

Transactive Management Study Concludes Unregulated Plants Will Operate Over 45 Years

SAN DIEGO, July 11, 2003 - Transactive Management announced today that it has completed an 18-month study of plant useful life and value for the PG&E National Energy Group (NEG), which will be used for reporting the depreciable life of NEG fossil-fired plants and hydroelectric generating systems.

The study found that NEG maintenance practices, will allow plants to have a depreciable life at least as long as that demonstrated by regulated plants, which is over 45 years for fossil-fired plants and up to 100 years for hydro plants.

Fossil-fired plant operational life was determined by estimating the service life of components in a system-by-system breakdown of original plant construction cost. Estimates were based on considering how repairing, replacing, and upgrading original components extends service life as well as the accounting treatment of costs incurred based on company policies for expensing or capitalizing maintenance costs.

Plant economic viability was determined by including service life and maintenance cost estimates in financial projections that test the extent to which cash flows allow the full recovery of capitalized costs. This analysis was conducted in accordance with accounting standards for assessing asset impairment.

The study included recommended steps for applying a unit of production method to determine the depreciable life of components affected by plant cycling. Component service life is based on monitoring hours and starts based operational factors that measure the impact of cycling in terms of equivalent operating hours.

Because changes in depreciable life fall within the purview of the Sarbanes-Oxley Act ("Sarbox"), study recommendations included steps for NEG validation and monitoring of the plant, company, industry, and broader business climate factors considered in determining service and economic life.

Sarbox ensures that investors will have the accounting information necessary to assess the value of publicly traded corporations by establishing requirements for accurate and transparent accounting. Requirements are relevant because a change in depreciation schedules changes book value and income, which in turn changes stock earnings per share. This key measure of corporate value influences stock transactions and prices. For example, if the depreciable life of plants representing 10 gigawatts of generating capacity were increased from 35-to-45 years, book income would increase by over \$20 million a year -- changing earnings per share.

Depreciable life recommendations were supported by a detailed review and analysis of industry and government trends over the past six years as well as a review of accounting standards that define how this information should be applied to determine asset life and value.

Conclusions regarding the service life of plants included the following:

- Even though plants are generally designed to operate for 30 years, the historic record continues to show that they operate for much longer periods -- over 45 years or more for fossil-fired plants, and up to 100 years for hydro plants with a generating capacity of 20 MW or more.
- For fossil-fired plants, this reflects an increasing emphasis on improved maintenance practices, plant life extension, and repowering.
- For hydro plants, this reflects life extension as well as the much more friendly operating environment -- i.e., components are not subjected to the high temperature and pressure of fuel combustion.

- In the future, plants will stay in service even longer because, following periods of significant new plant additions, OEM's shift their attention back to supporting the after market by developing and introducing retrofits and upgrades that extend plant life.
- Plants will continue to be repowered due to the financial advantages this approach has over a new plant construction including: using a significant portion of the existing balance of plant; lower \$/kW construction costs; continued plant operation and income during the development stage; and a construction period that is about half of that required for new plants.

Conclusions regarding the impact of deregulation of plant life and value included the following:

- Deregulation continues to bring about a fundamental change in external factors that determine the service life and value of power plants.
- The positive outlook for the social and economic benefits of deregulation up to the end of 2000 was reflected in optimistic industry and government projections, which influenced ambitious capacity expansion programs.
- The collapse of Enron, subsequent discovery of accounting and trading improprieties, and realigned credit ratings brought this phase to an end and marked the beginning of the current retraction phase.
- The overly optimistic view during the expansion phase has been replaced by an overly pessimistic view that predominates the retraction phase; both reflect an inherent weakness in the human psyche which has a tendency to place too much emphasis on relatively recent events in projecting 40-to-50 year trends.
- Public policy, investment, and depreciable life decisions regarding assets that have a service potential of over 45 years should be based on long-term secular trends -- e.g., demographic change, productivity change, technological improvements -- that remain relatively stable over numerous business cycles and generating capacity boom-and-bust cycles.
- Plant economic life projections should, therefore, be based on these same secular trends, which should be annually reviewed and assessed in conjunction with the annual business planning and budgeting process.
- Applying accounting standards for assessing asset economic life should favor long-term financial projections, which can take these trends into account, over measures of value based on recent transactions involving the same or similar assets, which can reflect near-term biases or less than normal circumstances -- e.g., bankruptcy, avoiding debt covenant defaults.
- Financial projections to test asset impairment should consider the likelihood that the public debate over deregulation versus re-regulation, will ultimately be resolved by promoting increased use of tolling agreements and power sales agreements, which allow spot prices to be stabilized by contract prices. Contract prices are based on construction, fuel, financing and other agreements which are negotiated to take long-term economic trends into account.
- Unregulated generating companies using depreciable life schedules that understate plant economic life and value could be the target of class action shareholder suites based on Sarbox provisions for accurate accounting -- which apply to both overvaluing and undervaluing assets of publicly-owned corporations.

Ray Mischkot, who conducted the study, stated: "The purpose of the study was to revisit and update the methods and conclusions of five earlier studies completed from 1997 through 2000, which are now used for depreciable life. Changes in depreciation accounting required the approval the NEG's independent public accountant, which could only be obtained after they reviewed each study. For plants funded by publicly traded debt and equity, the Securities and Exchange Commission also reviewed study methods prior to approving accounting changes."

Because the update study will require the same reviews, the 130-page Report provides a detailed discussion of the analytical framework, methods, research, and analysis that are the basis for conclusions. In addition, prior studies and documents and working papers used in the update are included in 11 large binders at numbered tabs that correspond to Report references.

Mischkot cautions that study conclusions cannot be used by other unregulated generators to support plant depreciation. "Although conclusions regarding broader industry trends apply to this sector as a whole, plant depreciable life must be supported by company and plant-specific practices, which will vary."

Mischkot added: "The study identified a number of management, accounting, and public policy issues that warrant further investigation. The NEG has agreed to allow the Report and supporting documents to be made available to graduate schools that could use this information for a case study or graduate thesis. I welcome any queries in this regard and can make arrangements for contacting the NEG as appropriate."

Transactive Management, is an independent consulting practices founded by Ramon (Ray) T. Mischkot in 1996. Consulting services are offered to the power generating and boarder energy industry in economic research and analysis; regulatory and litigation support; strategic planning and analysis; governance and corporate policies; management systems, processes and internal controls; market research and analysis; organizational design, staffing and effectiveness; and human resources planning and management. The attached Editors Advisory provides information on Mr. Mischkot's education and experience. Questions regarding this press release should be addressed to Ray Mischkot, President, Transactive Management, 3661 Overpark Road, San Diego, California; (858) 259-5501.

EDITORS: Please do not use "Pacific Gas and Electric" or "PG&E" when referring to PG&E Corporation or its subsidiary, PG&E National Energy Group, Inc. PG&E National Energy Group is not the same company as Pacific Gas and Electric Company, the utility, and is not regulated by the California Public Utilities Commission. Customers of Pacific Gas and Electric Company do not have to buy products or services from PG&E National Energy Group in order to continue to receive quality regulated services from Pacific Gas and Electric Company.

Additional Information on Ray Mischkot's education and experience

Ramon (Ray) T. Mischkot has more than 30 years of experience as an economist, business planner, general manager, and management and organizational consultant. He has been consulting to the power generating industry for 19 years. Prior to becoming a consultant, he was an economist with the U.S. Central Intelligence Agency, Office of Economic Research, and the Army Strategic Communications Command, Economic and Systems Analysis Division. He also held positions as economist, business planner, manager of business analysis and development, and general manager with General Atomics Company, which was jointly owned by Royal Dutch Shell and Gulf Oil during his tenure. Mischkot has a B.A. and M.A. in Economics from the University of California, Davis. From 1975 through 1980 he was an adjunct faculty member of Chapman College, where he taught undergraduate course in economic principles, money and banking, international trade, and comparative economic systems.

Overall approach to conducting plant useful life studies

Each study has been based on the analytical paradigm. Research and analysis is conducted to confirm a common working hypothesis -- deregulation is bringing about a change in market factors that determine plant economic life and value. Methods developed to reach conclusions are based on a multi-disciplinary approach to interpreting the data and information that traces this change.

Plant service life and financial projections to test economic viability are conducted consistent with accounting standards. The method used to determine service life meets or exceeds accounting standards proposed in a Accounting Standards Executive Committee (AcSEC) Statement of Position (SOP) entitled "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment" dated June 29, 2001. Although the Fair Accounting Standards Board (FASB), which is responsible for Generally Accepted Accounting Principles (GAAP), has not yet adopted these standards conversations with FASB confirmed that they remain under study. FASB also advised that there is nothing in the

proposed standards that is inconsistent with existing GAAP.

Economic life assessments are consistent with FASB Statement of Financial Accounting Standards No. 144, entitled "Accounting for the Impairment or Disposal of Long-Lived Assets" dated October 3, 2001. These assessments were conducted directly by the NEG to ensure that the analysis was generally consistent with related company financial projections.

Sarbanes-Oxley Act provisions regarding corporate governance, accounting, and internal audit were used to recommend steps for updating depreciable life assessments in conjunction with the annual planning and budgeting process.

Other Transactive Management depreciable life approaches and capabilities

The methods used in the NEG study can also be applied to quickly determine if an unregulated generating company is currently undervaluing its operating fleet by not fully recognizing their long-term service life and economic value. Transactive Management has designed an Independent Competitive Evaluation (ICE) that can be completed in about one week.

Prepared questionnaires are used to interview key managers in each area of inquiry. The results of these interviews in conjunction with reviewing policies, plans, and financial projections are used to reach conclusions on the extent to which current practices meet criteria used in the NEG study. The presentation of results includes an action agenda for implementing any necessary improvements.

Negotiations with Navigant Consulting

Mischkot is currently negotiating an agreement with Navigant Consulting to offer his services and proprietary methods through this nationally recognized consulting firm. Transactive Management will issue a press release once an agreement is finalized.

Source: Transactive Management

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