager Market Research and Sales Control*

LAW DEPARTMENT

F. T. Searls, *General Attorney*
R. W. White, *Manager Claims and Safety Department*

CREDIT AND COLLECTION DEPARTMENT

F. U. Naylor, *Manager*

PERSONNEL DEPARTMENT

H. F. Carr, *Manager*

AUTOMOTIVE DEPARTMENT

C. R. Stanley, *Manager*

PURCHASING AND STORES DEPARTMENT

F. E. Baxter, *Manager*

ADVERTISING AND PUBLICITY DEPARTMENT

A. J. McCollum, *Manager*

Division Managers

COAST VALLEYS: T. E. Ward, Salinas
COLGATE: F. Y. Kraft, Marysville
DE SABLA: George L. Works, Chico
DRUM: R. A. Cayot, Auburn
EAST BAY: W. F. Pape, Oakland
HUMBOLDT: D. F. Villa, Eureka
NORTH BAY: E. S. Day, San Rafael
SACRAMENTO: R. L. Hayden, Sacramento
SAN FRANCISCO: H. A. Lee, San Francisco
SAN JOAQUIN: A. D. Church, Fresno
SAN JOSE: L. J. Brundige, San Jose
SHASTA: L. H. Smith, Red Bluff
STOCKTON: C. V. Wilbur,* Stockton

*Retired December 31, 1956

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