PACIFIC GAS & ELECTRIC CO
Form 10-Q/A
June 30, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C., 20549

FORM 10-Q/A

Amendment No. 1

(Mark One)

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2003

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _______________ to _______________

Commission File Number	Exact Name of Registrant as specified in its charter	State or other Jurisdiction of Incorporation	IRS Employer Identification Number
1-12609	**PG&E Corporation**	**California**	**94-3234914**
1-2348	**Pacific Gas and Electric Company**	**California**	**94-0742640**

Pacific Gas and Electric Company
77 Beale Street
P.O. Box 770000
San Francisco, California 94177

PG&E Corporation
One Market, Spear Tower Suite 2400
San Francisco, California 94105

(Address of principal executive offices)(Zip Code)

Pacific Gas and Electric Company
(415) 973-7000

PG&E Corporation
(415) 267-7000

Registrant's telephone number, including area code

Indicate by check mark whether the registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve months (or for such shorter period that the registrant was required to file such reports), and (2) have been subject to such filing requirements for the past 90 days.

Yes ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes ý No o

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of latest practicable date.

Common Stock Outstanding, May 9, 2003:

PG&E Corporation	409,191,299 shares
Pacific Gas and Electric Company	Wholly owned by PG&E Corporation

Explanatory Note

Subsequent to the issuance of PG&E Corporation's 1st quarter 2003 Consolidated Financial Statements, management discovered a misclassification of certain offsetting revenues and expenses within its continuing operations of PG&E National Energy Group (PG&E NEG). The reclassification resulted in a decrease in Operating Revenues from $2,607 million to $2,401 million and a similar decrease in Operating Expenses Cost of Commodity Sales and Fuel from $364 million to $158 million. This Amendment No. 1 to PG&E Corporation's and Pacific Gas and Electric Company's joint Form 10-Q for the quarter ended March 31, 2003, contains revised consolidated financial statements for PG&E Corporation for the quarter ended March 31, 2003. To reflect the revisions, this Amendment No. 1 hereby amends:

Part I, Item 1. Financial Statements. Corrections have been made to the Consolidated Statement of Operations for the three months ended March 31, 2003 and to Note 1 of the "Notes to the Consolidated Financial Statements."

Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. Corrections have been made to the sections entitled "Results of Operations" and "Consolidated Statements of Operations."

Part I, Item 3. Quantitative and Qualitative Disclosures About Market Risk. References are made to the "Management's Discussion and Analysis of Financial Condition and Results of Operations" filed as part of this amended Form 10-Q/A.

Part II, Item 6. Exhibits and Reports on Form 8-K (amended to file herewith, Exhibit 99.1, Certifications of the Chief Executive Officer and the Chief Financial Officer of PG&E Corporation required by Section 906 of the Sarbanes-Oxley Act of 2002, and Exhibit 99.2, Certifications of the Chief Executive Officer and the Chief Financial Officer of Pacific Gas and Electric Company required by Section 906 of the Sarbanes-Oxley Act of 2002.)

PART I. FINANCIAL INFORMATION

ITEM 1: CONSOLIDATED FINANCIAL STATEMENTS

PG&E CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share amounts)

	Three months ended March 31,	
	2003	**2002**
	(as revised see Note 1)	
	(Unaudited)	
Operating Revenues		

	Three months ended March 31,	
Utility	$ 2,067	$ 2,453
Energy commodities and services	334	482
Total operating revenues	2,401	2,935
Operating Expenses		
Cost of electricity and natural gas for utility	1,027	149
Cost of energy commodities and services	158	306
Depreciation, amortization, and decommissioning	336	303
Operating and maintenance	774	860
Impairments, write-offs, and other charges	200	
Reorganization professional fees and expenses	35	16
Total operating expenses	2,530	1,634
Operating Income (Loss)	(129)	1,301
Reorganization interest income	10	22
Interest income	4	10
Interest expense	(375)	(334)
Other income (expense), net	3	20
Income (Loss) Before Income Taxes	(487)	1,019
Income tax provision (benefit)	(209)	396
Income (Loss) From Continuing Operations	(278)	623
Discontinued Operations		
Earnings (loss) from operations of USGenNE, Mountain View, and ET Canada (net of income tax expense (benefit) of $(35) million in 2003 and $5 million in 2002)	(65)	8
Net loss on disposal of USGenNE, Mountain View, and ET Canada (net of income tax (benefit) of $(2) million in 2003)	(5)	
Net Income (Loss) Before Cumulative Effect of Changes in Accounting Principles	(348)	631
Cumulative effect of changes in accounting principles (net of income tax (benefit) of $(4) million in 2003)	(6)	
Net Income (Loss)	$ (354)	$ 631
Weighted Average Common Shares Outstanding, Basic	382	364
Earnings (Loss) Per Common Share from Continuing Operations, Basic	$ (0.73)	$ 1.71
Net Earnings (Loss) Per Common Share, Basic	$ (0.93)	$ 1.73
Earnings (Loss) Per Common Share from Continuing Operations, Diluted	$ (0.73)	$ 1.69

Net Earnings (Loss) Per Common Share, Diluted	$ (0.93)	$ 1.71

See accompanying Notes to the Consolidated Financial Statements.

PG&E CORPORATION

CONSOLIDATED BALANCE SHEETS

(in millions)

	Balance at	
	March 31, 2003	**December 31, 2002**
	(Unaudited)	
ASSETS		
Current Assets		
Cash and cash equivalents	$ 4,568	$ 3,895
Restricted cash	567	708
Accounts receivable:		
Customers (net of allowance for doubtful accounts of $109 million in 2003 and $113 million in 2002)	2,307	2,747
Regulatory balancing accounts	126	98
Price risk management	717	498
Inventories	240	347
Assets held for sale	266	707
Prepaid expenses and other	449	480
Total current assets	9,240	9,480
Property, Plant and Equipment		
Utility	27,811	27,045
Non-utility:		
Electric generation	997	636
Gas transmission	1,779	1,761
Construction work in progress	1,315	1,560
Other	187	177
Total property, plant and equipment	32,089	31,179
Accumulated depreciation and decommissioning	(13,223)	(14,251)
Net property, plant and equipment	18,866	16,928
Other Noncurrent Assets		
Regulatory assets	1,984	2,053

	Balance at	
Nuclear decommissioning funds	1,314	1,335
Price risk management	264	398
Deferred income taxes	958	657
Assets held for sale	810	916
Other	1,857	1,929
Total other noncurrent assets	7,187	7,288
TOTAL ASSETS	$ 35,293	$ 33,696

See accompanying Notes to the Consolidated Financial Statements.

PG&E CORPORATION

CONSOLIDATED BALANCE SHEETS

(in millions)

	Balance at	
	March 31, 2003	**December 31, 2002**
	(Unaudited)	
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities Not Subject to Compromise		
Current Liabilities		
Debt in default	$ 4,373	$ 4,230
Long-term debt, classified as current	601	298
Current portion of rate reduction bonds	290	290
Accounts payable:		
Trade creditors	1,327	1,273
Regulatory balancing accounts	337	360
Other	721	660
Interest payable	219	139
Income taxes payable		129
Price risk management	642	506
Liabilities of operations held for sale	353	699
Other	660	685
Total current liabilities	9,523	9,269
Noncurrent Liabilities		
Long-term debt	4,279	4,345
Rate reduction bonds	1,086	1,160

	Balance at	
Asset retirement obligations	1,374	
Deferred income taxes	1,605	1,439
Deferred tax credits	139	144
Price risk management	259	305
Liabilities of operations held for sale	758	793
Other	3,286	2,963
Total noncurrent liabilities	12,786	11,149
Liabilities Subject to Compromise		
Financing debt	5,605	5,605
Trade creditors	3,611	3,580
Total liabilities subject to compromise	9,216	9,185
Commitments and Contingencies (Notes 1, 2, 3, and 6)		
Preferred Stock of Subsidiaries	480	480
Common Stockholders' Equity		
Common stock, no par value, authorized 800,000,000 shares, issued 408,610,591 common and 1,569,260 restricted shares in 2003 and 405,486,015 common shares in 2002	6,318	6,274
Common stock held by subsidiary, at cost, 23,815,500 shares	(690)	(690)
Unearned compensation	(21)	
Accumulated deficit	(2,233)	(1,878)
Accumulated other comprehensive loss	(86)	(93)
Total common stockholders' equity	3,288	3,613
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 35,293	$ 33,696

See accompanying Notes to the Consolidated Financial Statements.

PG&E CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

	Three months ended March 31,	
	2003	**2002**

	Three months ended March 31,	
	(Unaudited)	
Cash Flows From Operating Activities		
Net income (loss)	$ (354)	$ 631
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, amortization, and decommissioning	336	320
Deferred income taxes and tax credits, net	(48)	(82)
Reversal of ISO accrual (Note 2)		(970)
Price risk management assets and liabilities, net	12	23
Other deferred charges and noncurrent liabilities	94	107
Loss on impairment or disposal of assets	200	
Loss from discontinued operations	7	
Cumulative effect of a change in accounting principle	10	
Net effect of changes in operating assets and liabilities:		
Restricted cash	141	5
Accounts receivable	433	428
Inventories	107	120
Accounts payable	177	344
Accrued taxes	(129)	479
Regulatory balancing accounts, net	(51)	125
Other working capital	93	(40)
Payments authorized by the Bankruptcy Court on amounts classified as liabilities subject to compromise (Note 2)	(39)	(248)
Assets and liabilities of operations held for sale, net	(20)	(41)
Other, net	(36)	(11)
Net cash provided by operating activities	933	1,190
Cash Flows From Investing Activities		
Capital expenditures	(472)	(711)
Proceeds from disposal of discontinued operations	102	
Other, net	30	(6)
Net cash used by investing activities	(340)	(717)
Cash Flows From Financing Activities		
Net borrowings under credit facilities		76
Long-term debt issued	152	190
Long-term debt matured, redeemed, or repurchased	(18)	(340)
Rate reduction bonds matured	(75)	(75)
Common stock issued	21	21
Other, net		(20)
Net cash provided (used) by financing activities	80	(148)
Net change in cash and cash equivalents	673	325
Cash and cash equivalents at January 1	3,895	5,355
Cash and cash equivalents at March 31	$ 4,568	$ 5,680

	Three months ended March 31,	

Supplemental disclosures of cash flow information		
Cash received for:		
Reorganization interest income	$ 11	$ 22
Cash paid for:		
Interest (net of amounts capitalized)	149	108
Income taxes paid (refunded), net	1	8
Reorganization professional fees and expenses	22	2
Supplemental disclosures of noncash investing and financing activities		
Transfer of liabilities and other payables subject to compromise from operating assets and liabilities	47	75

See accompanying Notes to the Consolidated Financial Statements.

PACIFIC GAS AND ELECTRIC COMPANY, A DEBTOR-IN-POSSESSION

CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions)

	Three months ended March 31,	
	2003	**2002**
	(Unaudited)	
Operating Revenues		
Electric	$ 1,237	$ 1,778
Natural gas	830	675
Total operating revenues	2,067	2,453
Operating Expenses		
Cost of electricity	541	(166)
Cost of natural gas	486	315
Operating and maintenance	646	769
Depreciation, amortization, and decommissioning	310	271
Reorganization professional fees and expenses	35	16
Total operating expenses	2,018	1,205
Operating Income	49	1,248
Reorganization interest income	10	22

	Three months ended March 31,	
Interest income	1	
Interest expense (non-contractual interest of $30 million in 2003 and $65 million in 2002)	(220)	(263)
Other income (expense), net	4	(5)
Income (Loss) Before Income Taxes	(156)	1,002
Income tax provision (benefit)	(84)	406
Income (Loss) Before Cumulative Effect of Changes in Accounting Principles	(72)	596
Cumulative effect of changes in accounting principles (net of income taxes of $(1) million in 2003)	(1)	
Net Income (Loss)	(73)	596
Preferred dividend requirement	6	6
Income Available for (Loss Allocated to) Common Stock	$ (79)	$ 590

See accompanying Notes to the Consolidated Financial Statements.

10

PACIFIC GAS AND ELECTRIC COMPANY, A DEBTOR-IN-POSSESSION

CONSOLIDATED BALANCE SHEETS

(in millions)

	Balance at	
	March 31, 2003	December 31, 2002
	(Unaudited)	
ASSETS		
Current Assets		
Cash and cash equivalents	$ 3,646	$ 3,343
Restricted cash	191	150
Accounts receivable:		
Customers (net of allowance for doubtful accounts of $63 million in 2003 and $59 million in 2002)	1,511	1,900
Related parties	18	17
Regulatory balancing accounts	126	98
Inventories:		
Gas stored underground and fuel oil	82	154
Materials and supplies	122	121
Income taxes receivable	226	50
Prepaid expenses	66	110
Deferred income taxes		5
Total current assets	5,988	5,948

	Balance at	
Property, Plant and Equipment		
Electric	19,641	18,922
Gas	8,170	8,123
Construction work in progress	491	427
Total property, plant and equipment	28,302	27,472
Accumulated depreciation and decommissioning	(12,485)	(13,515)
Net property, plant and equipment	15,817	13,957
Other Noncurrent Assets		
Regulatory assets	1,949	2,011
Nuclear decommissioning funds	1,314	1,335
Other	1,248	1,300
Total other noncurrent assets	4,511	4,646
TOTAL ASSETS	$ 26,316	$ 24,551

See accompanying Notes to the Consolidated Financial Statements.

11

PACIFIC GAS AND ELECTRIC COMPANY, A DEBTOR-IN-POSSESSION

CONSOLIDATED BALANCE SHEETS

(in millions)

	Balance at	
	March 31, 2003	**December 31, 2002**
	(Unaudited)	
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities Not Subject to Compromise		
Current Liabilities		
Long-term debt, classified as current	$ 591	$ 281
Current portion of rate reduction bonds	290	290
Accounts payable:		
Trade creditors	468	380
Related parties	141	130
Regulatory balancing accounts	337	360
Other	388	374
Interest payable	189	126

	Balance at	
Deferred income taxes	73	
Other	527	625
Total current liabilities	3,004	2,566
Noncurrent Liabilities		
Long-term debt	2,429	2,739
Rate reduction bonds	1,086	1,160
Regulatory liabilities	1,814	1,461
Asset retirement obligations	1,371	
Deferred income taxes	1,529	1,485
Deferred tax credits	139	144
Other	1,293	1,274
Total noncurrent liabilities	9,661	8,263
Liabilities Subject to Compromise		
Financing debt	5,605	5,605
Trade creditors	3,794	3,786
Total liabilities subject to compromise	9,399	9,391
Commitments and Contingencies (Notes 1, 2, and 6)		
Preferred Stock With Mandatory Redemption Provisions		
6.30% and 6.57%, outstanding 5,500,000 shares, due 2002-2009	137	137
Stockholders' Equity		
Preferred stock without mandatory redemption provisions		
Nonredeemable, 5% to 6%, outstanding 5,784,825 shares	145	145
Redeemable, 4.36% to 7.04%, outstanding 5,973,456 shares	149	149
Common stock, $5 par value, authorized 800,000,000 shares, issued 321,314,760 shares	1,606	1,606
Common stock held by subsidiary, at cost, 19,481,213 shares	(475)	(475)
Additional paid-in capital	1,964	1,964
Reinvested earnings	726	805
Total stockholders' equity	4,115	4,194
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 26,316	$ 24,551

See accompanying Notes to the Consolidated Financial Statements.

12

PACIFIC GAS AND ELECTRIC COMPANY, A DEBTOR-IN-POSSESSION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

	Three months ended March 31, 2003	Three months ended March 31, 2002
	(unaudited)	
Cash Flows From Operating Activities		
Net income (loss)	$ (73)	$ 596
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, amortization, and decommissioning	310	271
Deferred income taxes and tax credits, net	117	(113)
Other deferred charges and noncurrent liabilities	80	70
Reversal of ISO accrual (Note 2)		(970)
Cumulative effect of a change in accounting principle	2	
Net effect of changes in operating assets and liabilities:		
Restricted cash	(41)	5
Accounts receivable	381	208
Inventories	71	111
Income taxes receivable	(176)	
Accounts payable	122	453
Income taxes payable		519
Regulatory balancing accounts, net	(51)	125
Other working capital	24	95
Payments authorized by the Bankruptcy Court on amounts classified as liabilities subject to compromise (Note 2)	(39)	(225)
Other, net	7	14
Net cash provided by operating activities	734	1,159
Cash Flows From Investing Activities		
Capital expenditures	(371)	(353)
Proceeds from sale of assets	5	
Other, net	9	(7)
Net cash used by investing activities	(357)	(360)
Cash Flows From Financing Activities		
Long-term debt matured, redeemed, or repurchased		(333)
Rate reduction bonds matured	(75)	(75)
Other, net	1	
Net cash used by financing activities	(74)	(408)
Net change in cash and cash equivalents	303	391
Cash and cash equivalents at January 1	3,343	4,341
Cash and cash equivalents at March 31	$ 3,646	$ 4,732

Supplemental disclosures of cash flow information

	Three months ended March 31,	
Cash received for:		
Reorganization interest income	$ 11	$ 22
Cash paid for:		
Interest (net of amount capitalized)	116	65
Reorganization professional fees and expenses	22	2
Supplemental disclosures of noncash investing and financing activities		
Transfer of liabilities and other payables subject to compromise from operating assets and liabilities, net	47	75

See accompanying Notes to the Consolidated Financial Statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: GENERAL

Organization and Basis of Presentation

PG&E Corporation was incorporated in California in 1995 and became the holding company of Pacific Gas and Electric Company, a debtor-in-possession (the Utility), and its subsidiaries on January 1, 1997. The Utility, incorporated in California in 1905, is the predecessor of PG&E Corporation. The Utility delivers electric service to approximately 4.8 million customers and natural gas service to approximately 3.9 million customers in Northern and Central California. Both PG&E Corporation and the Utility are headquartered in San Francisco. As discussed further in Note 2, on April 6, 2001, the Utility filed a voluntary petition for relief under the provisions of Chapter 11 of the U.S. Bankruptcy Code (Bankruptcy Code) in the U.S. Bankruptcy Court for the Northern District of California (Bankruptcy Court). Pursuant to Chapter 11, the Utility retains control of its assets and is authorized to operate its business as a debtor-in-possession while being subject to the jurisdiction of the Bankruptcy Court.

PG&E Corporation's other significant subsidiary is PG&E National Energy Group, Inc. (PG&E NEG) and its subsidiaries, headquartered in Bethesda, Maryland. PG&E NEG was incorporated on December 18, 1998, as a wholly-owned subsidiary of PG&E Corporation. Shortly thereafter, PG&E Corporation contributed various subsidiaries to PG&E NEG. PG&E NEG's principal subsidiaries include:

- PG&E Generating Company, LLC and its subsidiaries (collectively, PG&E Gen LLC);
- PG&E Energy Trading Holdings Corporation and its subsidiaries (collectively, PG&E Energy Trading or PG&E ET); and
- PG&E Gas Transmission Corporation and its subsidiaries (collectively, PG&E GTC), which includes PG&E Gas Transmission, Northwest Corporation and its subsidiaries (collectively, PG&E GTN), which includes North Baja Pipeline, LLC.

During February and March of 2003, certain lenders of PG&E Corporation exercised options to purchase 3 percent of the shares of PG&E NEG. No gain or loss was recognized by PG&E Corporation upon this transaction.

The Consolidated Financial Statements of PG&E Corporation and of the Utility have been prepared on a going concern basis, which contemplates continuity of operations, realization of assets, and repayment of liabilities in the ordinary course of business. However, as a result of the bankruptcy of the Utility and current liquidity concerns at PG&E NEG and its subsidiaries, as further discussed below, such realization of assets and liquidation of liabilities are subject to uncertainty.

PG&E NEG currently is focused on power generation and natural gas transmission in the United States. As a result of the sustained downturn in the power industry, PG&E NEG and its affiliates have experienced a financial downturn, which caused the major credit rating agencies to downgrade PG&E NEG's and its affiliates' credit ratings in the second half of 2002 to below investment grade. PG&E NEG is currently in default under various recourse debt agreements and guaranteed equity commitments totaling approximately $2.9 billion. In addition, other PG&E NEG subsidiaries are in default under various debt agreements totaling $2.7 billion, but this debt is non-recourse to PG&E NEG.

PG&E NEG, its subsidiaries, and their lenders have been engaged in discussions to restructure PG&E NEG's and its subsidiaries' debt obligations and other commitments since October 2002. No agreement has been reached yet and there can be no assurance that an agreement will be reached. Any restructuring agreement that may be reached would be implemented through a reorganization proceeding under Chapter 11 of the Bankruptcy Code. Although PG&E NEG and its subsidiaries are continuing their efforts to maximize cash and reduce liabilities, such efforts are not expected to restore the financial condition of PG&E NEG and its subsidiaries. Absent a negotiated agreement, the lenders may exercise their default remedies or force PG&E NEG and certain of its subsidiaries into an involuntary proceeding under the Bankruptcy Code. Notwithstanding the status of current negotiations, PG&E NEG and certain of its subsidiaries also may elect to voluntarily seek protection under the Bankruptcy Code as early as the second quarter of 2003. Although PG&E Corporation continues to provide assistance to PG&E NEG, its subsidiaries and its lenders in their negotiations, management does not expect the outcome of any bankruptcy proceeding involving PG&E NEG or any of its subsidiaries to have a material adverse effect on the financial condition of PG&E Corporation or the Utility.

This Quarterly Report on Form 10-Q/A is a combined report of PG&E Corporation and the Utility. Therefore, the Notes to the unaudited Consolidated Financial Statements apply to both PG&E Corporation and the Utility. PG&E Corporation's Consolidated Financial Statements include the accounts of PG&E Corporation, the Utility, PG&E NEG, and other wholly-owned and controlled subsidiaries. The Utility's Consolidated Financial Statements include its accounts and those of its wholly-owned and controlled subsidiaries.

PG&E Corporation and the Utility believe that the accompanying Consolidated Financial Statements reflect all adjustments that are necessary to present a fair statement of the consolidated financial position and results of operations for the interim periods. All material adjustments are of a normal recurring nature unless otherwise disclosed in this Form 10-Q/A. All significant intercompany transactions have been eliminated from the Consolidated Financial Statements.

This quarterly report should be read in conjunction with PG&E Corporation's and the Utility's Consolidated Financial Statements and Notes to the Consolidated Financial Statements included in their combined 2002 Annual Report on Form 10-K, as amended, and PG&E Corporation's and the Utility's other reports filed with the Securities and Exchange Commission (SEC).

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingencies. As these estimates involve judgments on a wide range of factors, including future economic conditions that are difficult to predict, actual results could differ from these estimates.

PG&E Corporation's and the Utility's Consolidated Financial Statements have been prepared in accordance with the American Institute of Certified Public Accountants' Statement of Position (SOP) 90-7, "Financial Reporting by Entities in Reorganization Under the Bankruptcy Code," and on a going-concern basis, which contemplates continuity of operation, realization of assets, and liquidation of liabilities in the ordinary course of business. However, as a result of the Utility's Chapter 11 filing and PG&E NEG's current liquidity concerns, such realization of assets and liquidation of liabilities are subject to uncertainty. Under SOP 90-7, certain liabilities of the Utility existing prior to the Utility's Chapter 11 filing are classified as Liabilities Subject to Compromise on PG&E Corporation's and the Utility's Consolidated Balance Sheets. Additionally, professional fees and expenses directly related to the Chapter 11 proceeding and interest income on funds accumulated during the bankruptcy are reported separately as reorganization items. Finally, the extent to which the Utility's reported interest expense differs from its stated contractual interest is disclosed on the Utility's Consolidated Statements of Operations.

Certain amounts in the 2002 Consolidated Financial Statements have been reclassified to conform to the 2003 presentation. These reclassifications did not affect the consolidated net income reported by PG&E Corporation and the Utility for the periods presented.

Adoption of New Accounting Policies and Summary of Significant Accounting Policies

The accounting principles used by PG&E Corporation and the Utility include those necessary for rate-regulated enterprises, which reflect the ratemaking policies of the California Public Utilities Commission (CPUC) and the Federal Energy Regulatory Commission (FERC). Except as disclosed below, PG&E Corporation and the Utility are following the same accounting principles discussed in their combined 2002 Annual Report on Form 10-K, as amended.

Guarantor's Accounting and Disclosure Requirements for Guarantees

PG&E Corporation incorporated the clarified disclosure requirements from Financial Accounting Standards Board (FASB) Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45) into its December 31, 2002, disclosures of guarantees. Beginning January 1, 2003, PG&E Corporation applied the initial recognition and initial measurement provisions of FIN 45 to guarantees issued or modified after December 31, 2002.

FIN 45 elaborates on existing disclosure requirements for most guarantees. It also clarifies that at the time a company issues a guarantee, it must recognize an initial liability for the fair value of the obligation it assumes under that guarantee, including its ongoing obligation to stand ready to perform over the term of the guarantee in the event that specified triggering events or conditions occur. This information also must be disclosed in interim and annual financial statements.

15

FIN 45 does not prescribe a specific account for the guarantor's offsetting entry when it recognizes the liability at the inception of the guarantee, noting that the offsetting entry would depend on the circumstances in which the guarantee was issued. There also is no prescribed approach included for subsequently measuring the guarantor's recognized liability over the term of the related guarantee. It is noted that the liability typically would be reduced by a credit to earnings as the guarantor is released from risk under the guarantee. The adoption of this interpretation did not have a material impact on the Consolidated Financial Statements of PG&E Corporation or the Utility.

Accounting for Asset Retirement Obligations

On January 1, 2003, PG&E Corporation adopted Statements of Financial Accounting Standards (SFAS) No. 143, "Accounting for Asset Retirement Obligations" (SFAS No. 143). SFAS No. 143 provides accounting requirements for costs associated with legal obligations to retire tangible long-lived assets. SFAS No. 143 requires that an asset retirement obligation be recorded at fair value in the period in which it is incurred, if a reasonable estimate of fair value can be made. In the same period, the associated asset retirement costs are capitalized as part of the carrying amount of the related long-lived asset. In each subsequent period, the liability is accreted to its present value and the capitalized cost is depreciated over the useful life of the long-lived asset. Rate-regulated entities may recognize regulatory assets or liabilities as a result of timing differences between the recognition of costs as recorded in accordance with this Statement and costs recovered through the ratemaking process.

The impacts of adopting SFAS No. 143 were as follows:

The Utility has identified its nuclear generation and certain fossil generation facilities as having asset retirement obligations as of January 1, 2003. No additional asset retirement obligations had been identified as of March 31, 2003. Through December 31, 2002, the Utility had recorded $1.4 billion for its nuclear and fossil decommissioning obligations in accumulated depreciation and decommissioning in the Consolidated Balance Sheets.

Upon adoption of this Statement, the Utility reclassified the decommissioning liabilities recorded through December 31, 2002, as asset retirement obligations in the Consolidated Balance Sheets. To record the decommissioning liabilities at fair value as required by SFAS No. 143, the Utility then reduced the asset retirement obligations by $53 million. The Utility increased its property, plant and equipment balance by $332 million to reflect the fair value of the asset retirement costs as of the date the obligation was incurred, less accumulated depreciation from the date the obligation was incurred through December 31, 2002. Finally, the Utility recorded a regulatory liability of $387 million to reflect the cumulative effect of adoption for its nuclear facilities. This regulatory liability represents timing differences between recognition of nuclear decommissioning obligations in accordance with GAAP and ratemaking purposes. The cumulative effect of the change in accounting principle for the Utility's fossil facilities as a result of adopting this Statement was a loss of $1 million, after-tax.

If this Statement had been adopted on January 1, 2002, the pro forma effects on earnings of the accounting change for the three months ended March 31, 2002, would not have been material. The amounts recorded upon adoption of this Statement reflect the pro forma effects on the Consolidated Balance Sheets had this Statement been adopted on December 31, 2002.

The Utility has established trust funds that are legally restricted for purposes of settling its nuclear decommissioning obligations. As of March 31, 2003, the fair value of these trust funds was approximately $1.3 billion.

The Utility may have potential asset retirement obligations under various land right documents associated with its transmission and distribution facilities. The majority of the Utility's land rights are perpetual. Any non-perpetual land rights generally are renewed continuously because the Utility intends to utilize these facilities indefinitely. Since the timing and extent of any potential asset retirements are unknown, the fair value of any obligations associated with these facilities cannot be reasonably estimated.

The Utility collects estimated removal costs in rates through depreciation in accordance with regulatory treatment. These amounts do not represent SFAS No. 143 asset retirement obligations and will continue to be recorded within accumulated depreciation. As of March 31, 2003, the Utility estimated the removal costs recorded in accumulated depreciation were approximately $1.7 billion.

PG&E NEG has identified its generating facilities as having asset retirement obligations as of January 1, 2003. Upon implementation of SFAS No. 143, PG&E NEG recorded $2 million to its property, plant and equipment to reflect the fair value of the asset retirement costs as of the date the obligation was incurred, and recognized $3 million for asset retirement obligations. The cumulative effect of the change in accounting principle as a result of adopting this Statement was a loss of

$3 million, after-tax, on PG&E Corporation Consolidated Statements of Operations. The impact to PG&E NEG of implementing SFAS No. 143 by its unconsolidated affiliates is immaterial.

If this Statement had been adopted on January 1, 2002, the pro forma effects on earnings of the accounting change for the three months ended March 31, 2002, would not have been material.

PG&E GTN may have potential asset retirement obligations under various land right documents associated with its gas transmission facilities. The majority of PG&E GTN's land rights are perpetual. Any non-perpetual land rights generally are renewed continuously because PG&E GTN intends to utilize these facilities indefinitely. Since the timing and extent of any potential asset retirements are unknown, the fair value of any obligations associated with these facilities cannot be reasonably estimated.

PG&E GTN collects estimated removal costs in rates through depreciation in accordance with regulatory treatment. These amounts do not represent SFAS No. 143 asset retirement obligations and will continue to be recorded within accumulated depreciation. PG&E GTN estimated the related removal costs accrued within accumulated depreciation were approximately $11.5 million at March 31, 2003.

Accounting for Costs Associated with Exit or Disposal Activities

On January 1, 2003, PG&E Corporation adopted SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This Statement supersedes previous accounting guidance, principally Emerging Issues Task Force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity" (EITF 94-3). SFAS No. 146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF 94-3, a liability for an exit cost is recognized at the commitment date of an exit plan. SFAS No. 146 also establishes that the liability initially should be measured and recorded at fair value. The adoption of this Statement did not have any current impact on the Consolidated Financial Statements of PG&E Corporation or the Utility.

Change from Gross to Net Method of Reporting Revenues and Expenses on Trading Activities

Effective at the quarter ended September 30, 2002, PG&E Corporation changed its method of reporting gains and losses associated with energy trading contracts from the gross method of presentation to the net method. PG&E Corporation believes that the net method provides a more accurate and consistent presentation of energy trading activities on the financial statements. Amounts to be presented under the net method include all gross margin elements related to energy trading activities.

Before implementation of the net method and the subsequent rescission of EITF Issue No. 98-10, "Accounting for Contracts Involved in Energy Trading and Risk Management Activities" (EITF 98-10), as noted below, PG&E Corporation had reported unrealized gains and losses on trading activities on a net basis in operating revenues. However, PG&E Corporation had reported realized gains and losses on a gross basis in operating income, as both operating revenues and costs of commodity sales and fuel. PG&E Corporation now is reporting realized gains and losses from trading activities on a net basis as operating revenues, and in accordance with the rescission of EITF 98-10, unrealized gains and losses on energy trading activities no longer are reported as these contracts are accounted for under the cost method.

Implementation of the net method has no net effect on gross margin, operating income, or net income. Accordingly, PG&E Corporation continues to report realized income from non-trading activities on a gross basis in operating revenues and operating expenses. Prior year financial statements have been reclassified to conform to the net method.

The schedule below summarizes the amounts impacted by the change in methodology on PG&E Corporation's Consolidated Statements of Operations for the three months ended March 31, 2002:

	Prior Method of Presentation (Gross Method)	As Presented (Net Method)
	Three months ended March 31, 2002	Three months ended March 31, 2002
	(in millions)	
Energy commodities and services(1)	$ 2,114	$ 498
Cost of commodities and services(2)	1,956	340
Net Subtotal	$ 158	$ 158

(1) These amounts, as presented in the net method, differ from the financial statements due to the exclusion of equity earnings in affiliates and eliminations and other, which amounted to net charges of $16 million at March 31, 2002.

(2) These amounts, as presented in the net method, differ from the financial statements due to the exclusion of eliminations and other, which amounted to a benefit of $34 million at March 31, 2002.

Rescission of EITF 98-10

In October 2002, the EITF rescinded EITF 98-10. Energy trading contracts that are derivatives in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities" (collectively, SFAS No. 133), will continue to be accounted for at fair value under SFAS No. 133. Contracts that previously were marked to market as trading activities under EITF 98-10 and that did not meet the definition of a derivative now are accounted for at cost, through a one-time adjustment recorded as a cumulative effect of a change in accounting principle. This requirement was effective as of January 1, 2003, and resulted in a $2 million loss, net of tax, reflected on the PG&E Corporation's Consolidated Statements of Operations for the three months ended March 31, 2003. For PG&E Corporation, the majority of trading contracts are derivative instruments as defined in SFAS No. 133. The rescission of EITF 98-10 has no effect on the accounting for derivative instruments used for non-trading purposes, which continue to be accounted for in accordance with SFAS No. 133. The reporting requirements associated with the rescission of EITF 98-10 were applied prospectively for all EITF 98-10 energy trading contracts entered into after October 25, 2002, although the number of energy trading contracts subject to the prospective implementation was considered immaterial.

Earnings (Loss) Per Share

Basic earnings (loss) per share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing net income (loss), adjusted for convertible note interest and amortization, by the weighted average number of common shares outstanding plus the assumed issuance of common shares for all dilutive securities.

The following is a reconciliation of PG&E Corporation's net income (loss) and weighted average common shares outstanding for calculating basic and diluted net income (loss) per share:

	Three months ended March 31, 2003	2002
	(in millions, except per share amounts)	
Income (loss) from continuing operations	$ (278)	$ 623
Discontinued operations	(70)	8
Net income (loss) before cumulative effect of a change in accounting principle	(348)	631
Cumulative effect of a change in accounting principle	(6)	
Net income (loss)	$ (354)	$ 631

	2003	2002
Weighted average common shares outstanding, basic	382	364
Add: Employee stock options and PG&E Corporation shares held by grantor trusts		4
Shares outstanding for diluted calculations	382	368
Earnings (Loss) Per Common Share, Basic		
Income (loss) from continuing operations	$ (0.73)	$ 1.71
Discontinued operations	(0.18)	0.02
Cumulative effect of a change in accounting principle	(0.02)	
Net earnings (loss)	$ (0.93)	$ 1.73
Earnings (Loss) Per Common Share, Diluted		
Income (loss) from continuing operations	$ (0.73)	$ 1.69
Discontinued operations	(0.18)	0.02
Cumulative effect of a change in accounting principle	(0.02)	
Net earnings (loss)	$ (0.93)	$ 1.71

The diluted earnings per share for the three months ended March 31, 2003, excludes approximately one million incremental shares related to employee stock options and shares held by grantor trusts, five million incremental shares related to warrants, and 18 million incremental shares related to the 9.5 percent Convertible Subordinated Notes, and includes associated interest expense of $4 million (net of income taxes of $3 million) due to the anti-dilutive effect upon loss from continuing operations.

PG&E Corporation reflects the preferred dividends of subsidiaries as other expense for computation of both basic and diluted earnings per share.

Stock-Based Compensation

PG&E Corporation and the Utility account for stock-based compensation using the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," as allowed by SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure, an Amendment of FASB Statement No. 123." Under the intrinsic value method, PG&E Corporation and the Utility do not recognize any compensation expense for stock options, as the exercise price is equal to the fair market value of a share of PG&E Corporation common stock at the time the options are granted. Had compensation expense been recognized using the fair value-based method under SFAS No. 123, PG&E

Corporation's pro forma consolidated earnings (loss) and earnings (loss) per share would have been as follows:

	Three months ended March 31,	
	2003	2002
	(in millions, except per share amounts)	
Net income (loss):		
As reported	$ (354)	$ 631
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(5)	(5)
Pro forma	$ (359)	$ 626
Basic earnings (loss) per share:		
As reported	$ (0.93)	$ 1.73
Pro forma	$ (0.94)	$ 1.72
Diluted earnings (loss) per share:		
As reported	$ (0.93)	$ 1.71
Pro forma	$ (0.94)	$ 1.70

Had compensation expense been recognized using the fair value-based method under SFAS No. 123, the Utility's pro forma consolidated earnings (loss) would have been as follows:

	Three months ended March 31,	
	2003	2002
	(in millions)	
Income available for (loss allocated to) common stock:		
As reported	$ (79)	$ 590
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(2)	(2)
Pro forma	$ (81)	$ 588

On January 2, 2003, PG&E Corporation awarded 1.6 million shares of restricted PG&E Corporation common stock to eligible employees of PG&E Corporation and its subsidiaries. The shares were granted with restrictions and are subject to forfeiture unless certain conditions are met.

The restricted shares were issued at the grant date and are held in an escrow account. The shares become available to the employees as the restrictions lapse. In general, the restrictions on 80 percent of the shares lapse automatically over a period of four years at the rate of 20 percent per year. Restrictions to the remaining 20 percent of the shares will lapse at a rate of 5 percent per year if PG&E Corporation is in the top quartile of its comparator group as measured by annual total shareholder return for each year ending immediately before each annual lapse date.

Total compensation expense resulting from the restricted stock issuance reflected on PG&E Corporation's Consolidated Statements of Operations for the three months ended March 31, 2003, was $1.4 million, of which $0.8 million was recognized by the Utility.

Comprehensive Income

PG&E Corporation's and the Utility's comprehensive income (loss) consists principally of changes in the market value of certain cash flow hedges under SFAS No. 133, as amended.

	PG&E Corporation		Utility	
	2003	**2002**	**2003**	**2002**
	(in millions)			
Three months ended March 31				
Net income available for (loss allocated to) common stock	$ (354)	$ 631	$ (79)	$ 590
Net gain (loss) in other comprehensive income (OCI) from current period hedging transactions and price changes in accordance with SFAS No. 133	(1)	(75)		
Net reclassification from OCI to earnings	5	5		
Foreign currency translation adjustment	3			
Comprehensive income (loss)	$ (347)	$ 561	$ (79)	$ 590

The above changes to OCI are stated net of income taxes of $48 million at March 31, 2003, and $38 million at March 31, 2002.

Income Taxes

In 2003, PG&E Corporation increased its valuation allowance due to the continued uncertainty in realizing certain state deferred tax assets arising at PG&E NEG. During the first quarter of 2003, valuation allowances of $10 million were recorded in continuing operations. Additional valuation allowances of $7 million were recorded in discontinued operations, and $5 million in accumulated other comprehensive loss.

In addition to the above reserves, PG&E NEG recorded valuation allowances due to continued uncertainty in realizing federal deferred tax assets. These valuation allowances were determined on a stand-alone basis. During the first quarter of 2003, valuation allowances of $66 million were recorded in continuing operations. Additional valuation allowances of $37 million were recorded in discontinued operations, $3 million recorded in cumulative effect of changes in accounting principles, and $48 million recorded in accumulated other comprehensive loss. These reserves were eliminated in consolidation, as PG&E Corporation believes that it is more likely than not that the federal deferred tax assets will be realized on a consolidated basis.

Related Party Transactions

In accordance with various agreements, the Utility and other subsidiaries provide and receive various services to and from their parent, PG&E Corporation. The Utility and PG&E Corporation exchange administrative and professional support services in support of operations. These services are priced either at the fully loaded cost (i.e., direct costs and allocation of overhead costs) or at the higher of fully loaded cost or fair market value, depending on the nature of the services provided. PG&E Corporation also allocates certain other corporate administrative and general costs to the Utility and other subsidiaries using a variety of factors, including the number of employees, operating expenses excluding fuel purchases, total assets, and other cost-causal methods. Additionally, the Utility purchases gas commodity and transmission services from, and sells reservation and other ancillary services to, PG&E NEG. These services are priced at either tariff rates or fair market value depending on the nature of the services provided. Intercompany transactions are eliminated in consolidation; therefore, no profit results from these transactions. The Utility's significant related party transactions were as follows:

	Three months ended March 31,	
	2003	**2002**
	(in millions)	

	Three months ended March 31,	
Utility proceeds from:		
Administrative services provided to PG&E Corporation	$ 2	$ 1
Gas reservation services provided to PG&E ET	3	3
Trade deposit due from PG&E GTN	3	
Utility payments for:		
Administrative services received from PG&E Corporation	$ 13	$ 27
Interest accrued on pre-petition liability	2	
Administrative services received from PG&E NEG		