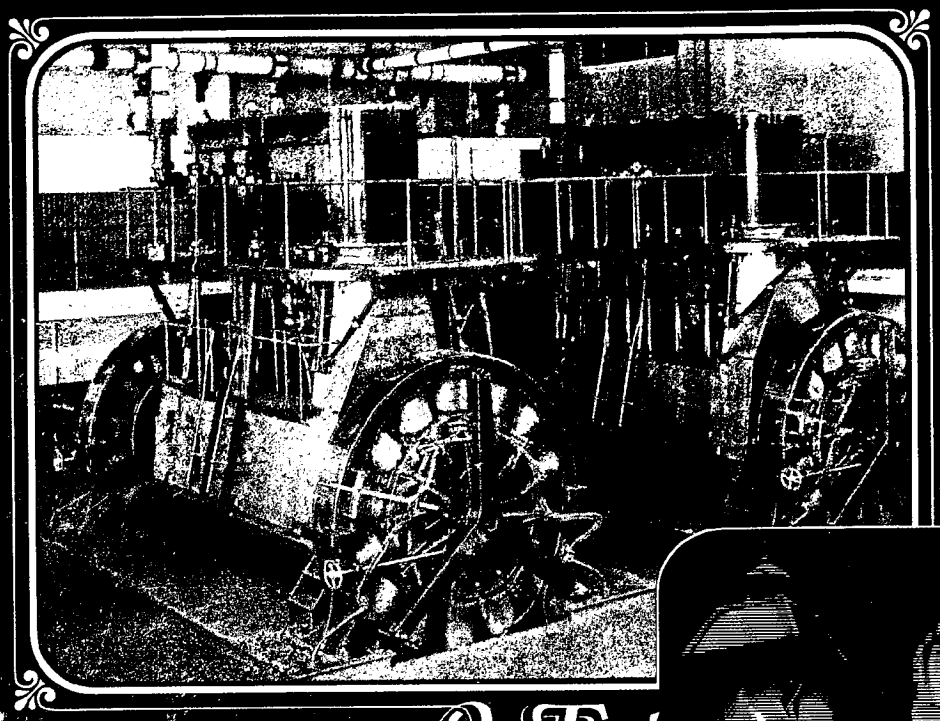
Pacific Gas and Electric Company
1977 Annual Report



Our First 125 Years

COVER

The dynamo room at the Jessie Street electric generating station in San Francisco, circa 1895, and a gas lamplighter symbolize the long history of electric and gas service in Northern and Central California.

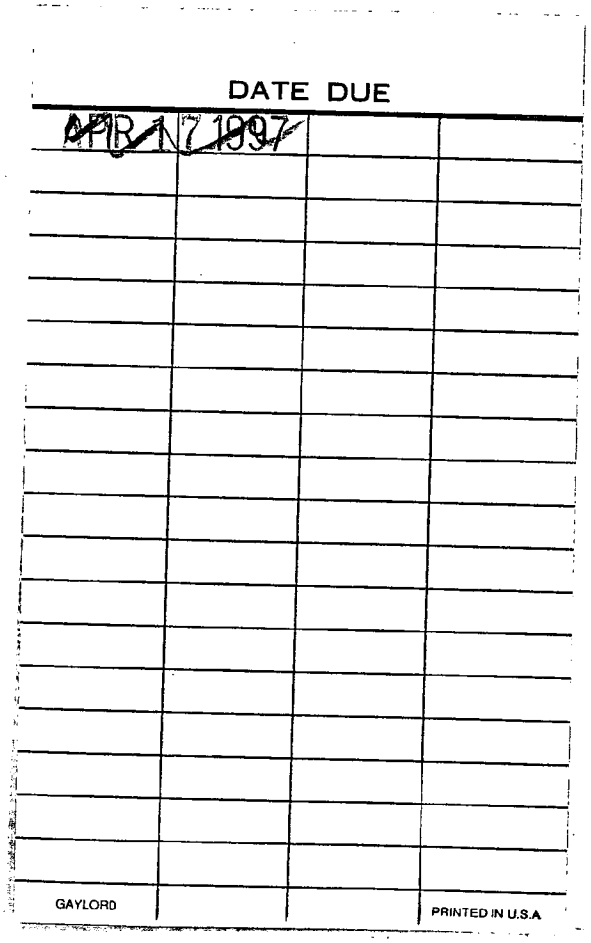
CORPORATE PROFILE

Pacific Gas and Electric Company is successor to a series of utility companies, the earliest of which was founded in 1852.

The Company is engaged principally in the generation and sale of electricity and the purchase and sale of natural gas.

The service territory includes 48 counties covering 94,000 square miles in Northern and Central California. Total population served is approximately 9 million. There are 3.2 million electric customers and 2.7 million gas customers.

To provide electric service the Company utilizes a variety of sources of energy—falling water, oil, natural gas, uranium, and natural steam.



STOCKHOLDERS' CALENDAR

Schedule of Dividend Payment Dates—1978

COMMON STOCK	PREFERRED STOCK
January 9	February 15
April 15	May 15
July 15	August 15
October 16	November 15

STOCK EXCHANGE LISTINGS

Common stock of the Company is listed on the New York and Pacific Stock Exchanges. Preferred stocks of the Company are listed on the American and Pacific Stock Exchanges.

ANNUAL MEETING

The Management will solicit proxies for the annual meeting to be held at the Masonic Auditorium, 1111 California Street, San Francisco, California, on Wednesday, April 19, 1978 at 2:00 p.m. In connection with such solicitation, it is expected that the proxy statement and form of proxy will be mailed to stockholders on or about March 17, 1978.

STOCK TRANSFER AGENT

Office of the Company
(W. Roby, Transfer Agent),
San Francisco

REGISTRAR OF STOCK

Wells Fargo Bank, N.A.,
San Francisco

EXECUTIVE OFFICE

Pacific Gas and Electric Company
77 Beale Street
San Francisco, California 94106

ANNUAL REPORT FOR 1977 ON FORM 10-K

A copy of the Company's report for 1977 filed with the Securities and Exchange Commission on Form 10-K will be provided to stockholders upon written request to the Corporate Secretary at the above address.

Highlights

	1977	1976	Increase (Decrease)
Operating Revenues	**$3,505,541,000**	$2,646,728,000	32 %
Net Income	**$ 356,298,000**	$ 301,984,000	18 %
Earnings Available for Common	**$ 282,395,000**	$ 238,299,000	19 %
Earnings Per Common Share	**$3.15**	$2.90	9 %
Declared Dividends Per Common Share	**$2.00**	$1.88	6 %
Total Assets	**$7,998,013,000**	$7,419,832,000	8 %
Capital Expenditures	**$ 690,324,000**	$ 599,278,000	15 %
Sales of Electricity to Customers (KWH)	**58,071,027,000**	56,559,826,000	3 %
Sales of Gas to Customers (MCF)	**557,899,000**	610,953,000	(9)%
Total Customers	**5,864,170**	5,708,567	3 %
Number of Stockholders	**358,913**	337,070	6 %
Number of Employees	**25,537**	24,583	4 %

CONTENTS

To Stockholders

During the year 1977 your Company realized a moderate improvement in earnings, and was able to avoid curtailments of electric service despite a tight energy situation aggravated by the severe two-year drought. Also, notwithstanding some setbacks and disappointments, progress was made toward achievement of the Company's long-range program to augment gas and electric energy supplies.

Earnings per share of common stock increased 25 cents, or 8.6%, to $3.15. This represents a 10.6% return on common shareholders' investment and compares favorably with the 9.6% and 10.1% returns recorded in 1975 and 1976 respectively. This improvement in earnings is the result of a number of constructive rate decisions by the California Public Utilities Commission, and justifies continued optimism for the future. Under the circumstances, the Board of Directors concluded that a higher common stock dividend would be appropriate, and recently increased the annual rate from $2.00 to $2.16 effective with the April 1978 payment.

Among the most significant determinations by the CPUC during the year were the establishment of a standardized timetable to render decisions on utility general rate cases within one year of the filing of an application, the granting of a $71 million partial electric rate increase effective January 1, 1978 on the Company's 1978 test year general rate request, the authorization of a procedure to adjust rates periodically to provide funds for energy exploration and development activities, and several authorizations to substantially increase rates to recover drought-related increased costs of electric energy and the continuing increases in the cost of natural gas.

Unfortunately, certain important elements of our electric resources program to achieve similar progress in providing adequate energy margins for the benefit of our customers have been delayed by various Federal and State regulatory bodies. Notwithstanding the well-publicized drought conditions in California during 1977, the Company managed to meet its peak electric demand and satisfy its customers' energy requirements. This was accomplished only as a result of (1) the ingenuity and dedication of Company personnel in operating generating facilities at record capacity factors, (2) the cooperation of neighboring utilities in providing power when required, and (3) conservation efforts by our customers.

The tight energy situation during the summer of 1977 could have been avoided had the Company received authorization from the Nuclear Regulatory Commission to operate its completed Unit 1 of the Diablo Canyon Nuclear Plant. Unit 2 is now virtually completed, and the combined units will increase the Company's generating capability by more than 2 million kilowatts and obviate the need for burning the equivalent of more than 20 million barrels of fuel oil per year. Even with above normal precipitation during the 1977-78 winter season, reserve margins without Unit 1 will be below the level deemed adequate for reliable service this summer.

At this time, it appears that the schedule for obtaining a decision on an operating license could permit operation of Unit 1 in the fall of 1978 and Unit 2 in the spring of 1979. The current proceedings are examining the health and safety effects of operation of the units, including issues relating to seismic conditions at the site. The Company believes that because of the conservative seismic criteria incorporated into the plant's design it is adequate to withstand the severe seismic conditions that have been postulated by the NRC. However, to avoid additional delay in the granting of a full-term operating license,

the Company is modifying the plant to strengthen it further. The modifications will be completed this summer.

Regarding our plans for future electric energy supplies, we are dismayed by decisions rendered by the State Energy Commission evincing a clear anti-nuclear bias. Alternative resource programs that may be preferred by the Commission will not provide the degree of energy reliability and cost effectiveness inherent in a well-balanced resources program that includes base load nuclear generating units.

Between now and 1990, more than 10 million kilowatts of new electric generating facilities will be needed in Northern and Central California to meet the growing demand for electricity, to provide reliable and dependable service, and to replace aging, well-used, less efficient units.

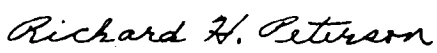
We believe we can accomplish our future resource plan provided that: (1) the Federal-State energy policy conflicts regarding use of oil, gas, coal and nuclear fuels are resolved promptly; (2) the principal regulatory agencies, and particularly the State Energy Commission, recognize that we are beginning to run out of time, and speed up their procedures accordingly; and (3) the Governor, the Legislature and the public at large understand the need for, and insist upon, the expedited authorizations required to bring these essential new energy supplies in on time.

With respect to natural gas service, we view the mid-1980's as the critical period for the delivery of new supplies. The best prospective long-term supplies are in fields located at great distances: Prudhoe Bay gas from the North Slope of Alaska; Mexican gas from the Reforma fields in southeastern Mexico; liquefied natural gas from Indonesia, the Cook Inlet of Alaska, Algeria, and possibly Australia; and gas from marginal wells in the tight formation of the Rocky Mountains. All of these gas supplies will incur high transportation costs, and hence will be expensive by current price standards.

Our program to augment gas supplies made good progress during 1977. Federal approval was received for the pipeline project to deliver gas from Prudhoe Bay to the lower 48 states; the Department of Energy authorized the importation of liquefied natural gas (LNG) from Indonesia to California; the State of California enacted special legislation to expedite the siting for an LNG terminal facility; and increases in customer rates were authorized to fund an expanded gas exploration and development program.

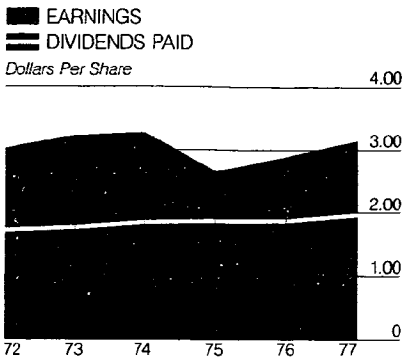
The past year marked the 125th anniversary of the beginning of gas service in Northern and Central California and next year will see the 100th anniversary of the first electric service. A special section of this report on pages 29 to 35 briefly highlights the achievements of the Company and its predecessors during this period.

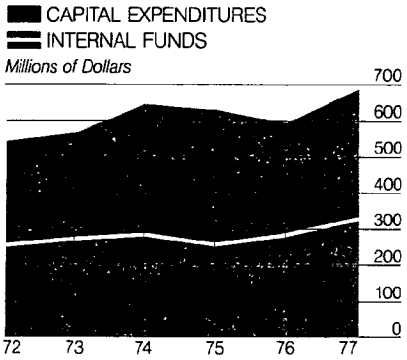
President and
Chief Executive Officer

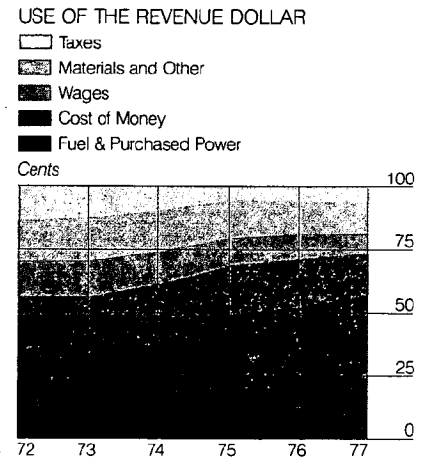


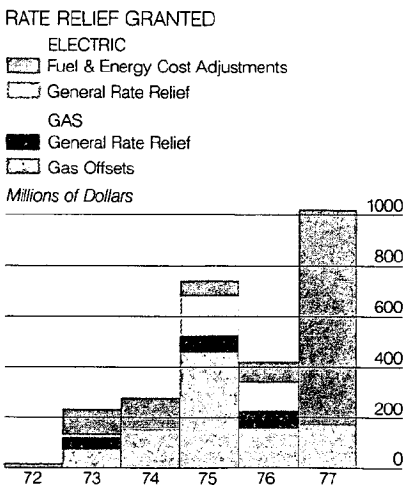
Chairman of the
Board of Directors

For the Board of Directors,
February 27, 1978









Financial and Rates

During 1977 the Company recorded an $859 million increase, or 32%, in operating revenues. As a result, most financial parameters showed significant improvement over the last two years. Additional information about the Company's financial performance is contained in Management's Discussion and Analysis of the Summary of Operations commencing on page 12.

The increased revenues resulted from rate adjustments obtained primarily to offset higher energy costs. Most of the electric rate adjustments were obtained pursuant to the Energy Cost Adjustment Clause (ECAC), which permits recovery of the costs of fuels used for electric generation and purchases of electricity from other producers.

Successive ECAC increases in January, April and July produced additional revenues, respectively, of $144 million semiannually, $63 million quarterly, and $77 million quarterly. However, during the first half of the year the increase in electric energy costs, attributable primarily to the second year of drought, exceeded the increase in operating revenues resulting from advances in customer rates. The unrecovered portion of such costs reached a peak of $375 million in July, but the July ECAC increase reduced this balance to $285 million by the end of the year.

The cost of gas purchased rose several times during the year. The aggregate of such increases amounted to approximately $200 million annually. These increases were accumulated in a gas cost balancing account, which is analogous to the ECAC account. As with the ECAC account, the balance in the account, plus 7% interest, is recovered by semiannual adjustments in customer rates.

To recover increases in nonenergy costs and to improve its rate of return, the Company on May 5 requested general increases in electric and gas rates amounting to $161 million and $131 million, respectively. These increases were intended to produce for the test year 1978 a 10.3% rate of return on rate base and a 15% rate of return on equity. Subsequent to the request, the CPUC adopted procedures designed to reduce regulatory lag. The twelve-month rate case processing period contemplated by these procedures should lead to a final decision on the Company's applications in mid-1978.

Since the decision is expected so late in the test year, the Company requested and the CPUC granted, effective January 1, 1978, a partial electric rate increase of $71 million. The increase was matched by an equivalent decrease in ECAC rates, which kept electric rates to customers stable. This procedure, known as the Rate Stabilization Plan, is possible because the ECAC rate is now at a level which not only covers current energy costs, but is also reducing the balance of unrecovered past costs. Although the January 1, 1978 decision will result in the recovery of such costs being spread over a longer period of time, interest on the unpaid balance is also being recovered.

The CPUC's adoption of such procedures as the ECAC, the gas cost balancing account, the plan to reduce regulatory lag, partial rate relief, and the Rate Stabilization Plan shows its willingness to address the various economic and regulatory

problems presented during the past few years. This improving regulatory situation contributed significantly to the financial results for 1977.

Capital expenditures during 1977 reached an all-time peak of $690 million, of which approximately 48% was generated internally. The balance of the funds necessary for this construction program and other capital requirements was obtained through three security offerings. In March, $106 million was raised through the sale of preferred stock at a cost to the Company of 8.73%. In April, the Company sold $200 million of 32-year bonds at an effective annual cost of 8.55%. In November, 7.5 million shares of new common stock were offered to the public, resulting in net proceeds to the Company of $172 million.

Participation in the Dividend Reinvestment Plan continues high. More than 9% of our shareholders now participate in this Plan, which raised a record $12 million in new common equity funds in 1977. In addition, $42 million of new common stock was issued to the Employees Savings Fund Plan during the year. These sales helped increase the common equity ratio to 40.2% of capitalization by year end, which will provide additional financial strength and flexibility for the future. Mortgage bonds comprised 45.9% of the Company's $7.0 billion total capitalization and preferred stock accounted for the remaining 13.9%. The total equity was owned by more than 220,000 common shareholders and 130,000 preferred shareholders at year-end 1977.

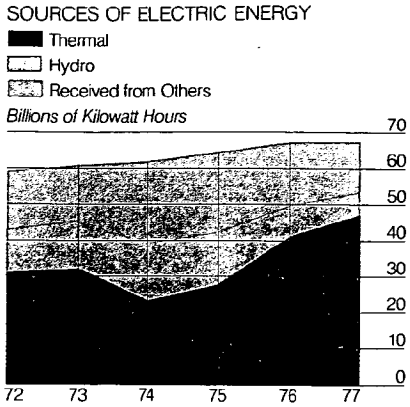
Electric

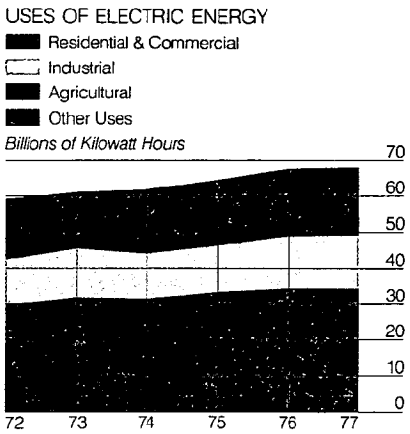
The drought which California experienced in 1976 and 1977 created a tight energy supply situation this past summer.

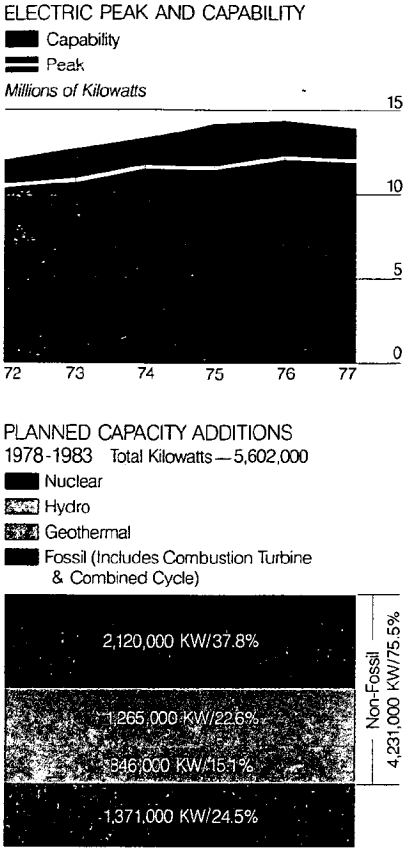
Company hydroelectric generation, which normally accounts for about 20% of total energy produced, was lower in 1977 than in 1976, itself a record dry year, and provided only 9% of the total system output. The Company burned 35 million barrels of low-sulfur fuel oil in its thermal generating plants, compared to 27 million barrels in 1976 and only 11 million barrels in 1975.

On August 1 the year's peak demand of 12,191,800 kilowatts was recorded. At that time, the system's net capability totaled 13,947,800 kilowatts, providing a reserve margin of 14% at peak usage. The margin was kept from declining further only as a result of rescheduling maintenance on steam-electric plants, limiting use of available hydroelectric plants to peaking conditions and purchasing power from other regions. Fortunately, as a result of both weather conditions and energy conservation by customers, the peak demand was less than had been forecast and represented a decline of one-half of 1% from the previous year's peak.

Electric energy sales for the year increased only 3% to 58 billion kilowatt-hours. This relatively small increase reflects primarily the effects of







energy conservation, which the Company is encouraging.

Despite the excellent efforts of our customers to conserve energy, electric sales are expected to increase at an average annual rate of approximately 4% because of continuing population growth in our service territory and expanding energy requirements of commercial and industrial enterprises.

To meet these energy requirements major additions to generating capacity will be needed. In making these additions, the Company plans to emphasize geothermal, coal and nuclear generation to reduce its dependence on oil and gas. With the addition of coal the Company will maintain its position of using more different types of electric generation technologies than any other utility in the country.

Operation of the Company's Diablo Canyon Nuclear Plant awaits approval of the Company's application for an operating license. The first of the two 1,060,000-kilowatt units in San Luis Obispo County is nearly ready to operate. Unfortunately, licensing of this unit has been slowed critically by the regulatory process. When both units are placed in operation at full capacity, they will increase the Company's generating capability by 19% and will displace the need for more than 20 million barrels of oil a year.

During 1977 the Company filed Notices of Intention (NOI), as provided by law, with the State Energy Commission for major nuclear and coal-electric generation projects to be developed in the 1980's. The filing for the nuclear project was rejected by the Commission ostensibly for insufficient data. The Company is challenging this rejection in court. The two-unit nuclear project will provide additional generating capacity of approximately 2,400,000 kilowatts. Action is awaited on the coal project NOI which was filed at year end. The coal-fired plant will consist of two 800,000-kilowatt generating units and will have stack gas scrubbers and other environmental controls.

The Company also asked for governmental approval to build The Geysers Units 16 and 17 for completion in 1981. Each unit will harness dry steam from deep within the earth to generate 110,000 kilowatts. Upon completion of these units and four other units presently under construction, The Geysers' capacity will be 1,128,000 kilowatts, or about 7.5 percent of the Company's total generating capability.

In November the California Public Utilities Commission authorized a procedure to provide funding for exploration and development of energy supplies for electric generation, including oil, coal, uranium and geothermal. The amount that can be included in rates to cover current expenses and carrying charges on capital expenditures can be as high as $50 million annually, and will support an exploration and development program of several times this amount.

Gas

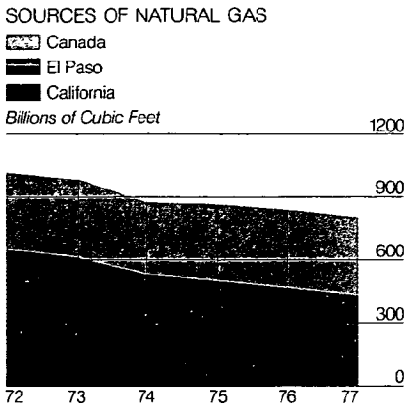
During 1977 the Company purchased approximately 801 billion cubic feet of natural gas. Approximately 47% of the total supply was Canadian gas purchased from Pacific Gas Transmission Company; approximately 37% was out-of-state gas purchased from El Paso Natural Gas Company; and 16% was purchased from various California producers.

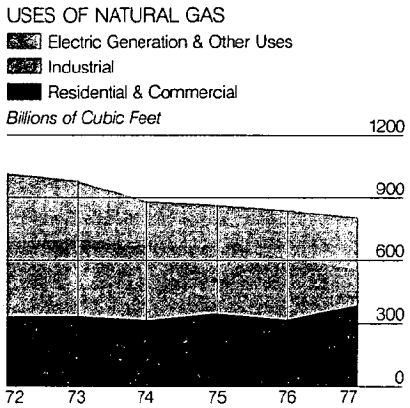
Although the total volume of gas purchased during the year was approximately 4% less than the previous year, high-priority residential and commercial customers continued to receive service as usual, and the Company was forced to curtail gas service to low-priority industrial customers for only 17 days during the 1976-77 winter. The main effect of the reduced gas availability was that gas supply to the boilers for the Company's Electric Department was completely or partially curtailed for most of the 1976-77 winter season. Service for most of the Company's gas customers' needs was accomplished despite continuing curtailments of contracted deliveries from El Paso Natural Gas Company ordered by the Federal government. California gas supply declined again because new gas discoveries in the State have been insufficient in the past several years to offset the declining deliverability of existing wells. Although the decline in these gas supplies is expected to continue, current supplies of gas are adequate to meet the needs of residential customers until the middle 1980's. To assure long-term gas supplies for our residential customers and provide adequate gas for commercial and industrial use, the Company continued an active program to acquire new gas supplies.

During 1977 the Northwest Alaskan Pipeline Company project (formerly known as the Alcan Project) won approval to move Arctic gas to Canada and the U.S. PGandE and its affiliates are designated to construct and operate the western leg of this project to bring Prudhoe Bay gas to the West Coast market. The Company also expects to participate financially in the construction of the Alaskan portion of the Northwest Alaskan Pipeline Company project.

The Company continued its participation with Southern California Gas Company in a joint venture to bring liquefied natural gas (LNG) to California by ship from Indonesia and South Alaska. The addition of these LNG supplies would provide about 470 million cubic feet of gas per day to PGandE, and would represent almost 20% of our total gas supplies in the early 1980's. On December 30 the Department of Energy issued an order approving the importation of LNG from Indonesia for 20 years subject to certain conditions. An application has been filed with the CPUC to construct and operate a terminal to receive this gas near Point Conception. Under California law, a decision on this application is required of the CPUC by July 31, 1978. The Company is also investigating possible supplies of LNG from other sources around the Pacific Basin.

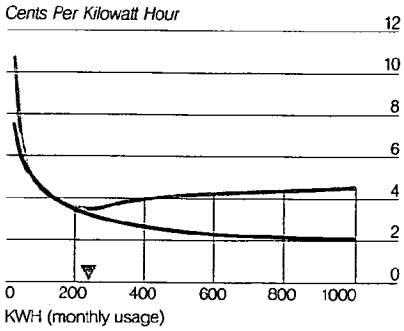
Through two of its subsidiaries, Natural Gas Corporation of California and Pacific Gas Transmission Company, PGandE has conducted natural gas exploration in the Rocky Mountains since 1971. As a result of these efforts, a small new supply of gas began flowing to PGandE customers in





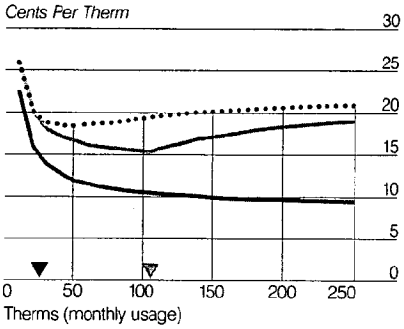
RESIDENTIAL ELECTRIC RATES

— As of December 31, 1977
— As of December 31, 1973
▽ Life Line



RESIDENTIAL GAS RATES

•••• As of December 31, 1977 for Summer (May-Oct.)
— As of December 31, 1977 for Winter (Nov.-Apr.)
— As of December 31, 1973
▼ Life Line—Summer
▽ Life Line—Winter



late 1977. The Company continues to assess the future deliverability of gas from other Rocky Mountain discoveries and is currently planning an expansion of its exploration program in this area.

Important new gas and oil reservoirs have been discovered in the Republic of Mexico. Mexico has expressed a willingness to export gas to this country for at least six years beginning in 1978 if an agreement can be reached on price. Though only modest amounts will be exported in the beginning, eventually the volume could increase to two billion cubic feet per day. El Paso Natural Gas Company will receive 15% of this Mexican gas, and the Company will share in this volume under its contract with El Paso.

In November the CPUC authorized a Gas Exploration and Development Adjustment in the Company's rates. The annual amount that can be included in rates to cover current expenses and carrying charges on capital expenditures can be as high as $50 million, and will support an exploration and development program of several times this amount. This program will facilitate a stepped-up exploration and development program by the Company both in the Rocky Mountains and in other areas of the United States with significant gas potential.

The Company continues its involvement in a number of pilot projects to obtain methane from municipal, animal and agricultural wastes and supports studies on other alternative sources of gas.

Conservation

During 1977, environmental concerns, scarce and expensive fossil fuels, increased costs, greater lead times required for constructing new facilities and the drought all contributed to an increasing emphasis on energy conservation by the Company and its customers.

The California Public Utilities Commission and the State Energy Commission also are vitally interested in successful conservation programs. To provide an incentive for conservation, the CPUC has ordered a restructuring of residential gas and electric rates so that customers pay higher rates as their usage increases.

Conservation stretches existing energy resources and delays the need to develop costly new resources. For example, because of reduced electric demand, we have revised downward our 1973 electric energy growth rate estimate of 6.5 percent to approximately 4 percent today. This lower estimate of growth has reduced by 3,200,000 kilowatts our plans for new generating capacity during the next five years, reducing capital requirements by nearly $2 billion.

More than $11 million was spent by PGandE in 1977 for programs to assist customers with reducing and changing the time of their energy usage, as well as for a variety of conservation research and development projects and load management studies.

We are pleased with the results of these programs. More than 115,000 customers insulated their home ceilings in 1977, reducing their use of

energy for heating by about 25% or $50 per year on an average bill. More than a billion kilowatt-hours and a half billion therms of gas will be saved as a consequence of 1977 programs on a life cycle basis. This is enough electricity to serve approximately 16,000 typical electric residential customers for ten years, and enough gas to serve 53,000 typical residential gas customers for the same period.

We plan to expand greatly our conservation efforts during 1978. The programs will include Company-funded home insulation loans, increased technical analysis of large customers' energy use, rate research programs, and additional investment in solar research and development. Implementation of these programs will assist the Company in meeting both the short-term and long-term energy requirements of our customers.

Regulation

The Company is subject to regulation by four principal agencies:

The California Public Utilities Commission has broad regulatory jurisdiction, including the authority to establish rates for retail service, to regulate security issues and to prescribe rates of depreciation and uniform systems of accounts.

The Federal Energy Regulatory Commission (FERC), successor to the Federal Power Commission, has authority to regulate rates for interstate transmission and sales of electricity for resale, and to regulate the acquisition and disposition of certain property, licensing of hydroelectric projects and accounting. Pursuant to the Natural Gas Act, the FERC also exercises jurisdiction over the operations of the Company's domestic subsidiaries involved in the supply and transmission of natural gas in interstate commerce.

The California Energy Resources Conservation and Development Commission has responsibility for forecasting electric energy requirements. In addition, it has the authority to approve sites and facilities for thermal-electric power generation in California.

The Federal Nuclear Regulatory Commission has jurisdiction over the construction and operation of the Company's nuclear generating plants.

Personnel

Total employment for the Company was 25,537 employees at the end of 1977. This is an increase of 954 employees since the beginning of the year. The increase was necessary to meet expanding governmental requirements and the needs of the increasing population in our service area.

Approximately 70% of the Company's employees were represented by the International Brotherhood of Electrical Workers (AFL-CIO), and 8% by the Engineers and Scientists of California. During 1977 the Company reached agreement with both unions on contracts establishing wages and working conditions for a three-year period ending December 31, 1979. The wage increases provided were 7.25% effective January 1, 1977; 7% effective

January 1, 1978; and 6.75% effective January 1, 1979. The 1979 increase may be renegotiated if the Consumer Price Index exceeds a specified point by October 1978. Agreements of varying lengths were reached with both unions with respect to retirement and insurance plans.

As a result of the Company's Affirmative Action efforts, minority employee representation increased to 23% of the total payroll. This slightly exceeds the percentage of minorities among the working age population within the PGandE service area. In addition, women and minority employees continue their upward mobility into supervisory and management positions through established avenues of promotion. Over 16% of such positions are filled by these employees.

The Company has a stable work force. Over one-quarter of all our employees have achieved twenty or more years of service with the Company. 477 of our employees retired during the year, bringing the total number of pensioners to 4,996.

PGandE encourages its employees to take an active role in their communities. Many of our employees serve on the governing bodies or staffs of various school boards, public commissions, civic and charitable organizations.

Executive Changes

During the past year there were a number of changes in the membership of the Board of Directors.

Robert H. Gerdes resigned as a Director and Chairman of the Board's Executive Committee. Mr. Gerdes served as a Director for 24 years and as Chairman of the Executive Committee for the last eight years. He had served previously as President and Chairman of the Board and Chief Executive Officer of the Company.

Also resigning from the Board were C. Raymond Dahl, President and Chief Executive Officer, Crown Zellerbach Corporation, and Walter A. Haas, Honorary Chairman of the Board, Levi Strauss & Company. Mr. Dahl had served as a Director since 1972. Mr. Haas served as a Director of PGandE for 29 years.

New members elected to the Board in 1977 include Richard B. Madden, Chairman of the Board and Chief Executive Officer, Potlatch Corporation; Myron Du Bain, Chairman, President and Chief Executive Officer, Fireman's Fund Insurance Companies; John Lyons Sullivan, Yuba City rancher and Chairman of the Board of Directors of California Canners and Growers; and Mervin G. Morris, Chairman of the Board and Chief Executive Officer, Mervyn's department stores.

In December three Senior Vice Presidents, Barton W. Shackelford, Stanley T. Skinner and John A. Sproul, were appointed Executive Vice Presidents. Mr. Shackelford was elected a Director. Mr. Robert W. Brooks, formerly President of Pacific Gas Transmission Company, was elected Vice President-Gas Supply.

Summary of Operations

Pacific Gas and Electric Company / For the Five Years Ended December 31, 1977

	Thousands				
	1977	1976	1975	1974	1973
OPERATING REVENUES:					
Electric	**$2,345,144**	$1,571,842	$1,293,551	$1,104,715	$ 947,500
Gas	**1,160,397**	1,074,886	939,820	622,040	542,656
TOTAL	**3,505,541**	2,646,728	2,233,371	1,726,755	1,490,156
OPERATING EXPENSES:					
Operation	**2,506,654**	1,787,844	1,474,201	961,682	744,109
Maintenance	**110,407**	96,277	90,853	90,631	77,083
Depreciation	**209,227**	199,491	178,978	166,605	158,329
Taxes on Income	**76,564**	16,579	13,783	54,203	72,559
Property and Other Taxes	**158,476**	142,667	128,303	123,025	120,556
TOTAL	**3,061,328**	2,242,858	1,886,118	1,396,146	1,172,636
OPERATING INCOME	**444,213**	403,870	347,253	330,609	317,520
OTHER INCOME AND INCOME DEDUCTIONS	**131,811**	102,766	89,336	84,236	59,156
INTEREST CHARGES	**219,726**	204,652	185,010	153,608	133,069
NET INCOME	**356,298**	301,984	251,579	261,237	243,607
PREFERRED DIVIDEND REQUIREMENTS	**73,903**	63,685	48,301	45,253	36,682
EARNINGS AVAILABLE FOR COMMON	**$ 282,395**	$ 238,299	$ 203,278	$ 215,984	$ 206,925
AVERAGE COMMON SHARES OUTSTANDING	**89,728**	82,138	76,265	66,146	64,140
EARNINGS PER COMMON SHARE	**$3.15**	$2.90	$2.67	$3.27	$3.23
DIVIDENDS DECLARED PER COMMON SHARE	**$2.00**	$1.88	$1.88	$1.88	$1.78

Quarterly Common Stock Prices and Declared Dividends

Pacific Gas and Electric Company / December 31, 1977 and 1976

	1977				1976			
	4th	**3rd**	**2nd**	**1st**	4th	3rd	2nd	1st
High	**$24¾**	**$25½**	**$24⅝**	**$24⅜**	$24⅛	$23¾	$21¾	$23⅛
Low	**23**	**23⅛**	**22⅞**	**22¼**	20¾	20⅛	20	20
Dividend	**50¢**	**50¢**	**50¢**	**50¢**	47¢	47¢	47¢	47¢

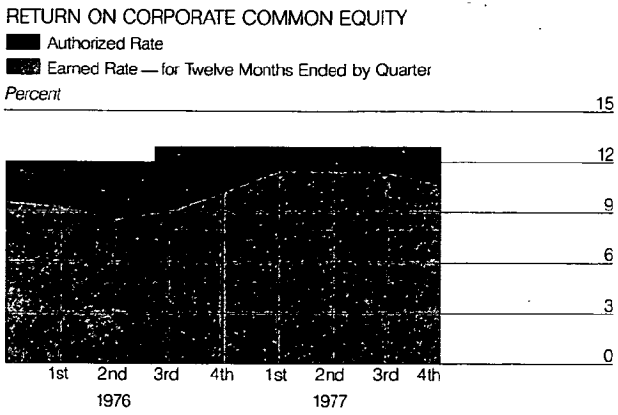
Lines of Business

Pacific Gas and Electric Company / For the Five Years Ended December 31, 1977

The approximate percentage of operating revenues and operating income, including the allocation of taxes on income, attributable to each principal line of business was as follows:

	Operating Revenues		Operating Income	
	Electric	Gas	Electric	Gas
1973	64%	36%	79%	21%
1974	64%	36%	83%	17%
1975	58%	42%	74%	26%
1976	59%	41%	75%	25%
1977	**67%**	**33%**	**77%**	**23%**

Management's Discussion and Analysis of the Summary of Operations



Summary

Although the Company's earned rate of return remained below the level of return found to be reasonable by the California Public Utilities Commission (CPUC), it improved in the latter part of 1976 and during 1977. This improvement was largely the result of the Energy Cost Adjustment Clause (ECAC), in effect since April 1976. This energy cost provision essentially assures satisfactory recovery of electric energy expenses.

The primary reasons the authorized rate of return was not earned in 1976 were (1) regulatory lag which delayed the granting of general rate relief until August of 1976, and (2) increased fuel costs incurred prior to approval of new ECAC rate provisions allowing recovery of fuel costs.

Increased expenses and reduced sales volumes prevented greater improvement of earnings in 1977. The Company requested additional general rate relief which resulted in an interim general rate increase of $71,000,000 annually on January 1, 1978. For additional information about pending rate increases, see the "Financial and Rates" section on page 4.

Operating Revenues

Operating revenues for 1977 amounted to $3 billion 506 million, an increase of $859 million or 32% over 1976. Electric revenues contributed about 67% of the total, and gas revenues 33%. The significant increase in operating revenues in recent years is due primarily to increases in both cost of energy adjustments and general rates. The following table sets forth the amounts by which the Company's electric and gas revenues during each of the last four years exceeded the revenues for the preceding years, together with the estimated increases and decreases attributable to the major factors. Additional information about the Company's 1977 rate increases can be found in the "Financial and Rates" section.

	Year Ended December 31,			
	1977	1976	1975	1974
	Millions of Dollars			
Electric Revenues:				
Rate Increases:				
Cost of Energy	**$630.7**	$ 52.3	$ 94.0	$153.6
General	**88.7**	146.8	34.4	2.3
Sales Volume and Other Changes	**53.9**	79.2	60.4	1.3
Net Increase	**$773.3**	$278.3	$188.8	$157.2
Gas Revenues:				
Rate Increases:				
Cost of Gas Purchased	**$138.6**	$166.9	$291.1	$ 99.2
General	**28.8**	49.7	13.4	1.7
Sales Volume and Other Changes	**(81.9)**	(81.5)	13.3	(21.5)
Net Increase	**$ 85.5**	$135.1	$317.8	$ 79.4

Operating Expenses

The cost of gas sold and the cost of producing electric energy have increased substantially in recent years, from 42% of operating expense in 1973 to 68% in 1977. Also, the higher price and limited availability of natural gas for use as boiler fuel and the drought-induced reduction in hydroelectric generation have required the Company to increase substantially its use of higher-cost low-sulfur oil in the generation of electric power. The combination of these factors has caused substantial increases in fuel cost. The following table shows fuel oil burned, power purchased, and natural gas delivered, together with the average prices of natural gas and fuel oil.

	Year Ended December 31,				
	1977	1976	1975	1974	1973
Fuel Oil Burned (Thousands of Barrels)	**35,928**	27,652	11,622	11,421	5,790
Average Cost per Barrel of Fuel Oil Burned	**$14.26**	$14.86	$14.90	$10.85	$4.99
Power Purchased (Thousands of Dollars)	**$235,528**	$147,455	$106,469	$66,904	$44,831
Power Purchased (Millions of KWH)	**9,792**	13,112	16,287	17,242	10,418
Natural Gas Delivered (Thousands of MCF)	**792,921**	832,202	860,178	833,127	981,073
Average Cost of Gas Delivered (Per MCF)	**$1.60**	$1.32	$.95	$.57	$.41

From April 1973 through March 1976 the Company's electric rates were adjustable on a quarterly basis, subject to the approval of the CPUC, to reflect changes in the costs and relative quantities of natural gas and fuel oil expected to be consumed in the Company's generating plants assuming, among other things, average weather conditions. The effect of this procedure was that actual weather conditions produced large variations in the Company's earnings. Increased purchase prices of gas sold did not materially affect Company earnings because the CPUC authorized changes in gas rates to customers that were approximately equal to the changes in cost of gas sold.

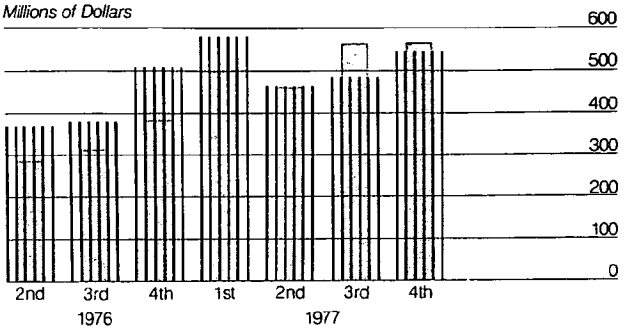
In accordance with the order of the CPUC authorizing an ECAC, the Company has, since April 1976, deferred in a balancing account the difference between the cost of its electric energy and the energy cost collected from its customers. Subsequently, the Company has been required to maintain similar accounts to record undercollections and overcollections of gas costs. The deferred amounts are amortized as periodic changes are made in customer rates.

Electric energy cost undercollections, primarily costs under ECAC, totaled $285 million at December 31, 1977. As a result of the drought-induced need to use greater quantities of fuel for electric generation and purchased energy during the early part of 1977, these balancing accounts peaked at approximately $375 million in July 1977. Gas energy cost overcollections totaled $11 million at December 31, 1977.

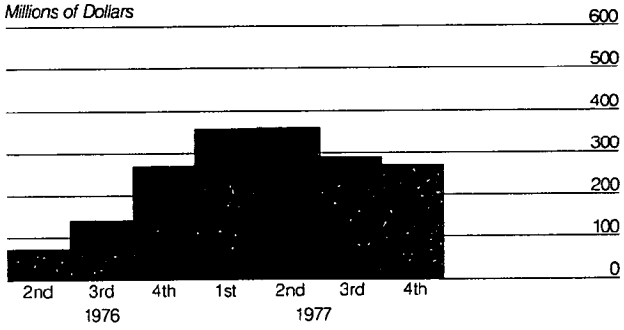
Deferred energy costs are deducted currently on federal and state income tax returns. For financial statement purposes such deferred costs are recognized in the computation of income tax accruals as the deferred costs are amortized. The effect of using energy cost balancing accounts is that changes in costs of electric energy and gas no longer affect the Company's earnings since energy costs are included in operating expenses only when they are offset by revenues. The first chart on the right shows the relationship between energy costs incurred and energy costs recovered through revenues. The second chart shows the cumulative amounts of such costs not recovered which have been deferred on the Balance Sheets.

Transmission and distribution expenses increased by $13,000,000 in 1976 over 1975. Of this increase, approximately $5,000,000 was due to the higher price of natural gas used in the compressor stations, and $7,000,000 represents increases in labor costs included in electric and gas distribution expenses.

COST OF ENERGY BY QUARTER
Electric and Gas Combined
▮▮▮▮ Actual Energy Cost
▭ Energy Cost Recovered by Revenues
Millions of Dollars



QUARTERLY ENERGY COST BALANCING ACCOUNTS
Electric and Gas Combined
Millions of Dollars



Other operations expense increased $35,000,000 in 1977 and $33,000,000 in 1976. Administrative and general expense contributed $29,000,000 and $14,000,000 to each of these increases, respectively, because of higher franchise fees resulting from higher revenues, higher cost of employee benefits, especially pension costs, and higher wage costs. Customer related expenses increased $8,000,000 in 1976. Oil storage cost increased $6,000,000 in 1976 for additional leased capacity.

A discussion of the factors that contributed to variations in income tax expense can be found in Note 3 of the Notes to Financial Statements.

Other Income and Income Deductions

The amount of allowance for funds used during construction (ADC) has increased in recent years primarily due to the construction of Units 1 and 2 of the Company's Diablo Canyon

nuclear generating plant. The amount of ADC recorded in 1977 which is estimated to be applicable to construction planned for completion in 1978, 1979 and 1980 is $53,000,000, $35,300,000 and $300,000, respectively. Substantially all of the ADC applicable to jobs planned for completion in 1978 and 1979 represents ADC for the two nuclear units at Diablo Canyon. In connection with the August 24, 1976 interim decision on the Company's general rate increase, the CPUC stated that current ratemaking procedures are not well suited to the timely inclusion in rate base of significant additions to plant. Accordingly, the CPUC proposes to consider the ratemaking treatment of the Diablo Canyon nuclear generating plant in conjunction with an energy cost adjustment proceeding in order to grant timely rate treatment.

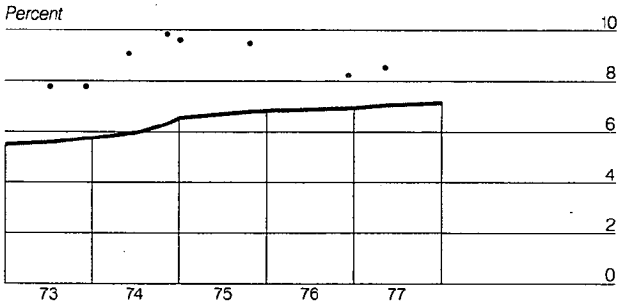
The gain on bonds purchased for the sinking fund declined in 1976 over 1975 for two reasons —first as a result of purchasing bonds on the open market which are closer to maturity, and secondly due to a change in the method of recognizing the gain. In September of 1976, the CPUC changed the method of recognition so that any gain realized would be amortized over the remaining life of the reacquired issues, with the amortized portion reflected as a reduction of interest expense.

The increase in other-net for 1977 and 1976 was principally due to increased interest income and higher earnings of subsidiaries. Since the latter part of 1976, the CPUC has allowed interest on the unbilled recoverable energy cost at the rate of 7% per annum. For 1976 this amounted to $2.5 million and increased to $24 million in 1977.

Interest Charges and Preferred Dividend Requirements

Interest charges increased approximately $15,000,000 in 1977 and $20,000,000 in 1976. Short-term debt interest expense increased approximately $8,000,000 in 1976 because of an increase in the average amount of such debt outstanding. The remainder of the increases in interest expense for 1977 and 1976 was principally the result of the issuance of new bonds. As the chart below depicts, the weighted average interest rate of the Company's long-term debt has continued to rise. There are two primary factors responsible for this: first, the issuance of bonds with interest rates higher than the weighted average interest rate; and second, the reacquisition of both bonds maturing and bonds required for sinking fund purposes whose interest rates were lower than the weighted average interest rate.

INDIVIDUAL BOND SALES AND WEIGHTED AVERAGE INTEREST COSTS



The increase in the preferred dividend requirements for 1977 and 1976 is the result of the issuance of additional preferred stock.

Revenues and Sales

Pacific Gas and Electric Company / For the Years Ended December 31, 1977 and 1976

	Thousands			
			Increase (Decrease)	
	1977	1976	Amount	Percent
ELECTRIC DEPARTMENT				
REVENUES:				
Residential	**$ 661,502**	$ 517,574	$ 143,928	27.8 %
Commercial	**789,401**	536,938	252,463	47.0
Industrial (1000 KW demand or over)	**498,462**	277,694	220,768	79.5
Agricultural Power	**212,649**	115,952	96,697	83.4
Public Street and Highway Lighting	**33,501**	24,537	8,964	36.5
Other Electric Utilities	**103,890**	61,664	42,226	68.5
Miscellaneous	**42,075**	33,727	8,348	24.8
Other	**3,664**	3,756	(92)	(2.4)
TOTAL	**$2,345,144**	$1,571,842	$ 773,302	49.2 %
SALES—KWH:				
Residential	**17,383,011**	17,147,610	235,401	1.4 %
Commercial	**16,771,232**	17,162,248	(391,016)	(2.3)
Industrial (1000 KW demand or over)	**14,354,359**	14,258,149	96,210	0.7
Agricultural Power	**5,113,726**	4,601,147	512,579	11.1
Public Street and Highway Lighting	**491,558**	465,387	26,171	5.6
Other Electric Utilities	**3,957,141**	2,925,285	1,031,856	35.3
Total Sales to Customers	**58,071,027**	56,559,826	1,511,201	2.7
Delivered for the Account of Others	**3,832,822**	4,492,231	(659,409)	(14.7)
TOTAL	**61,903,849**	61,052,057	851,792	1.4 %
GAS DEPARTMENT				
REVENUES:				
Residential	**$ 414,087**	$ 416,660	$ (2,573)	(0.6) %
Commercial	**365,623**	130,878	234,745	179.4
Industrial	**366,293**	502,942	(136,649)	(27.2)
Other Gas Utilities	**14,349**	13,492	857	6.4
Miscellaneous	**45**	10,914	(10,869)	(99.6)
TOTAL	**$1,160,397**	$1,074,886	$ 85,511	8.0 %
SALES—MCF:				
Residential	**223,732**	243,258	(19,526)	(8.0) %
Commercial	**163,828**	74,718	89,110	119.3
Industrial	**162,529**	284,261	(121,732)	(42.8)
Other Gas Utilities	**7,810**	8,716	(906)	(10.4)
Total Sales to Customers	**557,899**	610,953	(53,054)	(8.7)
Company Use (electric generation)	**217,272**	194,950	22,322	11.5
TOTAL	**775,171**	805,903	(30,732)	(3.8) %

Comparative Statistics

Pacific Gas and Electric Company / For the Eleven Years Ended December 31, 1977

	1977	1976	1975	1974
PER COMMON SHARE:				
Earnings	**$ 3.15**	$ 2.90	$ 2.67	$ 3.27
Dividends Declared	**$ 2.00**	$ 1.88	$ 1.88	$ 1.88
Dividend Payout Ratio	**63.5%**	64.8%	70.4%	57.5%
Book Value (end of year)	**$28.78**	$28.16	$27.71	$28.18
Market Price — High	**25½**	24⅛	23½	24⅞
Market Price — Low	**22¼**	20	18⅛	17
Market Price — Close	**24**	23⅛	20¾	20⅛
CAPITAL EXPENDITURES (Thousands):				
Electric Department	**$599,126**	$518,398	$540,790	$536,931
Gas Department	**91,198**	80,880	89,799	108,729
TOTAL	**$690,324**	$599,278	$630,589	$645,660
ELECTRIC STATISTICS:				
Net System Output (Millions of KWH)	**65,428**	66,416	63,402	60,932
Net System Output — Percent				
Hydroelectric Plants	**9.2%**	12.2%	22.6%	25.6%
Thermal Electric Plants	**72.4**	62.0	43.6	38.1
Other Producers	**18.4**	25.8	33.8	36.3
Total	**100.0%**	100.0%	100.0%	100.0%
System Capability — KW (at annual peak)				
Hydroelectric Plants (adverse conditions)	**2,350,900**	2,419,900	2,396,900	2,396,900
Thermal Electric Plants	**8,294,000**	8,261,000	8,053,000	7,947,000
Other Producers (adverse conditions)	**3,302,900**	3,743,400	3,766,100	2,948,700
Total	**13,947,800**	14,424,300	14,216,000	13,292,600
Net System Peak Demand — KW	**12,191,800**	12,245,800	11,632,800	11,648,800
Average Annual Residential Consumption — KWH	**6,408**	6,509	6,462	6,260
Total Customers (end of year)	**3,179,362**	3,087,300	3,005,518	2,936,106
Customers Per Mile of Distribution Line	**38.1**	37.7	37.2	36.9
GAS STATISTICS:				
Gas Purchased (Thousands of MCF)	**800,950**	836,333	861,860	876,537
Sources of Gas Purchased — Percent				
From California	**16.4%**	16.8%	16.2%	16.8%
From Other States	**37.0**	38.2	41.4	43.7
From Canada	**46.6**	45.0	42.4	39.5
Total	**100.0%**	100.0%	100.0%	100.0%
Average Cost of Gas Purchased — MCF				
From California	**112.1¢**	96.1¢	56.7¢	42.7¢
From Other States (at Calif.-Ariz. border)	**110.0**	83.0	72.7	55.8
From Canada (at Calif.-Ore. border)	**218.0**	192.1	136.8	65.4
Average	**160.7¢**	134.2¢	97.3¢	57.4¢
Peak Day Sendout — MCF	**3,186,229**	3,348,909	3,352,881	3,020,215
Average Annual Residential Consumption — MCF	**90.5**	100.8	111.1	104.5
Total Customers (end of year)	**2,674,890**	2,611,551	2,555,216	2,503,203
Customers Per Mile of Distribution Main	**97.2**	96.8	96.4	96.1

1973	1972	1971	1970	1969	1968	1967
$ 3.23	$ 3.02	$ 2.75	$ 2.47	$ 2.58	$ 2.55	$ 2.49
$ 1.78	$ 1.72	$ 1.64	$ 1.50	$ 1.50	$ 1.45	$ 1.40
55.1%	57.0%	59.7%	60.9%	58.2%	57.0%	56.3%
$27.80	$26.36	$24.91	$23.66	$22.79	$21.71	$20.62
32⅝	33⅜	36⅜	35	39½	38⅞	38
21½	26⅜	28⅜	22½	29½	30¾	31⅝
22⅞	32⅝	32⅜	34⅝	32¾	38⅛	35⅝
$465,422	$458,817	$379,198	$330,559	$265,789	$220,516	$253,130
100,117	84,823	72,653	84,772	74,201	68,884	57,861
$565,539	$543,640	$451,851	$415,331	$339,990	$289,400	$310,991
60,572	59,124	54,665	51,277	48,885	46,994	43,663
21.5%	19.8%	25.6%	26.9%	31.4%	23.8%	32.9%
53.4	52.7	46.5	48.6	45.2	62.2	47.1
25.1	27.5	27.9	24.5	23.4	14.0	20.0
100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
2,384,800	2,369,800	2,364,900	2,364,900	2,247,900	2,277,300	2,278,500
7,841,000	7,062,000	6,956,000	6,942,400	6,962,400	6,302,600	6,289,600
2,554,700	2,609,900	2,438,700	2,098,000	1,560,700	1,056,200	1,110,100
12,780,500	12,041,700	11,759,600	11,405,300	10,771,000	9,636,100	9,678,200
10,867,800	10,469,800	9,713,000	8,807,700	8,227,100	8,126,200	7,757,900
6,417	6,213	6,048	5,697	5,545	5,181	5,000
2,854,585	2,767,978	2,675,942	2,597,314	2,536,703	2,483,480	2,429,306
36.5	36.0	35.4	34.8	34.5	34.3	34.0
984,061	1,015,319	1,004,547	950,652	878,484	888,075	802,221
23.6%	23.5%	24.8%	25.2%	25.2%	27.5%	26.3%
38.4	40.3	41.2	43.7	45.3	45.5	48.3
38.0	36.2	34.0	31.1	29.5	27.0	25.4
100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
37.0¢	33.7¢	31.7¢	30.2¢	29.9¢	30.3¢	30.2¢
43.0	39.4	37.5	33.9	31.4	27.9	28.4
44.1	36.9	32.7	30.4	28.2	28.0	29.3
42.0¢	37.2¢	34.3¢	31.9¢	30.1¢	28.6¢	29.1¢
3,423,896	3,918,844	3,798,462	3,633,341	3,445,626	3,338,669	3,363,503
113.4	115.7	121.7	107.7	116.2	109.7	112.4
2,443,889	2,383,609	2,317,686	2,258,285	2,208,046	2,160,569	2,110,510
95.9	95.6	95.0	94.1	94.0	93.8	93.5

Statements of Income

Pacific Gas and Electric Company / For the Years Ended December 31, 1977 and 1976

	Thousands	
	1977	1976
OPERATING REVENUES:		
Electric	**$2,345,144**	$1,571,842
Gas	**1,160,397**	1,074,886
TOTAL	**3,505,541**	2,646,728
OPERATING EXPENSES:		
Operation:		
Cost of Electric Energy	**1,175,140**	624,114
Cost of Gas Sold	**921,714**	796,186
Transmission and Distribution	**121,823**	114,910
Other	**287,977**	252,634
Total	**2,506,654**	1,787,844
Maintenance	**110,407**	96,277
Depreciation	**209,227**	199,491
Taxes on Income (Note 3)	**76,564**	16,579
Property and Other Taxes	**158,476**	142,667
TOTAL	**3,061,328**	2,242,858
OPERATING INCOME	**444,213**	403,870
OTHER INCOME AND INCOME DEDUCTIONS:		
Allowance for Equity Funds Used During Construction	**75,827**	60,559
Other—net	**55,984**	42,207
TOTAL	**131,811**	102,766
INCOME BEFORE INTEREST CHARGES	**576,024**	506,636
INTEREST CHARGES:		
Interest Expense (principally mortgage bonds)	**245,431**	223,255
Less Allowance for Borrowed Funds Used During Construction	**(25,705)**	(18,603)
TOTAL	**219,726**	204,652
NET INCOME	**$ 356,298**	$ 301,984
EARNINGS PER COMMON SHARE	**$3.15**	$2.90
DIVIDENDS DECLARED PER COMMON SHARE	**$2.00**	$1.88

The accompanying notes to financial statements and schedule are an integral part of these statements.

Balance Sheets

Pacific Gas and Electric Company / December 31, 1977 and 1976

	Thousands	
	1977	1976
ASSETS		
UTILITY PLANT—At Original Cost:		
Electric	**$5,635,911**	$5,344,976
Gas	**1,725,295**	1,653,846
Construction Work in Progress	**1,690,303**	1,399,552
Total Utility Plant	**9,051,509**	8,398,374
Accumulated Depreciation	**2,278,694**	2,095,304
UTILITY PLANT—NET	**6,772,815**	6,303,070
INVESTMENTS IN SUBSIDIARIES (Note 6)	**126,821**	101,502
CURRENT ASSETS:		
Cash	**25,466**	24,962
Short-term Investments—at cost which approximates market	**6,993**	—
Accounts Receivable (less allowance for uncollectible accounts: 1977, $5,120; 1976, $4,972)	**347,540**	268,182
Estimated Federal Income Tax Refund	**—**	75,000
Materials and Supplies	**33,096**	34,006
Fuel Oil	**246,400**	209,491
Energy Costs—Recoverable	**285,230**	275,855
Gas Stored Underground	**108,706**	90,298
Prepayments	**32,172**	25,612
TOTAL CURRENT ASSETS	**1,085,603**	1,003,406
DEFERRED CHARGES	**12,774**	11,854
TOTAL	**$7,998,013**	$7,419,832
CAPITALIZATION AND LIABILITIES		
CAPITALIZATION:		
Common Stock—at par (Schedule I)	**$ 983,901**	$ 886,106
Additional Paid-in Capital	**623,042**	488,976
Reinvested Earnings	**1,224,344**	1,120,301
Common Stock Equity	**2,831,287**	2,495,383
Preferred Stock—at par (Schedule I)	**977,451**	877,451
Total Stockholders' Equity	**3,808,738**	3,372,834
Mortgage Bonds (Note 2)	**3,232,807**	3,128,038
TOTAL CAPITALIZATION	**7,041,545**	6,500,872
CURRENT LIABILITIES:		
Short-term Borrowings (Note 4)	**97,628**	265,995
Accounts Payable	**284,287**	244,114
Taxes Accrued	**178,206**	122,155
Advance Collections of Energy Costs	**11,432**	—
Refund Payable to Customers	**53,212**	1,187
Dividends Payable	**45,374**	41,620
Mortgage Bonds—current portion (Note 2)	**55,695**	54,914
Other	**64,059**	53,560
TOTAL CURRENT LIABILITIES	**789,893**	783,545
CUSTOMER ADVANCES FOR CONSTRUCTION	**66,081**	53,334
DEFERRED INVESTMENT TAX CREDITS	**34,588**	24,843
OTHER DEFERRED CREDITS	**31,369**	19,755
DEFERRED INCOME TAXES ON DEFENSE FACILITIES	**34,537**	37,483
TOTAL	**$7,998,013**	$7,419,832

The accompanying notes to financial statements and schedule are an integral part of these statements.

Statements of Changes in Financial Position

Pacific Gas and Electric Company / For the Years Ended December 31, 1977 and 1976

	Thousands	
	1977	1976
FUNDS PROVIDED:		
Funds Derived from Operations:		
Net Income	**$ 356,298**	$ 301,984
Non-fund Items in Net Income:		
Depreciation (including charges to other accounts)	**212,751**	203,865
Allowance for Equity Funds Used During Construction	**(75,827)**	(60,559)
Other—net	**(12,689)**	(12,107)
Total Funds Derived from Operations	**480,533**	433,183
Common Stock Sold—net proceeds	**225,638**	187,770
Preferred Stock Sold—net proceeds	**106,223**	105,894
Mortgage Bonds Sold—net proceeds	**198,393**	172,804
Advance Collections of Energy Costs	**11,432**	—
Other Funds Provided—net	**12,675**	(718)
TOTAL	**$1,034,894**	$ 898,933
FUNDS APPLIED:		
Capital Expenditures	**$ 690,324**	$ 599,278
Allowance for Equity Funds Used During Construction	**(75,827)**	(60,559)
Funds Used for Capital Expenditures	**614,497**	538,719
Fuel Oil Inventory Change	**36,909**	(26,704)
Energy Costs Recoverable	**9,375**	275,855
Mortgage Bonds Purchased for Sinking Fund (at cost)	**33,261**	37,446
Matured Mortgage Bonds Retired	**47,156**	38,387
Dividends—preferred and common stock	**252,255**	216,155
Changes in Other Working Capital Items (a)	**41,441**	(180,925)
TOTAL	**$1,034,894**	$ 898,933
(a) Changes in Other Working Capital Items:		
Accounts Receivable—net	**$ 79,358**	$ 41,677
Estimated Federal Income Tax Refund	**(75,000)**	75,000
Taxes Accrued	**(56,051)**	(101,018)
Accounts Payable	**(40,173)**	(47,895)
Refund Payable to Customers	**(52,025)**	(443)
Short-term Borrowings	**168,367**	(148,845)
Other Changes in Working Capital	**16,965**	599
Total—increase (decrease)	**$ 41,441**	$(180,925)

The accompanying notes to financial statements and schedule are an integral part of these statements.

Statements of Stockholders' Equity

Pacific Gas and Electric Company / For the Years Ended December 31, 1977 and 1976

	Thousands			
	Preferred Stock	Common Stock	Additional Paid-in Capital	Reinvested Earnings
Balance, January 1, 1976	$777,451	$799,673	$381,745	$1,034,472
Net Income—for year				301,984
Preferred Stock Sold (4,000,000 Shares)	100,000		5,894	
Common Stock Sold (8,643,315 Shares)		86,433	101,337	
Dividends Declared—Cash:				
Preferred Stock				(61,556)
Common Stock				(154,599)
Balance, December 31, 1976	877,451	886,106	488,976	1,120,301
Net Income—for year				356,298
Preferred Stock Sold (4,000,000 Shares)	100,000		6,223	
Common Stock Sold (9,779,518 Shares)		97,795	127,843	
Dividends Declared—Cash:				
Preferred Stock				(72,352)
Common Stock				(179,903)
Balance, December 31, 1977	**$977,451**	**$983,901**	**$623,042**	**$1,224,344**

Schedule I Capital Stock

Pacific Gas and Electric Company / December 31, 1977

	Redemption Price	Thousands		
		Shares Authorized	Outstanding—Held by Public	
			Shares	Amount
COMMON, PAR VALUE $10 PER SHARE		125,000	98,390	$983,901
PREFERRED, CUMULATIVE, PAR VALUE $25 PER SHARE				
REDEEMABLE:				
10.46% ($2.615 a share)	$30.10	3,500	3,500	$ 87,500
10.18% ($2.545 a share)	30.00	4,000	4,000	100,000
9.48% ($2.37 a share)	30.25	3,000	3,000	75,000
9.30% ($2.325 a share)	29.80	4,000	4,000	100,000
9.28% ($2.32 a share)	28.00	707	707	17,674
9% ($2.25 a share)	29.25	881	881	22,027
8.20% ($2.05 a share)	30.00	2,000	2,000	50,000
8.16% ($2.04 a share)	29.375	3,000	3,000	75,000
8% ($2.00 a share)	30.00	2,000	2,000	50,000
7.84% ($1.96 a share)	29.00	2,000	2,000	50,000
5% ($1.25 a share)	26.75	2,861	2,861	71,524
5%—Series A ($1.25 a share)	26.75	1,750	1,719	42,985
4.80% ($1.20 a share)	27.25	1,517	1,517	37,934
4.50% ($1.125 a share)	26.00	1,128	1,128	28,186
4.36% ($1.09 a share)	25.75	1,000	1,000	25,000
Unclassified in Series	—	20,871	—	—
TOTAL REDEEMABLE		54,215	33,313	832,830
NON-REDEEMABLE:				
6% ($1.50 a share)		4,212	4,212	105,292
5.50% ($1.375 a share)		1,173	1,173	29,329
5% ($1.25 a share)		400	400	10,000
TOTAL NON-REDEEMABLE		5,785	5,785	144,621
TOTAL PREFERRED		60,000	39,098	$977,451

The accompanying notes to financial statements are an integral part of these statements and this schedule.

Notes to Financial Statements

Pacific Gas and Electric Company / December 31, 1977 and 1976

NOTE 1—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Accounting Records

The accounting records of the Company are maintained in accordance with the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC) and adopted by the California Public Utilities Commission (CPUC).

Utility Plant

The cost of additions to utility plant and replacements of retirement units of property is capitalized. Cost includes labor, material and similar items and indirect charges for such items as engineering, supervision and transportation. An allowance for funds used during construction (ADC) is included in construction work in progress (CWIP) and credited to other income and interest charges. A composite rate for this allowance, which assumes that funds used for construction were provided by short and long-term debt and preferred and common equity, is applied to CWIP. This accounting practice results in the inclusion in CWIP of amounts considered as an appropriate cost of funds for purposes of establishing rates for utility charges to customers. Costs of depreciable units of plant retired are eliminated from utility plant accounts and such costs plus removal expenses less salvage are charged to accumulated depreciation. Costs of repairing major units of property and replacement of minor items of property are included in the Statements of Income as maintenance.

Research and Development

Research and development (R&D) costs related to specific construction projects and a portion of general engineering research costs are capitalized. Other R&D costs are charged to expense as incurred.

Inventories

Inventories of materials and supplies, fuel oil, and gas stored underground are stated at average cost.

Revenues

Revenues from residential and commercial customers are recorded as meters are read on a cycle basis throughout each month.

Balancing Accounts

In accordance with the requirements of the CPUC, the Company has, since April 1976, deferred in a balancing account the difference between the cost of its electric energy and the energy cost collected from its customers. Subsequently, the Company has been required to maintain balancing accounts to record undercollections and overcollections of gas cost increases. The deferred amounts are amortized as corresponding changes are made in customer rates. Although such deferred costs are deducted currently on federal and state income tax returns, for financial statement purposes such costs are recognized in the computation of income tax accruals as the deferred costs are amortized. The effect of using these balancing accounts is that changes in cost of electric energy and gas no longer affect the Company's earnings since energy costs are included in operating expenses when they are offset by revenues.

Depreciation

For financial statement purposes, depreciation of utility plant is computed on a straight-line remaining life basis at rates based on the estimated useful lives of properties. The annual provisions for depreciation expressed as a percentage of the average balances of depreciable plant were 3.1% for 1977 and 1976.

Income Taxes

The CPUC requires that the Company include in net income the current tax differences arising from certain timing differences in connection with depreciation, ADC and other overhead costs of construction and gain on bonds purchased for sinking fund. For federal income tax purposes, depreciation is generally computed using the most liberalized methods allowed by the Internal Revenue Code. Investment tax credits are applied as a reduction of federal income tax expense through the use of a five-year moving average method. Such tax differences are reflected in customer rates authorized by the CPUC.

Bond Premium, Discount and Related Expenses

Bond issuance premium or discount and related expenses are being amortized over the lives of the issues to which they pertain. Prior to September 1976 gain on reacquisition of bonds to satisfy sinking fund requirements was credited to other income in the year of acquisition, thereby conforming to the requirements of

the Financial Accounting Standards Board and the ratemaking of the CPUC. Beginning in September 1976 the CPUC changed its method of recognizing such gain or loss for ratemaking purposes. The new method requires amortization of gain or loss over the remaining life of the reacquired issues. In accordance with the requirements of the FERC the Company on that date adopted the same method of accounting for book purposes. The federal income tax on such gain is recognized over the average life of the remaining property.

Retirement Plan

Retirement plan costs are accrued in accordance with an actuarial cost method (individual entry age normal method). At December 31, 1977, the value of retirement plan assets exceeded the estimated vested benefits of the plan.

Investments in Subsidiaries

Investments in subsidiaries are stated in accordance with the equity method. The assets, revenues, and earnings of the subsidiaries are not significant in relation to those of the Company. Approximately 63% and 64% of the cost of the Company's natural gas purchased in the years 1977 and 1976 were from Pacific Gas Transmission Company, a 53% owned subsidiary. The price paid is regulated by the FERC.

Earnings Per Common Share

Earnings per common share were computed by dividing earnings available for common stock by the weighted average number of common shares outstanding. The weighted average number of common shares outstanding is computed by dividing the aggregate of the number of common shares outstanding at the beginning of each month during each year by twelve.

NOTE 2—MORTGAGE BONDS:

At December 31, 1977, the First and Refunding Mortgage Bonds outstanding held by the public were as follows:

	Thousands			
Maturity	2¾% to 3¾%	4¼% to 6⅞%	7½% to 9.85%	Total
1978	$ 47,600			$ 47,600
1979	66,973			66,973
1980	51,405			51,405
1981	21,117			21,117
1982	63,750		$ 150,000	213,750
1983-1992	152,059	$227,699	175,000	554,758
1993-2002		622,476	334,884	957,360
2003-2009			1,393,550	1,393,550
Total Mortgage Bonds	$402,904	$850,175	$2,053,434	3,306,513
Mortgage Bonds Included in Current Liabilities				55,695
Unamortized Discount Net of Premium				18,011
Mortgage Bonds Included in Capitalization				$3,232,807

Subject to indenture provisions as to earnings coverages and bondable property available for security, additional bonds may be issued up to an outstanding aggregate amount of $5,000,000,000. The Board of Directors may from time to time increase the amount authorized. All real properties and substantially all personal properties are subject to the lien of the mortgage. Securities representing investments in subsidiaries are pledged as collateral for the bonds.

The Company is required, according to provisions of the First and Refunding Mortgage, to make semiannual sinking fund payments on February 1 and August 1 of each year for the retirement of the bonds of any series equal to ½ of 1% of the aggregate bonded indebtedness outstanding on the preceding November 30 and May 31, respectively. Bonds of any series may be used to satisfy this requirement.

Sinking fund requirements due in 1978 for bonds outstanding at December 31, 1977 amount to $33,470,000. This amount, less treasury bonds of $25,375,000 plus Series CC Bonds of $47,600,000 maturing on December 1, 1978, is included in current liabilities.

The combined aggregate amount of bonds maturing and sinking fund requirements for the years 1978 through 1982, calculated on the basis of bonds outstanding at December 31, 1977, will amount to $81,070,000, $99,637,000, $83,171,000, $51,976,000 and $243,835,000, respectively.

NOTE 3—TAXES ON INCOME:

Taxes on income generally reflect amounts currently payable or refundable with two exceptions. Investment tax credits are used to reduce federal income tax expense through the use of a five-year moving average and energy costs reduce income tax expense when the energy costs are included in bills to customers. (See Note 1).

Income tax regulations require that energy costs be deducted on tax returns in the years such costs are incurred. Therefore, approximately $276 million of unbilled recoverable energy costs were deducted in the 1976 income tax returns which gave rise to a $75 million

federal refund, representing the amount of prior years' taxes available for such refund. Deduction of such energy costs also made available tax credits of approximately $63 million to reduce federal income tax payments in subsequent years.

The reasons for the differences between the reported income tax expense and the amount computed by applying the U.S. federal income tax rate of 48% to income before taxes are as follows:

	1977 Percent of Pretax Income	1976 Percent of Pretax Income
Computed provision	48.0 %	48.0 %
Increases (reductions) resulting from:		
Investment tax credits	(5.8)	(6.4)
Adjustment of prior years' accruals	—	(5.3)
State tax on income	1.8	1.5
Allowance for borrowed and equity funds used during construction	(11.6)	(12.7)
Tax depreciation in excess of book depreciation	(5.0)	(7.4)
Other overhead construction costs	(3.8)	(4.2)
Repair allowance	(2.4)	(6.3)
Property taxes deductible in excess of book taxes	(2.1)	(3.0)
Property removal expenses	(1.4)	(2.0)
Other—net	(2.4)	(3.0)
Total	15.3 %	(.8)%

Income tax expense is included in the financial statements as follows:

	Thousands 1977	Thousands 1976
Included in operating expenses:		
Tax on operating income	$79,509	$19,524
Amortization of deferred taxes on defense facilities	(2,945)	(2,945)
Total	76,564	16,579
Included in other income	(12,047)	(19,038)
Total	$64,517	$(2,459)

The components of income tax expense are:

	Thousands 1977	Thousands 1976
Current:		
Federal	$ 7,826	$(75,000)
State	14,780	—
Deferred:		
Tax related to changes in unbilled recoverable energy costs:		
Federal	35,296	53,543
State	(185)	8,725
Investment tax credit:		
Federal	9,745	13,218
Amortization of deferred taxes on defense facilities:		
Federal	(2,694)	(2,694)
State	(251)	(251)
Total	$64,517	$ (2,459)

NOTE 4—COMPENSATING BALANCES AND SHORT-TERM BORROWING ARRANGEMENTS:

Lines of credit for loans were maintained with sixteen banks at December 31, 1977, the unused portion of which was $378,500,000.

The Company compensates banks for lines of credit and other banking services by fee payments or by maintaining cash balances. The cash balances maintained at the banks are not legally restricted.

As of December 31, 1977 and December 31, 1976 there were $97,628,000 and $265,995,000 of the Company's commercial paper outstanding at average interest rates of 6.7% and 4.8%, respectively. The maximum amount of aggregate short-term borrowings outstanding at any month-end during the years 1977 and 1976 were $317,316,000 and $354,670,000, respectively.

During the years 1977 and 1976 the approximate weighted average interest rates for short-term borrowings were 5.2% and 5.3%, respectively, and the approximate average short-term borrowings outstanding were $140,082,000 and $227,587,000, respectively. These weighted average interest rates were computed on a daily basis weighted for the amounts borrowed at each rate.

The usual terms of short-term borrowings are 90 days for bank loans and 10 to 90 days for commercial paper.

NOTE 5—ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (ADC):

The Uniform System of Accounts of the FERC and the CPUC provide a procedure for capitalizing the costs of financing new utility plant while it is under construction. Although ADC in the Statements of Income does not represent current cash earnings, ADC becomes a part of utility plant and is recovered in future periods from ratepayers as a cost of service through the provision for depreciation. Included in other income is the equity earnings of the unconsolidated subsidiaries, $8,950,000 of which represents ADC.

The ADC rate for 1976 without compounding was 8%. Effective January 1, 1977, the FERC established a formula method for calculating a ceiling ADC rate. The formula permits compounding of ADC and requires that the Statement of Income show the debt and equity components separately. The rate for 1977 using the FERC formula was 7%. The Company believes that if the former method of calculating ADC had been in effect in 1977, the amount of ADC would not have been significantly different.

The debt portion of ADC for periods prior to January 1, 1977 has been reclassified in the Statements of Income as a deduction from interest expense. Formerly, the entire ADC amounts were classified as other income. The Statement of Changes in Financial Position has also been changed so that only the equity portion of ADC is deducted in deriving funds provided from operations and funds used for capital expenditures. Formerly, the entire ADC was deducted in deriving these amounts. Management believes that the reclassification of the debt component of ADC has no effect on the Company's ability to issue mortgage bonds or preferred stock.

NOTE 6—COMMITMENTS AND OTHER MATTERS:

Capital expenditures for the year 1978 are estimated at $837,000,000.

Total research and development costs incurred during the years 1977 and 1976 were approximately $50,000,000 and $31,000,000, of which $38,000,000 and $21,000,000 were capitalized as part of the cost of construction projects.

The Company provides retirement and savings fund plans for substantially all employees. The costs of these plans, charged to expense and utility plant, were $67,258,000 and $51,438,000 for the years 1977 and 1976.

Alberta and Southern Gas Co. Ltd. (A&S), a wholly-owned subsidiary of the Company, has as its principal functions the acquiring of natural gas in Canada and providing for its transportation to the United States border. A&S loaned funds for the exploration and development of natural gas reserves in Canada and has made advances based on proven reserves. Such loans amount to approximately $65,000,000 as of December 31, 1977, and are subject to repayment without regard to the success of the exploration and development efforts. Approximately $31,000,000 of these loans are scheduled to be repaid starting July 1978. Other advances of approximately $7,000,000 are refundable out of production. To finance this program A&S has borrowed, as of December 31, 1977, approximately $72,000,000 from Canadian banks. The Company has received all necessary approvals of the CPUC and executed a guarantee of all such loans.

Interest on these loans has been allowed as one of the costs of service deductible from the Canadian regulated price of gas purchased by A&S. The Alberta Public Utilities Board is conducting an inquiry into the determination of cost of service and is expected to review the deductibility of these interest costs.

On November 17, 1977 a CPUC hearing officer issued his proposed report in Phase II of the Company's 1976 General Rate Case that would require the Company to reduce its electric and gas rates by $56,500,000 annually, effective August 27, 1976, the date the increased rates under Phase I became effective. The Company and other interested parties filed exceptions to the proposed report. The CPUC held oral argument on January 13, 1978, and the decision in Phase II is pending which may accept, reject, or modify the proposed report.

NOTE 7—SEGMENT INFORMATION:

Segment Information for 1977 and 1976 is as follows:

	1977			
	Thousands			
	Electric	Gas	Intersegment Eliminations	Total Company
Operating Revenues	$2,345,144	$1,160,397		$3,505,541
Intersegment Sales (A)	3,163	507,748	$(510,911)	—
Total Operating Revenues	2,348,307	1,668,145	(510,911)	3,505,541
Operating Expenses (excluding depreciation) (B)	1,849,114	1,513,898	(510,911)	2,852,101
Depreciation	158,341	50,886		209,227
Total Operating Expenses	2,007,455	1,564,784	(510,911)	3,061,328
Operating Income	$ 340,852	$ 103,361		$ 444,213
Capital Expenditures (C)	$ 599,126	$ 91,198		$ 690,324
Utility Assets (C)	$4,783,644	$1,397,245		$6,180,889
Construction Work in Progress (C)	1,657,912	32,391		1,690,303
Investment in Subsidiaries		126,821		126,821
Total Assets	$6,441,556	$1,556,457		$7,998,013

	1976			
	Thousands			
	Electric	Gas	Intersegment Eliminations	Total Company
Operating Revenues	$1,571,842	$1,074,886		$2,646,728
Intersegment Sales (A)	2,488	347,191	$(349,679)	—
Total Operating Revenues	1,574,330	1,422,077	(349,679)	2,646,728
Operating Expenses (excluding depreciation) (B)	1,121,121	1,271,925	(349,679)	2,043,367
Depreciation	150,358	49,133		199,491
Total Operating Expenses	1,271,479	1,321,058	(349,679)	2,242,858
Operating Income	$ 302,851	$ 101,019		$ 403,870
Capital Expenditures (C)	$ 518,398	$ 80,880		$ 599,278
Utility Assets (C)	$4,531,861	$1,386,917		$5,918,778
Construction Work in Progress (C)	1,373,725	25,827		1,399,552
Investment in Subsidiaries		101,502		101,502
Total Assets	$5,905,586	$1,514,246		$7,419,832

(A) Intersegment sales for 1977 and 1976 represent 30% and 24%, respectively, of Total Gas Revenues and less than 1% of Total Electric Revenues. Intersegment Electric and Gas Sales are accounted for at tariff rates prescribed by the CPUC.

(B) Income taxes and general corporate expenses are allocated to departments in accordance with the Uniform System of Accounts and requirements of the CPUC.

(C) Includes allocation of Common Utility Plant.

NOTE 8—QUARTERLY FINANCIAL DATA (unaudited):

Operating revenues, operating income, net income and earnings per common share for the four quarters of 1977 and 1976 are shown in the table below. Due to the seasonal nature of the utility business, the annual amounts are not generated evenly by quarter during the year.

	Thousands			Earnings Per
Quarter Ended	Operating Revenues	Operating Income	Net Income	Common Share
December 31, 1977	$946,811	$103,272	$84,954	$.73
September 30, 1977	$911,062	$120,320	$98,118	$.88
June 30, 1977	$803,091	$109,068	$86,982	$.76
March 31, 1977	$844,577	$111,553	$86,244	$.78
December 31, 1976	$704,093	$110,371	$87,793	$.81
September 30, 1976	$642,351	$109,691	$82,608	$.82
June 30, 1976	$618,280	$106,445	$80,230	$.80
March 31, 1976	$682,004	$ 77,363	$51,353	$.47

NOTE 9—REPLACEMENT COST (unaudited):

The Securities and Exchange Commission (SEC) requires that the Company disclose in financial statements filed with the SEC the estimated current "replacement cost" of certain of its assets, accumulated replacement cost depreciation applicable to those assets, and the amount of depreciation based on "replacement costs." There is considerable controversy over the usefulness of such information in assessing the current economics of the Company in an inflationary economy. The Company believes that the calculations necessary to provide the estimated "replacement cost" as required by the SEC are not appropriate in determining the impact of inflation on regulated utilities such as the Company. The Company's operations, including substantially all of its revenues, are subject to regulation by the CPUC. It is the practice of the CPUC to authorize rates at a level to allow the Company to recover its actual investment in facilities used in providing utility service. Therefore, when facilities are replaced at costs higher than the cost of existing facilities, rates can be changed to cover any changes in depreciation and other costs including the return on any additional investment required. The impact on earnings can reasonably be expected, therefore, to be zero.

The SEC requires that this annual report refer to the replacement cost information contained in the Company's 10-K report for 1977. A copy of that report may be obtained upon written request to the Corporate Secretary.

Accountants' Opinion

The Stockholders and the Board of Directors of Pacific Gas and Electric Company:

We have examined the balance sheets of Pacific Gas and Electric Company as of December 31, 1977 and 1976 and the related statements of income, stockholders' equity, and changes in financial position for the years then ended. Our examinations were 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.

In our opinion, such financial statements present fairly the financial position of the Company at December 31, 1977 and 1976 and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Haskins & Sells

San Francisco, California
February 10, 1978

Departmental Organization

ELECTRIC OPERATIONS
Managers:
W. H. Barr, Steam Generation
F. C. Buchholz, Hydro Generation
D. H. Colwell, System Protection
T. R. Ferry, Communications
E. F. Kaprielian, Power Control
H. J. Stefanetti, Electric Transmission and Distribution
J. N. Ylarraz, Substations

GAS OPERATIONS
Managers:
J. A. Fairchild, Gas Distribution
C. A. Miller, Gas Utilization
I. C. Odom, Gas System Planning
F. J. Parsons, Gas Control
C. J. Tateosian, Gas System Design

GAS SUPPLY
Managers:
H.G. Culp, Contract Administration
D. E. Fissell, Exploration, Pacific Region
J. K. A. Harral, Gas Resources
J. M. Kunz, Gas Procurement
D. L. McLeod, Gas Purchase
J. L. Wroble, Exploration, Rocky Mountain Region

COAL SUPPLY
J. C. Osmond, Manager

ENGINEERING
Chiefs:
G. H. Aster, Design-Drafting
R. V. Bettinger, Civil Engineer
W. R. Johnson, Electrical Engineer
D. V. Kelly, Mechanical and Nuclear Engineer
J. J. McCann, Engineering Services
G. V. Richards, Engineering Quality Control
J. O. Schuyler, Nuclear Project Engineer

CUSTOMER OPERATIONS
Managers:
J. S. Cooper, Energy Conservation and Services
J. G. O'Neill, Customer Services
J. M. Stearns, Commercial

INTERNAL AUDITING
E. C. Suess, Manager

PLANNING AND RESEARCH
Chiefs:
R. F. Cayot, Engineering Research
E. E. Hall, Siting Engineer
H. R. Perry, Planning Engineer

RATES AND VALUATION
Managers:
S. M. Andrew, Economics and Statistics
H. E. Crowhurst, Jr., Valuation
L. R. Gardner, Rate

COMPTROLLER
J. W. Hall, Assistant Comptroller
K.S. Taylor, Assistant Comptroller
Managers:
R. W. Beck, Corporate Accounting
A. W. Defoe, Disbursement Accounting
H. W. Gleason, Income Tax
N. D. Hennings, Plant Accounting
R. E. Palmer, Property Tax
E. M. Schroeder, Customer Accounting

LAW
M. H. Furbush, Associate General Counsel
Assistant General Counsel:
C. T. Van Deusen
P. A. Crane, Jr.
H. J. LaPlante
R. A. Clarke
J. B. Gibson
A. L. Hillman, Jr.
R. Ohlbach
C. W. Thissell

COMPUTER SYSTEMS AND SERVICES
G. A. Maneatis, Manager

STOCK TRANSFER
W. Roby, Manager

INSURANCE
J.A. Crockwell, Manager

TREASURER
Managers:
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Office of the San Francisco Gas Company,
February 8th, 1854.

Sir

The Trustees of the San Francisco Gas Company request the honor of your company at the Oriental Hotel, from 7 1-2 to 9 o'clock, on Saturday Evening, the 11th inst., on the occasion of their introducing Gas Light into the Streets of San Francisco.

Very respectfully,

JOHN CRANE, Secretary.

Our First 125 Years

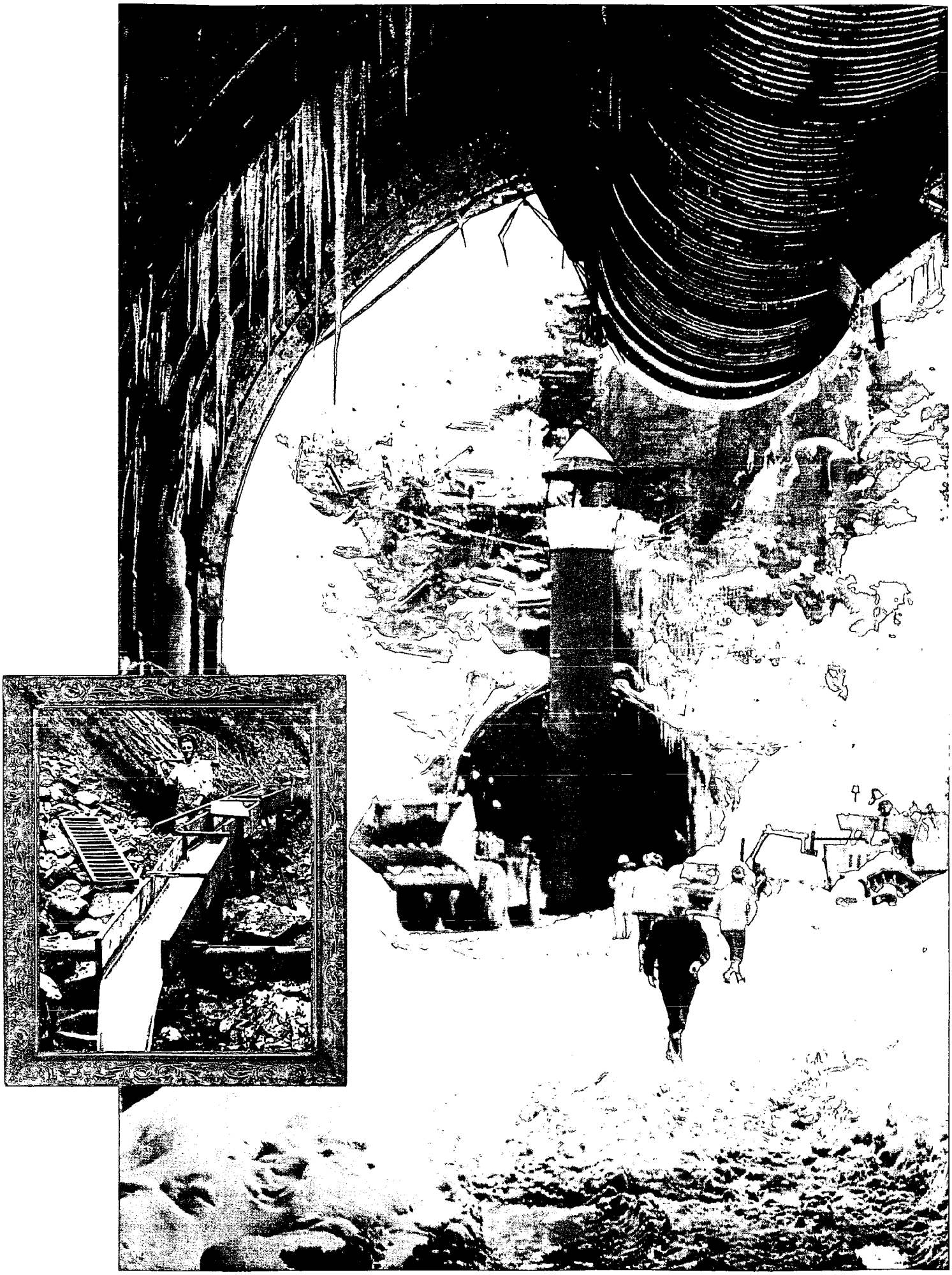
THE SAN FRANCISCO OF GOLD RUSH DAYS

walked in darkness, its streets largely unlighted, its homes lit only by oil lamps and candles. But among the hordes of 49'ers was one who would change this.

He was Peter Donahue. Surveying the ragged but growing town, he told a companion, "This is going to be a great city at no distant day." His own efforts would do much to help fulfill that prophecy.

In 1852, with his brother James, he founded the San Francisco Gas Company, the first gas company in the West—and the first predecessor of the Pacific Gas and Electric Company.

From that little gas company, in an unbroken line, the PGandE of today traces its history, a history closely linked with that of San Francisco and the Golden State itself.



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The Donahues built a small plant at the edge of the Bay to manufacture gas from coal brought by windjammer from Australia. Gas first lighted the streets of San Francisco on February 11, 1854.

The new business prospered. Other gas companies sprang up in other Northern and Central California communities. Their histories followed a pattern — growth, lowering of rates and eventual merger with the oncoming electric systems.

The first electric company was California Electric Light Company, founded by George H. Roe in 1879. Because this, too, is a direct ancestor, PGandE next year will observe another anniversary — the centennial of electric service.

In 1879, electricity was not a total stranger in San Francisco. A few individual buildings had arc lighting supplied by their own primitive generators. But in September of that year California Electric Light's little plant near Fourth and Market Streets sent electricity to 18 sputtering arc street lamps, becoming the first central station in the United States and probably in the world to serve electricity to customers.

This was three years before Thomas Edison's better-publicized Pearl Street Station went into operation in New York.

Other predecessor companies of PGandE were harnessing the rushing rivers of the Sierra Nevada to generate electricity, often using the great network of flumes and ditches built to deliver water to the gold miners. Eugene J. de Sabla, Jr. and John Martin, often called the fathers of PGandE, built several of the pioneer hydroelectric plants.

In the San Joaquin Valley a merger laid the foundations of what later became the San Joaquin Light and Power Corporation system. On the Feather River in the north, Guy C. Earl and Edwin T. Earl in 1902 organized the Western Power Company, which later became the Great Western Power Company of California.

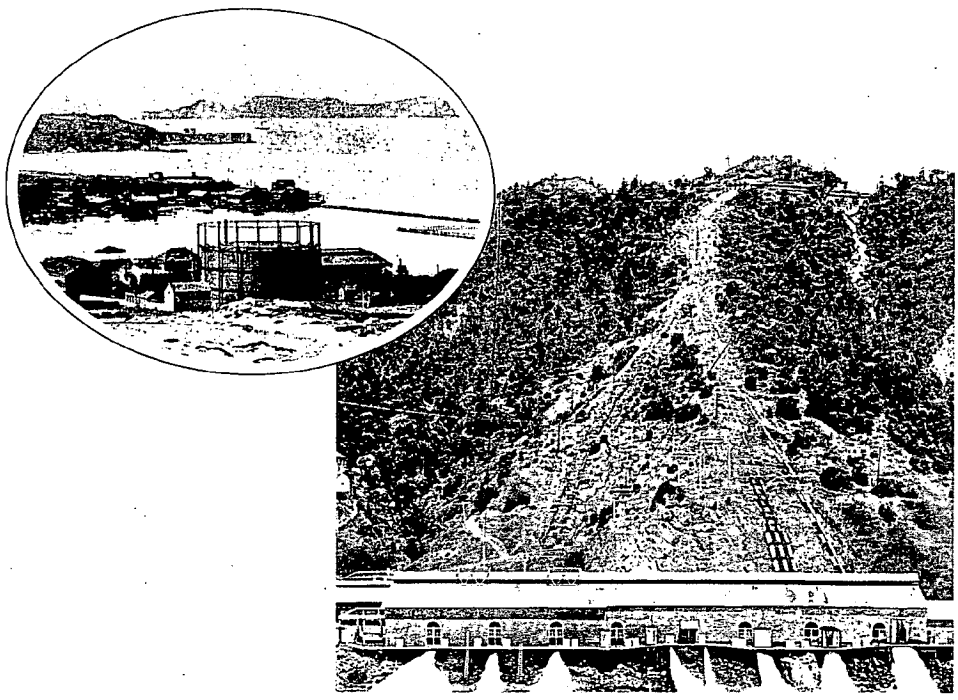
Meanwhile, gas and electric systems in San Francisco were being consolidated.

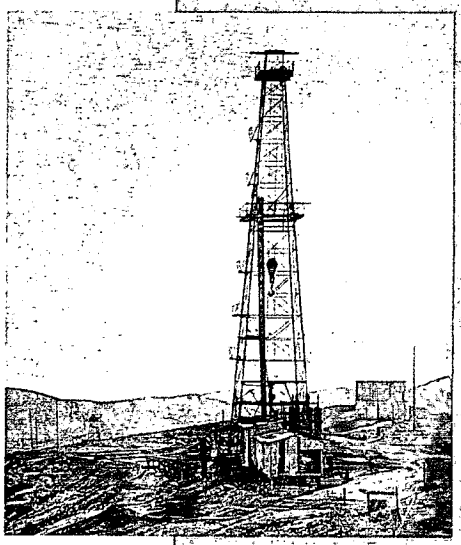
In 1896, the Donahue and Roe companies were merged to form the San Francisco Gas and Electric Company. On October 10, 1905, that company was consolidated with California Gas and Electric Corporation under the name of Pacific Gas and Electric Company, incorporated on that day.

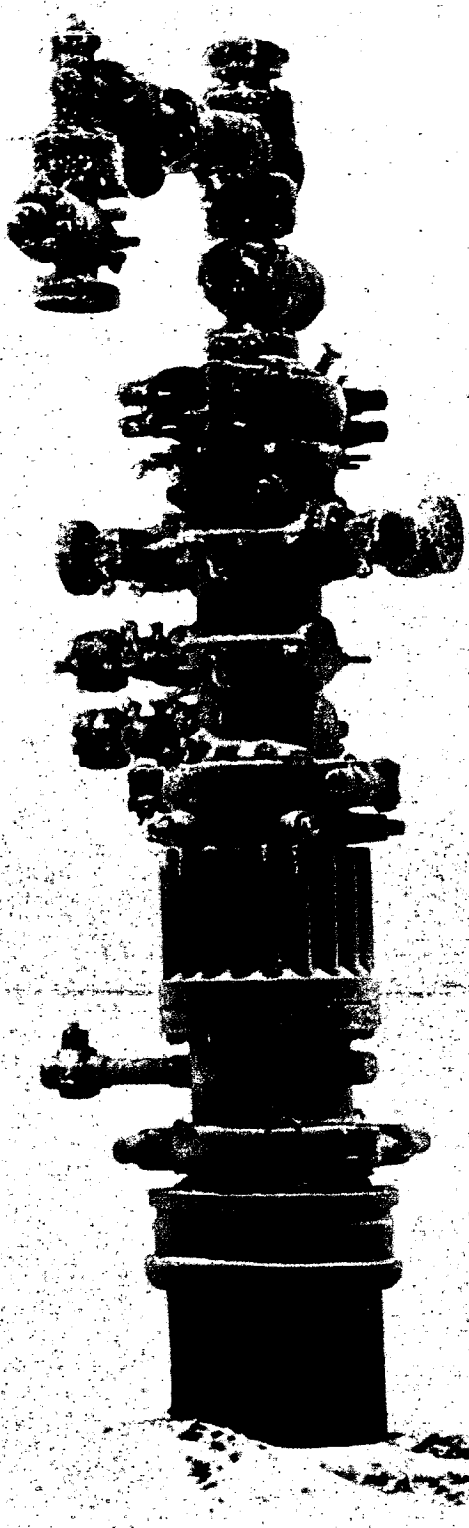
Left; flumes and tunnels, built by the '49ers for placer mining, led the way to today's giant hydroelectric projects, such as the Helms underground powerhouse and pumped storage project.

The first gas plant in the West built by the San Francisco Gas Company was on the shore of San Francisco Bay.

Important advances in long distance transmission by 1899 allowed Colgate Powerhouse on the Yuba River to begin producing power for use in Sacramento 60 miles away.







Towering challenges faced the Company from the outset. The earthquake and fire of 1906 destroyed or damaged much of its property and created a financial crisis. Needed equity capital was hard to obtain. But the Company weathered these and other mammoth problems over the years.

In the 1930's, the framework of the present PGandE system was completed when the San Joaquin Light and Power Corporation and Great Western Power Company were brought into the organization under single management and control.

An important milestone was reached in 1929-30 when natural gas was introduced in Northern California.

Since pioneer days water power had been the first choice for electric generation because it was cheap and available in the rivers of the Sierra Nevada. Steam-operated power plants were expensive and inefficient and were used mainly for peaking and standby services.

Although hydroelectric development continued in the postwar years, good hydro sites were growing scarcer, and new technologies were making steam generation more efficient and reducing costs. Steam-electric capacity, not hydroelectric, became the dominant source.

After World War II, to meet rocketing demand for electric power in a fast-growing state, PGandE undertook a construction program unequaled in magnitude in the history of the utility industry up to that time. In six postwar years, 1946 to the end of 1951, the Company invested $800 million in new facilities and added more than 1.3 million kilowatts to its system.

Moss Landing Power Plant was placed in operation in 1950 and Contra Costa Power Plant a year later. By 1953 these two giants alone generated the equivalent of 81% of the capacity of PGandE's 58 hydro plants. Until Pittsburg Power Plant was completed in 1954, they were the two largest steam-electric plants in the West. Pittsburg Power Plant came on the line that year with a 568,500-kilowatt net capacity. With subsequent additions, it now can generate 2 million kilowatts and is one of the largest plants in the nation.

Geothermal power was added to the Company's resources when the first unit of The Geysers power plant was completed in 1960 at a site in Sonoma County, 90 miles north of San Francisco. The Geysers now includes 11 units in operation, with four under construction. It is the only commercial geothermal power plant in the United States and the largest in the world.

PGandE has been deeply involved in nuclear power development from the beginning.

In 1951 the Company was one of the original eight industrial companies in the nation

In the 1920's, natural gas, piped from wells in the Kettleman Hills in Southern California, brought a cleaner, cheaper fuel to PGandE customers. Exploration is now under way in the Arctic to meet future customer demand. Left; the wellhead is on Alaska's North Slope.

The Company's service territory was pictured on the side of its office building on San Francisco's Sutter Street in 1913.

Conservation of energy was the theme for PGandE's advertising during World War II.

selected by the Atomic Energy Commission to study feasibility of atomic power generation. In 1957 the Vallecitos Atomic Power Plant, jointly built by PGandE and General Electric Company, went into operation under U.S. Atomic Energy Commission License No. 1. The unit was retired ten years later when work with its developmental reactors was completed.

PGandE's commercial-sized nuclear power plant, first west of the Mississippi, came on line in 1963 at Humboldt Bay near Eureka. Rated at 63,000-kilowatt capacity, it has been a reliable and economic arm of the Company system. It presently is shut down for refueling, repairs and seismic design modifications.

At Diablo Canyon, on the central California coast, PGandE has under construction a two-unit nuclear plant with a capacity of 2.2 million kilowatts. It will generate as much electricity in a year as would be generated by burning more than 20 million barrels of expensive, imported low-sulfur oil, or more than 4 million tons of coal.

Seeing the need for more natural gas to serve its customers, in 1950 PGandE began importing supplies from fields in Texas and New Mexico. In 1961 it went to Canada for additional supplies. The Company and its subsidiaries built a 36-inch diameter pipeline from Alberta to the San Francisco Bay area, through which the Company receives about one-half of its supply of natural gas.

In the late 1960's, the era of cheap energy began to wane. Inflation began to force rates upward. Environmental restrictions slowed down construction and forced higher costs in many areas. A further factor was the increasing scarcity and higher cost of fossil fuels, including oil and natural gas.

The Company embarked on a far-ranging search for large additional gas supplies. Plans have been made to bring liquefied natural gas from Indonesia and the Cook Inlet of Alaska. The Company also is involved in a project to bring Prudhoe Bay natural gas by pipeline from the North Slope of Alaska to California as part of what will be the world's largest privately financed construction project. Since 1958, the Company has operated the McDonald Island underground natural gas storage field to provide customers with gas at times of high demand in the winter months.

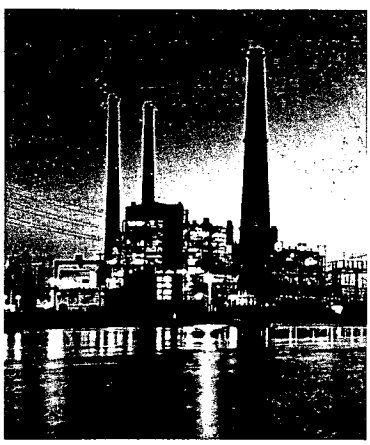
From its small beginnings, PGandE has become the largest combination utility in the nation. The Company now serves 8.9 million people living in 94,000 square miles of Northern and Central California—from the ice-carved summits of the Sierra Nevada to the Pacific Ocean; from the redwoods of Humboldt to the Mojave Desert. It is the only utility that produces electricity from these five sources of primary energy: fuel oil, natural gas, falling water, geothermal steam and uranium. Coal will become the sixth source.

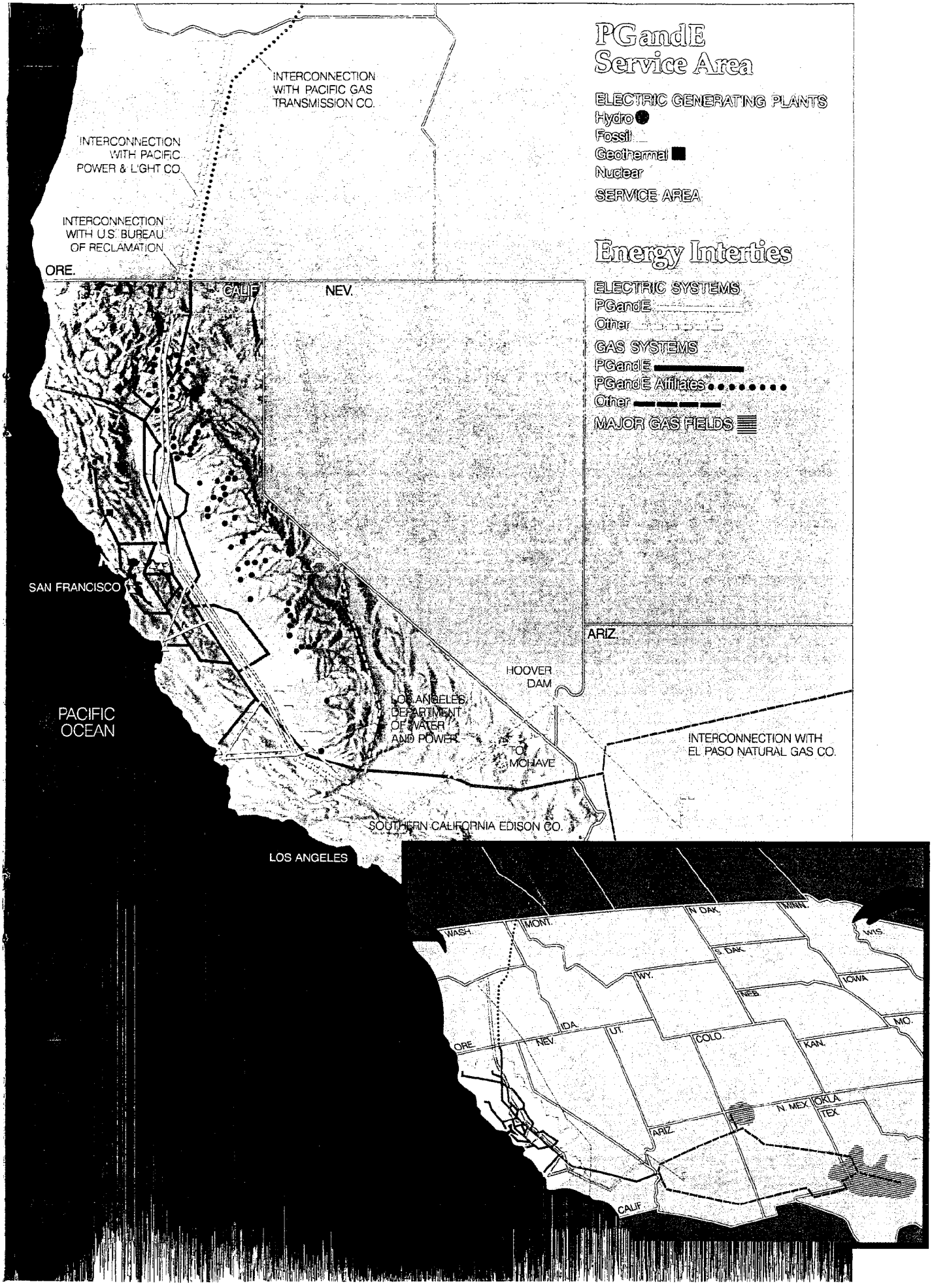
Throughout its history, PGandE has been led by men of sure purpose and vision. It has proved to be a sound company for its investors and a reliable provider of service for its customers.

Fossil-fueled steam generating plants, such as this major plant at Pittsburg, generate a large share of the Company's electric energy output.

A growing source of generation is the natural steam from the earth at The Geysers, 90 miles north of San Francisco.

PGandE has developed far-flung sources of natural gas and electric energy. As indicated on the map, natural gas pipelines reach 1,400 miles northward into Canada and almost an equal distance southeasterly to the Permian Basin of Texas and New Mexico. In addition, PGandE's electric generating system is augmented by major interconnections with other sources. The Pacific Intertie links the hydroelectric plants of the Columbia River Basin with the thermal generating resources in Northern and Southern California.





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