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USNRC

March 26, 2003 (2:49PM)

OFFICE OF SECRETARY
RULEMAKINGS AND
ADJUDICATIONS STAFF

March 21, 2003

Annette L. Vietti-Cook, Secretary
U.S. Nuclear Regulatory Commission
Washington, DC 20555-0001

Re: **Pacific Gas & Electric Company**
(Diablo Canyon Power Plant, Units 1 & 2)
Docket Nos. 50-275-LT, 50-323-LT

Dear Ms. Vietti-Cook:

On March 14, 2003, Pacific Gas and Electric Company ("PG&E") provided the Nuclear Regulatory Commission ("NRC") Staff with supplemental information pertaining to the Plan of Reorganization for PG&E ("PG&E Plan") currently pending in the United States Bankruptcy Court for the Northern District of California. The information relates to certain financial modifications recently made to the PG&E Plan. These modifications do not alter PG&E's November 30, 2001, license transfer application pending at the NRC. As a courtesy, however, PG&E is, by this letter, providing a copy of the March 14, 2003, submittal to the service list in the now-terminated license transfer proceeding.

Respectfully submitted,

David A. Repka

David A. Repka
Counsel for Pacific Gas & Electric Company

Enclosure

cc: Service List

300273.1

Template = SECY-043

SECY-02

Pacific Gas and Electric Company

Gregory M. Rueger
Senior Vice President–
Generation and
Chief Nuclear Officer

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March 14, 2003

PG&E Letter DCL-03-030

U.S. Nuclear Regulatory Commission
ATTN: Document Control Desk
Washington, DC 20555-0001

Docket No. 50-275, OL-DPR-80
Docket No. 50-323, OL-DPR-82
Diablo Canyon Power Plant, Units 1 and 2
Supplemental Information Related to License Transfer Application

Dear Commissioners and Staff:

On November 30, 2001, Pacific Gas and Electric Company (PG&E) filed an application pursuant to Section 184 of the Atomic Energy Act and 10 CFR 50.80, requesting consent to the transfer of the Nuclear Regulatory Commission (NRC) operating licenses for the Diablo Canyon Power Plant, Units 1 and 2 (DCPP). PG&E requested these transfers in connection with a Plan of Reorganization for PG&E (PG&E Plan) filed by PG&E and its Parent, PG&E Corporation (Parent), with the United States Bankruptcy Court for the Northern District of California (the Bankruptcy Court) under Chapter 11 of the United States Bankruptcy Code.

This letter provides information to the NRC with respect to certain financial modifications (Modifications) recently made to the PG&E Plan. The Modifications do not alter PG&E's license transfer application pending at the NRC. The Modifications are described here solely for the purpose of apprising the NRC of developments concerning the proposed reorganization of PG&E.

On February 24, 2003, PG&E and Parent filed the Modifications to the PG&E Plan with the Bankruptcy Court. The Modifications are designed to provide flexibility to Reorganized PG&E, GTrans LLC (GTrans), ETrans LLC (ETrans) and Electric Generation LLC (Gen) (collectively, GTrans, ETrans and Gen are referred to as the Newco Companies) to alter the amount and type of debt each may issue under the PG&E Plan if necessary to obtain investment grade credit ratings. A Narrative Description of the Modifications filed with the Bankruptcy Court, including a copy of a related letter from Standard & Poor's Rating Services (S&P) described below, is provided as an Enclosure to this letter.

While the financial projections relating to PG&E, Gen, and the other Newco Companies in the PG&E Plan have not materially changed over the approximately 14 months since S&P provided preliminary or "indicative" ratings of the debt securities to be issued under the PG&E Plan, the manner and assumptions rating agencies use to evaluate energy and utility businesses have been changing and have become more conservative. In a letter to Parent dated February 19, 2003, S&P confirmed its opinion that based on current market conditions and an updated financial model supplied by PG&E and Parent, the debt securities to be issued under the PG&E Plan, as well as Reorganized PG&E and the Newco Companies, are each capable of achieving investment grade ratings as long as certain conditions are met. The new S&P conditions specify that Reorganized PG&E and the Newco Companies be in a position to: (1) reduce their debt levels by about $615 million in the aggregate from the levels contemplated under the PG&E Plan as previously filed, and that Parent be prepared to contribute up to $700 million of additional capital if necessary to achieve such reduction, and (2) issue secured rather than unsecured debt securities under the PG&E Plan to the extent that this is necessary, given then-current market conditions, to secure investment grade ratings for the debt.

The financial projections filed with the Bankruptcy Court on February 24, 2003, (as compared to the prior projections) have been adjusted to reflect an aggregate reduction in debt of $615 million consistent with the amount of debt Reorganized PG&E and each Newco Company could support under current market conditions while still obtaining investment grade ratings. The revised financial projections show the amount of debt to be issued by Gen – the proposed transferee for the DCPP licenses - is expected to decrease by $700 million ($2.4 to $1.7 billion). The estimates are subject to change to take into account, among other things, changes in market conditions, such as lower interest rates than those assumed by S&P.

On February 27, 2003, the Bankruptcy Court convened a status conference to consider the impact of the Modifications on the ongoing trial related to confirmation of the PG&E Plan. While the Bankruptcy Court found that the Modifications do not require a new solicitation of creditor votes, it determined that all creditors should be given notice of the Modifications and a brief opportunity to interpose objections to, and engage in discovery on, the PG&E Plan as it would be modified. The Bankruptcy Court subsequently directed PG&E, Parent, the California Public Utilities Commission, the Official Creditors' Committee, and certain other parties to attend a pre-settlement conference before a settlement judge on March 10, 2003. By order dated March 11, 2003, the Bankruptcy Court stayed the further proceedings in the PG&E bankruptcy confirmation trial for a period of sixty days, effective as of March 11, 2003, in order to facilitate discussions before the settlement judge.

The Modifications do not materially affect the pending NRC license transfer application for the DCPP units or the financial qualifications of Gen. Indeed, as discussed in the Enclosure, the Modifications will assist in the achievement of investment grade ratings, thus facilitating the ability of Gen to carry out its obligations as the DCPP operating licensee. With respect to the financial projections for Gen previously provided to the NRC in connection with the license transfer application, the Modifications do not result in any change material to the NRC's financial qualifications review. Under the current market conditions reflected in the S&P letter, the Modifications would result in reduced debt (overall and for Gen) and reduced costs associated with debt service, and would not materially affect projected revenues, projected operating expenses, or projected liquid assets.

If you have any questions about this matter, please contact Mr. Terence Grebel at (805) 595-4160.

Sincerely,

Gregory M. Rueger
Senior Vice President – Generation and Chief Nuclear Officer

tlg/4160
Enclosure

cc: Edgar Bailey, DHS
Sylvia D. Gardner
Ellis W. Merschoff
David L. Proulx
Diablo POR Distribution
cc/enc: Girija S. Shukla

PG&E's Narrative Description of PG&E Plan Modifications Dated February 24, 2003

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PACIFIC GAS AND ELECTRIC COMPANY

FILED
FEB 24 2003
UNITED STATES BANKRUPTCY COURT
SAN FRANCISCO, CA

UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

In re PACIFIC GAS AND ELECTRIC COMPANY, a California corporation, Debtor. Federal I.D. No. 94-0742640	Case No. 01-30923 DM Chapter 11 Case Date: February 27, 2003 Time: 9:30 a.m.. Place: 235 Pine Street, 22nd Floor San Francisco, CA Judge: Hon. Dennis Montali

HOWARD RICE NEMEROVSKI CANADY FALK & RABKIN
A Professional Corporation

PG&E'S NARRATIVE DESCRIPTION OF PG&E PLAN MODIFICATIONS DATED FEBRUARY 24, 2003

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Pursuant to the Court's direction in open Court on February 18, 2003, the debtor Pacific Gas and Electric Company ("PG&E" or the "Debtor") and the co-proponent of its Plan of Reorganization, its parent PG&E Corporation ("Parent," and together with the Debtor, the "PG&E Proponents"), jointly submit this narrative summary of their Modifications Dated February 24, 2003 filed concurrently herewith (the "Modifications") to the Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company dated April 19, 2002 jointly propounded by the PG&E Proponents, as amended to date (the "PG&E Plan").[1]

BACKGROUND/OVERVIEW

The PG&E Proponents, in order to restore the Debtor to financial health and pay creditors' claims, have from the outset sought to develop a plan that will achieve investment grade ratings for the debt securities to be issued under the PG&E Plan, as well as for the issuers of such securities. The PG&E Proponents therefore have been in touch with a leading credit rating agency, Standard & Poor's ("S&P"), to remain informed and abreast of what will be required to obtain investment grade ratings.

This is sensible due diligence in the context of this complex Chapter 11 case and the pending competing plans of reorganization. In light of the turbulence that has affected the energy and utility sector, the manner and assumptions used by the rating agencies to rate energy and utility businesses have been changing. In a word, the rating agencies have become much more conservative in the last year as to how they view the energy sector. Thus, even though the financial projections pertaining to the Reorganized Debtor and the Newco entities have not materially changed over the 14 months since the prior preliminary or "indicative" ratings of the debt securities to be issued under the PG&E Plan were provided by S&P, S&P's expectations regarding debt capacity at the Reorganized Debtor and Newco

[1]Unless otherwise specified, all capitalized words or terms used herein have the same meanings ascribed to them in the PG&E Plan; where special emphasis is placed on the PG&E Plan as it existed prior to the Modifications, the term "existing PG&E Plan" is used.

entities have evolved.

As part of the effort to keep informed of what may presently be required to obtain investment grade credit ratings for the debt securities to be issued by the Reorganized Debtor, ETrans, GTrans and Gen under the PG&E Plan and for the issuers themselves, the PG&E Proponents have recently obtained from S&P an updated preliminary rating evaluation of such debt securities and issuers. In its letter to the Parent dated February 19, 2003 (a copy of which is appended hereto for the Court's convenient reference), S&P, based on current market conditions and an updated financial model supplied by the PG&E Proponents earlier this month,[2] has stated its opinion that the debt securities to be issued under the PG&E Plan by the Reorganized Debtor, ETrans, GTrans and Gen, as well as the four companies themselves, are each capable of achieving investment grade ratings (at least "BBB-"), based on certain conditions specified in Appendix A to the S&P letter.

In a nutshell, the Modifications seek to address the new key financial conditions identified by S&P in its February 19 letter for achieving investment grade ratings for the debt securities to be issued under the PG&E Plan and for the issuers. These key S&P conditions are that (1) the Reorganized Debtor and the three Newco entities (i.e., ETrans, GTrans and Gen) be in a position to reduce their collective debt levels by about $615 million in the aggregate from the levels contemplated under the existing PG&E Plan, and the Parent be prepared to contribute up to $700 million of additional capital if necessary to achieve such reduction, and (2) the Reorganized Debtor and the three Newco entities be prepared to issue secured rather than unsecured debt securities under the PG&E Plan.

The Modifications address these two broad conditions in a sensible and practical way without adversely affecting any creditors of the Debtor. On the contrary, the Modifications can only <u>benefit</u> creditors. Those creditors who already are receiving all Cash

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[2]The updated financial model is not materially different than the financial model on which the financial projections for the existing PG&E Plan are based, except that the reductions in debt specified by S&P have been incorporated into the updated model.

on their Allowed Claims are benefited because the Modifications help secure the investment grade ratings that are necessary for timely consummation of the PG&E Plan. Those creditors in Classes 5, 6 and 7 who receive part Cash and part Long-Term Notes on their Allowed Claims are benefited by the Modifications because, to the extent the S&P-required debt levels of any one or more of GTrans, ETrans and Gen are lower at the Effective Date than those contemplated under the existing PG&E Plan, Classes 5, 6 and 7 will always receive more in Cash and less in Notes. Specifically, for the three Newco entities issuing both Long-Term Notes and New Money Notes under the PG&E Plan, any required reduction in debt will reduce the Long-Term Notes and not the New Money Notes, meaning that creditors in Classes 5, 6 and 7 necessarily would receive a greater percentage of their distributions in Cash. Conversely, while the Modifications permit one or more of the Reorganized Debtor and the Newco entities to issue additional debt securities under certain circumstances,[3] any such additional debt securities must be in the form of New Money Notes and not Long-Term Notes, so that no creditor under any circumstance would receive less Cash and more Long-Term Notes under the Modifications than under the existing PG&E Plan.

In short, the Modifications are a salutary, no-lose proposition for all creditors: the Modifications mean that creditors in Classes 5, 6 and 7 may receive a higher percentage of their distributions in Cash on the Effective Date and a lower percentage in Long-Term Notes than under the existing PG&E Plan, and creditors under no circumstance will receive less Cash on the Effective Date than under the existing PG&E Plan.

[3] The amount of debt that can be supported while still obtaining an investment grade rating is determined on a company-by-company basis, and it is therefore possible that while the aggregate debt of the Reorganized Debtor and the three Newco companies may need to be decreased from the levels contemplated in the existing PG&E Plan in order to obtain investment grade ratings, one or more of the companies will be able to support debt in an amount greater than the amount contemplated in the existing PG&E Plan. See footnote 4 below for additional discussion.

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MODIFICATIONS ALLOWING FLEXIBILITY TO ISSUE SECURED DEBT, AND RELATED MATTERS.

Exhibit A to the existing PG&E Plan, containing the Summary of Terms of Debt Securities, currently specifies that the New Money Notes, the Long-Term Notes and the QUIDS Notes will be unsecured obligations of their respective issuers. The Modifications revise Exhibit A to allow one or more of the issuers to issue secured debt. The changes to Exhibit A include information regarding ranking, collateral, exceptions to collateral and release of collateral that will apply if the debt is secured. The Modifications also provide that if any of ETrans, GTrans or Gen issues secured New Money Notes, its Long-Term Notes (and the QUIDS Notes in the case of Gen) will be secured. This is to ensure that as to each issuer of debt securities under the PG&E Plan, all of such issuer's debt securities issued under the PG&E Plan are pari passu.

Pursuant to the Modifications, debt securities under the PG&E Plan could be issued on a secured basis to the extent necessary to obtain investment grade ratings, or, even if not necessary to obtain investment grade ratings, for the purpose of reducing the interest rates on the New Money Notes if appropriate under then-existing market conditions. Under current credit market conditions, the PG&E Proponents expect that all of the New Money Notes, the Long-Term Notes and the QUIDS Notes would be secured. However, as market conditions evolve between now and the Effective Date, it may not be necessary for one or more of the Reorganized Debtor or the Newco entities to issue secured debt to obtain an investment grade rating for its debt securities to be issued under the PG&E Plan. Therefore, the Modifications provide for the flexibility to issue secured or unsecured debt, depending on the market conditions at the time of issuance.

The Modifications specify certain covenants expected to be included in the indenture for the Gen New Money Notes, Gen Long-Term Notes and QUIDS Notes that would require establishment and maintenance of debt service reserve and operating reserve accounts. The Modifications also restrict Gen from issuing additional debt above a specified amount without confirming that issuing the additional debt would not cause Gen's then-

HOWARD RICE NEMEROVSKI CANADY FALK & RABKIN existing debt to be downgraded to speculative grade from investment grade.

If the Reorganized Debtor issues secured New Money Notes, the Modifications provide for two additional practical changes, which beneficially affect the treatment of three Classes and do not prejudice any creditors. These changes are as follows:.

(a) In addition to what it already receives under the Plan, Class 4c, consisting of MBIA's claims under the MBIA Reimbursement Agreement as reimbursement for payments made by MBIA under the PC Bond Insurance Policy, will receive a contingent note issued under the same indenture as, and equal in ranking to, the Reorganized Debtor New Money Notes, in an amount equal to the outstanding principal amount of the MBIA Insured PC Bonds. This ensures that to the extent the Reorganized Debtor's senior debt obligations are secured, its principal obligations to MBIA after the Effective Date rank pari passu with such other senior debt. That is the case under the existing PG&E Plan: the Reorganized Debtor's obligations to MBIA are currently pari passu with the Reorganized Debtor's other senior unsecured obligations.

(b) The Mortgage Backed PC Bonds (Class 4a) would not remain outstanding. Rather, the Mortgage Backed PC Bonds would be redeemed by the Reorganized Debtor on the Effective Date in accordance with their terms. New Mortgage Bonds would not be issued to replace the Mortgage Bonds currently backing the Mortgage Backed PC Bonds. Each holder of an Allowed Secured Claim relating to the Mortgage Backed PC Bonds (Class 4a) would be paid Cash in the amount of its Allowed Claim. The contingent Claim of Class 3b would be extinguished by the same payments. Thus, if it is determined that the Reorganized Debtor must secure its New Money Notes to obtain an investment grade rating, these transactions allow the Reorganized Debtor New Money Notes to have a first lien on property of the Reorganized Debtor.

MODIFICATIONS WITH RESPECT TO INCREASES AND DECREASES OF DEBT SECURITIES

The existing PG&E Plan specifies fixed amounts of Long-Term Notes to be issued by ETrans, GTrans and Gen and fixed amounts of New Money Notes to be issued by ETrans, GTrans, Gen and the Reorganized Debtor (as well as an aggregate principal amount of PC Bonds expected to remain outstanding). To take into account that the amount of debt that each of ETrans, GTrans, Gen and the Reorganized Debtor can support and still obtain investment grade credit ratings has changed since the PG&E Plan was prepared (and may change again before the Effective Date),[4] and that the amounts of available Cash and Allowed Claims may also continue to change, the Modifications provide a mechanism by which the aggregate amount of Long-Term Notes and New Money Notes of ETrans, GTrans and Gen and New Money Notes of the Reorganized Debtor can be adjusted. Such adjustment in the amount of debt may be necessary to satisfy the Cash obligations of the Reorganized Debtor as of the Effective Date in respect of Allowed Claims and required deposits to escrow accounts for Disputed Claims, or to obtain the issuance of investment-grade credit ratings for the New Money Notes, Long-Term Notes and QUIDS Notes under the PG&E Plan.

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Under this adjustment mechanism, if additional Cash is required and additional debt can be issued and still obtain investment grade credit ratings, an amount of New Money Notes (and only New Money Notes) greater than that contemplated by the existing PG&E Plan may be issued by one or more of ETrans, GTrans, Gen and the Reorganized Debtor. On the other hand, if debt less than that contemplated by the existing PG&E Plan is required to satisfy the Cash obligations of the Reorganized Debtor as of the Effective Date or if debt less than that contemplated by the existing PG&E Plan is necessary to obtain the issuance of an

[4]Based on the financial model provided to S&P earlier this month and current market conditions, the aggregate amount of debt that Gen and the Reorganized Debtor currently could support while still obtaining investment grade ratings is less than the aggregate amount of debt for these entities contemplated in the existing PG&E Plan, while the aggregate amount of debt that ETrans and GTrans currently could support and still obtain investment grade ratings is greater. Thus, notwithstanding that under current conditions the overall debt to be issued by the Reorganized Debtor and the three Newco companies would decrease by approximately $615 million from that contemplated by the existing PG&E Plan in order to obtain investment grade ratings, the more relevant focus is what decrease is required for any one or more of the four companies to secure an investment grade rating, and what increase for any one or more of the four companies can be absorbed without jeopardizing an investment grade rating for such company.

investment grade rating for one or more of ETrans, GTrans, Gen or the Reorganized Debtor, the amount of Long-Term Notes (and only Long-Term Notes) to be issued by ETrans, GTrans or Gen (or, in the case of the Reorganized Debtor, the amount of New Money Notes to be issued by the Reorganized Debtor) will be reduced. As a result, any reduction in the amount of debt at ETrans, GTrans or Gen increases the amount of Cash that will be distributed to holders of Allowed Claims in Classes 5, 6 and 7. Conversely, any increase in debt, which can only be effected through the issuance of New Money Notes, has no effect on what the holders of Allowed Claims will receive.

MODIFICATIONS WITH RESPECT TO INFUSION OF CAPITAL BY THE PARENT

Under certain circumstances, reductions in the amount of debt securities that the Reorganized Debtor and the three Newco entities can issue and still obtain investment grade ratings could result in insufficient Cash available as of the Effective Date in respect of Allowed Claims and required deposits to escrow accounts for Disputed Claims. The Modifications reflect the Parent's willingness to safeguard against such a shortfall. More specifically, the Modifications provide that, if necessary to provide needed Cash to the Reorganized Debtor to consummate the PG&E Plan, the Parent will make an offering of its own equity securities or use other sources of Cash and contribute up to $700 million to the capital of the Reorganized Debtor on or before the Effective Date. This is no way prejudices any creditor or equity holder of the Debtor. This commitment by the Parent to infuse up to

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$700 million in capital in the Debtor is a powerful backstop and safety net, making additional Cash available on the Effective Date if necessary to obtain investment grade ratings. This can only be a good thing for all creditors in this case; it has only upside and no downside.

DATED: February 24, 2003

Respectfully,

HOWARD, RICE, NEMEROVSKI, CANADY,
FALK & RABKIN
A Professional Corporation

By: [signature]
JAMES L. LOPES

Attorneys for Debtor and Debtor in Possession
PACIFIC GAS AND ELECTRIC COMPANY

WD 022403/1-1419915/108/1057969

HOWARD RICE NEMEROVSKI CANADY FALK & RABKIN
A Professional Corporation

Corporate Ratings
55 Water Street
New York, NY 10041-0003

Standard & Poor's
A Division of The McGraw-Hill Companies

February 19, 2003

Mr. Peter A. Darbee
Senior Vice President and Chief Financial Officer
PG&E Corporation
One Market, Spear Tower
Suite 2400
San Francisco, California 94105

Dear Mr. Darbee:

Pursuant to your request, Standard & Poor's has performed a preliminary rating evaluation of the corporate credit ratings of, and the approximately $8.5 billion of secured debt ("Securities") to be issued or reinstated by, the four companies that have been proposed to succeed the debtor, Pacific Gas and Electric Company ("PG&E"), in connection with its emergence from bankruptcy should the Plan of Reorganization ("Plan") proposed and filed by PG&E in its Chapter 11 bankruptcy proceedings be adopted. The four companies include: an electric and gas distribution company ("the distribution company"); an electric transmission company; a gas transmission company; and an electric generation company ("the four companies").

In arriving at this preliminary rating evaluation, we have had discussions with PG&E and its advisors. We have also reviewed materials supplied to us by representatives of PG&E including, but not limited to:

- The PG&E Plan;
- The April 19, 2002 Disclosure Statement accompanying the PG&E Plan;
- Regulations promulgated by the California Public Utilities Commission ("CPUC");
- The revised financial model ("Model"), including financial forecasts and assumptions supplied to Standard & Poor's by representatives of PG&E on February 10, 2003; and
- Such other materials as we have deemed appropriate.

Based upon our review, it is Standard & Poor's current opinion that the approximately $8.5 billion of Securities proposed to be issued by the four companies, as well as the corporate credit ratings of the four companies proposed to succeed PG&E, would be capable of achieving investment grade ratings of at least 'BBB-'. Please note that the ultimate assignment of investment grade ratings hinges on the satisfaction of each of the several conditions cited in Appendix "A" to this letter.

A preliminary rating evaluation is not a rating. A preliminary rating evaluation is solely a credit opinion based on the facts and circumstances presented to us by PG&E. This preliminary rating evaluation should be understood as qualified by the fact that (i) additional information or changes to the information previously presented to us may result in credit risk stronger or weaker than that suggested by the preliminary rating evaluation and, consequently, a different definitive rating; (ii) the preliminary rating evaluation is not a prediction of the actual future performance of the Securities; (iii) Standard & Poor's does not warrant or endorse suitability of the preliminary rating evaluation for any particular purpose or use; (iv) the preliminary rating evaluation is provided without any express or implied warranties whatsoever; (v) the preliminary rating evaluation is based solely on information provided to us by PG&E and does not represent an audit by Standard & Poor's; (vi) Standard & Poor's relied upon PG&E, its accountants, counsel and other experts for the accuracy and completeness of the information submitted in connection with the preliminary rating evaluation; (vii) the preliminary rating evaluation shall not be construed to have been undertaken with the rigor and level of detail required for Standard & Poor's to provide a definitive rating opinion; and (viii) Standard & Poor's does not and cannot guarantee the accuracy, completeness or timeliness of the information relied upon in connection with the preliminary rating evaluation or the results obtained from the use of such information. Please note that the preliminary rating evaluation speaks only as of the date hereof and is not subject to surveillance or update. A more comprehensive analysis might lead to an outcome different than that of the preliminary rating evaluation. In addition, the preliminary rating evaluation does not address the validity of the assumptions made by PG&E in preparing the Model.

You may use this preliminary rating evaluation in connection with proceedings in *In re: Pacific Gas and Electric Company*. Standard & Poor's reserves the right to publish this preliminary rating evaluation and the conditions attendant thereto and to advise its own clients, subscribers, and the public thereof.

PG&E understands that Standard & Poor's has not consented to, and will not consent to, being named an "expert" under the federal securities laws, including without limitation, Section 7 of the Securities Act of 1933. In addition, it should be understood that the preliminary rating evaluation is neither a "market" rating nor a recommendation to buy, hold, or sell the Securities.

We are pleased to have been of service to PG&E. If we can be of further assistance, please do not hesitate to contact us.

Very truly yours,

Solomon B. Samson
Managing Director

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attachment

Appendix A

The results of Standard & Poor's preliminary rating evaluation, set forth in the February 19, 2003 letter, are predicated upon the satisfaction of each of the following conditions (a) through (kk):

a) The Plan will be conformed to the financial Model that PG&E furnished to Standard & Poor's on February 10, 2003, the Plan is confirmed and implemented substantially in the form proposed by PG&E, and is confirmed within the time frame contemplated by PG&E;
b) All financial targets set forth in the revised Model are substantially attained by each of the four companies without any material deviation from the projected results, each can successfully access capital markets to the extent forecast, each can secure any assumed liquidity facilities, and forecast cash balances are available to discharge a portion of creditors' claims as contemplated;
c) The Utility Reform Network's appeal to the 9th Circuit Court of Appeals, that challenges on both procedural and substantive grounds the settlement agreement reached between CPUC and Southern California Edison Company ("SCE") in SCE's "filed rate doctrine" litigation, does not establish legal precedents that defeat, diminish or impair the cash balances PG&E has forecast to be available for the satisfaction of creditors' claims, or defeat, diminish or impair PG&E's entitlement to recover historical power procurement costs;
d) The amount of claims made against the bankruptcy estate are substantially as estimated by PG&E's Plan;
e) Debt at each of the four companies will be secured debt, the amount of debt throughout the forecast will be no greater than the levels projected in the Model, the debt will be amortized as forecast, and interest costs do not materially exceed anticipated levels, noting that for analytical purposes Standard & Poor's examined the generation company using a 10% interest rate;
f) Debt of the yet-to-be-named parent of the electric transmission company, gas transmission company and electric generation company ("Parent" or "Parent and its three subsidiaries"), will be reduced by at least $500 million prior to or simultaneous with the emergence of PG&E from bankruptcy, such debt reduction will be accomplished with Parent's cash on hand, and Parent's administrative expenses are consistent with those forecast in the Model;
g) PG&E Corporation will issue $700 million of equity whose proceeds will be deployed, on or before emergence from bankruptcy, to reduce the four companies' debt to levels consistent with the Model, and such equity issuance will take place unless other monies -- whether resulting from lower than anticipated creditor claims, FERC-ordered generator refunds, or other sources -- are available to be applied to debt reduction and can obviate or mitigate the need for the equity issuance;
h) The electric generation company will establish and fund a debt service reserve account and an operating reserve account, the latter to be held to defray expenses associated with the shutdown of the Diablo Canyon Nuclear Power Plant ("Diablo"), currently projected to be incurred in or about 2022, 2023 and 2024, such reserves will be funded in accordance with the schedule established in the Model, will be restricted as to use, and, if monies on deposit in the debt service reserve account are drawn during the forecast period and rated debt

remains outstanding at the electric generation company, the debt service reserve account will be replenished from first available funds without compromising operating reserve account balances or any scheduled additional deposits to the operating reserve account;

i) With the exception of draws on working capital facilities whose cumulative drawn balances do not exceed $100 million as a result of the use of the facilities, the electric generation company will not issue any debt beyond the amount forecast in the Model without first obtaining from Standard & Poor's confirmation that the issuance of such additional debt will not cause any investment grade ratings assigned to outstanding electric generation company debt to be downgraded to speculative grade from investment grade;

j) Parent and its three subsidiary companies will not take any actions that are inconsistent with the representations made by PG&E to Standard & Poor's that Parent's National Energy Group family of companies subsidiaries ("NEG"), their assets and their business activities are not strategic to the operations and viability of Parent and Parent's other three subsidiary companies, because Standard & Poor's has relied upon this PG&E representation in concluding that it could exclude NEG's financial data from the consolidated financial analysis of Parent and its other three subsidiary companies, and it is Standard & Poor's opinion that if NEG had been included in the consolidated financial analysis of Parent and its other three subsidiary companies, the corporate credit and debt ratings of the electric generation, electric transmission, and gas transmission companies, would be incapable of achieving investment grade ratings;

k) Neither Parent nor its three subsidiaries will issue debt for the purpose of infusing capital into any of the NEG companies, moreover, neither Parent nor its three subsidiary companies other than NEG shall transfer, dividend or otherwise deploy available cash balances to NEG if such use of cash will result in the issuance of debt by Parent or its three subsidiary companies other than NEG;

l) PG&E obtains all approvals from regulatory bodies required for the implementation of the Plan and the Model, including, but not limited to, approvals from the Federal Energy Regulatory Commission ("FERC"), the Nuclear Regulatory Commission, and the Securities and Exchange Commission;

m) The bankruptcy court will, as contemplated by the Plan, (1) issue valid orders that override all California legislation and regulations that are inconsistent with the Plan, including, but not limited to, those that preclude PG&E from transferring generation assets to third-parties, (2) approve the proposed twelve-year power sales agreement ("PSA") between the distribution company and the electric generation company as successors to PG&E under the Plan, (3) enforce the PSA in accordance with its terms, and (4) approve the transfer of electric transmission, gas transmission, and electric generation assets to the appropriate companies as contemplated by the Plan;

n) FERC finds the wholesale power rates proposed under the PSA to be just and reasonable;

o) The rates payable by the distribution company to the electric generation company will not be reduced through renegotiation or otherwise during the life of the PSA, and the obligations created under the PSA contract may not be extinguished or terminated by the parties thereto;

p) The electric generation company will contract all of its owned capacity and energy to the distribution company for eleven years and approximately half of such capacity and energy in the twelfth year, and the distribution company will make capacity and energy payments to the electric generation company as contractually provided;

q) For so long as the PSA is in effect, the electric generation company's ability to divest generation assets will be restricted as contractually provided;

r) Hydrology conditions are consistent with the average-year levels set forth in the Model presented to Standard and Poor's by PG&E, and Diablo will exhibit capacity and availability factors consistent with those represented in the Model without any meaningful degradation associated with steam generator tubes or otherwise;

s) The ability of the distribution company to procure power at the prices anticipated under the PSA will not be frustrated by any inability of the electric generation company to dispatch its units due to either operational problems, transmission congestion, or emergencies declared by legislative or regulatory bodies within the state of California or federal agencies;

t) Following the January 1, 2006 expiration of those provisions of California Assembly Bill 57 / Senate Bill 1078 of 2002 that cover the timeliness of utility cost recovery, the CPUC will continue to act in a manner consistent with the provisions of that legislation, even though no longer legislatively mandated to do so;

u) The CPUC will provide for the distribution company to recover, in a timely manner that does not compromise cash flow, all power and fuel procurement expenses, whether related to the PSA, bilateral contracts, QF contracts, net open position, other sources of supply, or the retail gas distribution system;

v) Recovery of expenses identified in the preceding paragraph will occur irrespective of amounts of electricity that the distribution company sells as retail or surplus, or is deemed to have sold as surplus under CPUC regulations, and the distribution company will generally earn the contemplated rate of return without any material deviation from projected results;

w) During any period, including, but not limited to, off-peak periods, or the period following any customer losses due to retail choice, to the extent that the distribution company's electric and gas purchases exceed the distribution company's customers' retail demand, the distribution company will be permitted to resell to third-parties the surplus portions of the electricity and gas that must be purchased by the distribution company under the PSA, QF contracts, bilateral contracts, or from other sources of supply, and the distribution company will be capable of making such arrangements as will permit it to achieve its forecast financial results;

x) The amount of collateral that PG&E must post to procure net open position power or any other electricity is consistent with the levels projected in the Model, and capital costs associated with collateral are recoverable in rates;

y) The bankruptcy court, notwithstanding any contrary state law, regulation or policy, will prohibit or shield the distribution company from assuming financial responsibility for California Department of Water Resources ("CDWR") energy contracts, and Standard & Poor's further assumes that any action to the contrary that assigns financial responsibility for CDWR contracts to the distribution company will impair any investment grade ratings then assigned to the distribution company and lead to the assignment of speculative grade ratings;

z) The financial performance of the distribution company will not be materially compromised by (1) the operational and dispatch responsibility for CDWR contracts that has been vested in PG&E by the CPUC, (2) the sale of surplus CDWR capacity by PG&E on behalf of

CDWR, (3) any methodology created by the CPUC for the measurement of surplus sales, or (4) the allocation and recovery of CDWR contract costs;

aa) FERC authorizes the electric transmission company to earn the rate of return assumed in the Model;

bb) The gas transmission company acquires, as contemplated by the Plan, a segment of gas pipeline within Oregon, currently owned by National Energy Group's Gas Transmission Northwest Corporation, the acquisition will be made at a price that is not inconsistent with the financial forecast and, through such acquisition, the gas transmission company will be deemed to be an interstate pipeline subject to FERC jurisdiction and regulation;

cc) FERC assumes jurisdiction over the gas transmission company's operations, materially displaces state regulation, permits the gas transmission company to enter into long-term contracts, and authorizes the gas transmission company to earn the rate of return assumed in the Model;

dd) The majority of the "qualifying generation facilities" ("QF") will operate under the fixed energy price arrangements that expire in 2006 that are reflected in the Model, the remaining QF facilities will operate under the other contractual arrangements embedded in the Model, and after the expiration of such QF contracts, the distribution company will be able to recover the costs of replacement power and such costs will be consistent with those forecast in the Model;

ee) Should the CPUC reject any or all of the distribution company's proposed electric procurement plans, or portions thereof, the distribution company will be able to secure alternative wholesale electric supplies at prices acceptable to the CPUC, and the costs associated with such electric supply will be recoverable in rates in a timely manner;

ff) The California Independent System Operator ("California ISO"), while acting in its intermediary role as a clearinghouse for the settlement of payments for transmission, transactions, will not materially impair the cash flow of the electric transmission company or any of its affiliate companies;

gg) The distribution company's ability to dispatch the generation units and the electric generation company's ability to earn its anticipated revenues are not impaired as a result of any action of the California ISO in its oversight of the state's transmission network, in its provision of access to the network, or as a result of congestion upon such transmission network;

hh) FERC's implementation of Standard Market Design will not materially impair the forecast cash flow of the distribution company, the electric transmission company, the electric generation company, or the gas transmission company;

ii) Any financial obligations arising from the several compressor station chromium contamination litigations pending against PG&E, do not impair the financial results forecast in the Model;

jj) The final order of the bankruptcy court will preempt any inconsistent findings, orders or regulations of the CPUC arising from hearings opened by the CPUC on January 7, 2003, to examine the merits of the competing reorganization plans that have been proposed for PG&E by CPUC and PG&E; and

kk) Evidence that CPUC has developed and implemented a methodology for the prospective approval of the prudence and reasonableness of the distribution company's risk management and risk tolerance activities, and evidence that the CPUC will permit as a ministerial matter the recovery of the distribution company's costs of securing risk management tools and also permit the recovery of costs associated with that portion of the power and fuel portfolio that is not hedged.