

Credit and Risk Management

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Laura L. Langer
Vice President Risk Management,
PG&E Corporation



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The Merchants' Challenge

What the Industry Can Do

- Establish industry standards and protocols
- Provide the expertise and informed basis for rules
- Recommend approaches to self-regulation and oversight
- Education and transparency

Industry Goals

- Public acceptance of merchant business model and conduct
- Consistent valuation processes and assumptions
- Consistent expectations for financial disclosure
- Common standards for credit

The Merchants' Response

What the Industry Can Do

- Establish industry standards and protocols
- Provide the expertise and informed basis for rules
- Recommend approaches to self-regulation and oversight

What the Industry has Done

- Code of Ethics for merchant operations
- CRO guidance on
 - Governance and role of risk management
 - Disclosure
 - Valuation
 - Credit
- Ongoing efforts on settlement, netting, other issues

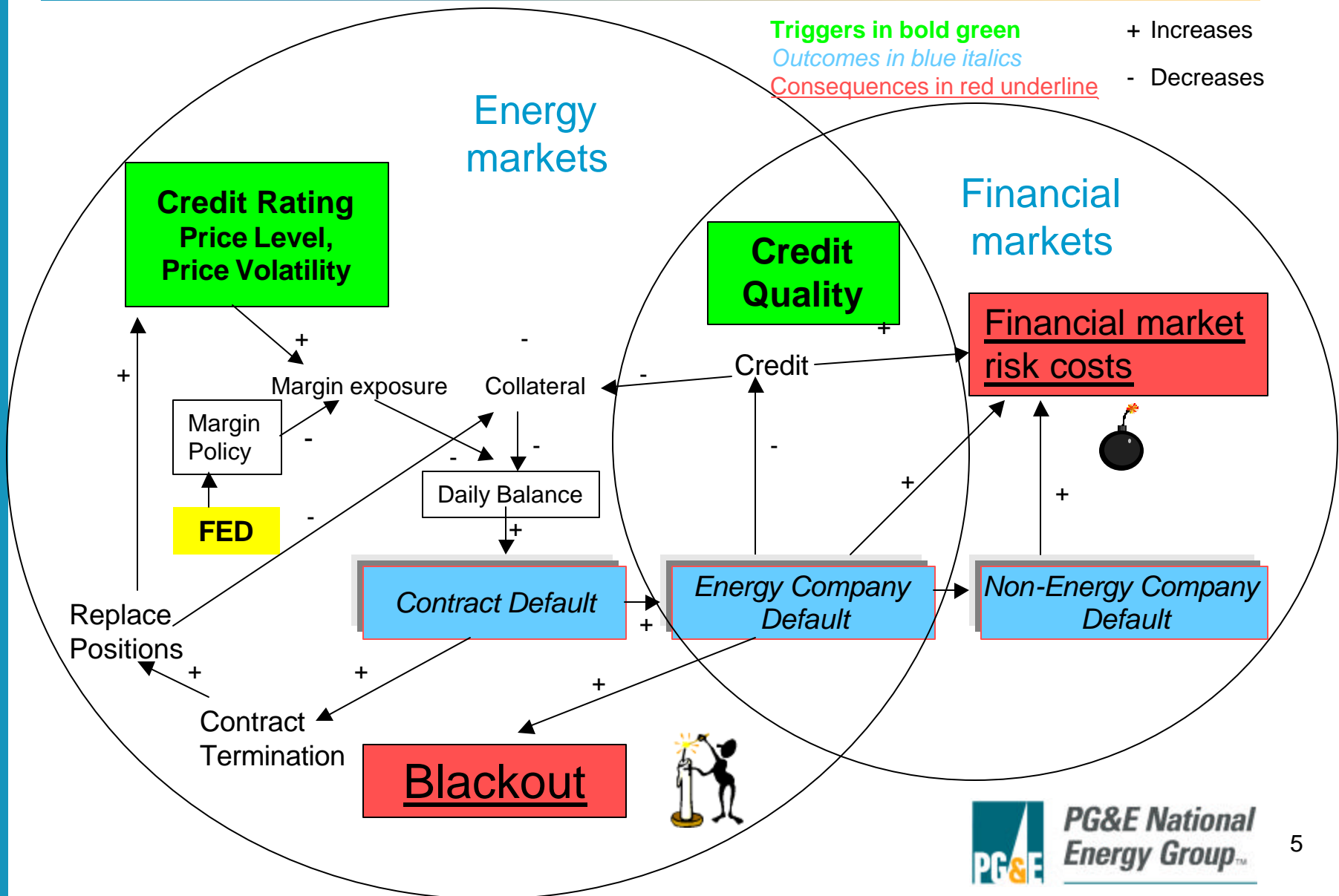
In the Meantime...

- Merchant industry continues to take a beating
- Continued accusations of market manipulation, reporting overstated valuations, insufficient credit
- Consequences have included
 - Energy Markets (spark spreads) compression
 - Rating agency actions
 - Regulatory scrutiny
 - Implications to debt and equity markets
 - Loss of market participants and liquidity

Some solutions – but more issues

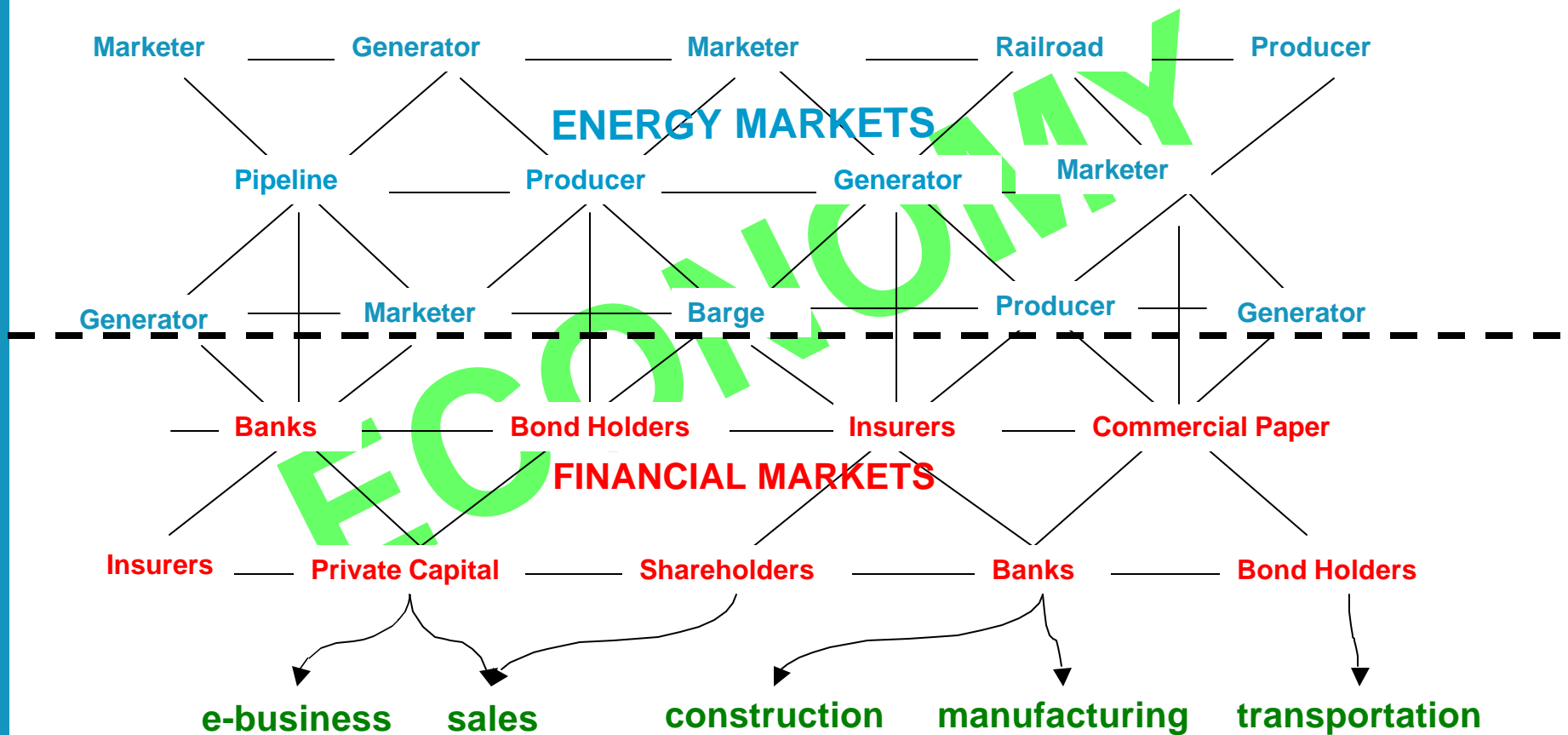
- Stalled or reversed transition to merchant energy
 - contribution to overbuild
 - detrimental to liquidity
- Slow progress on market rules
- Residual ratings triggers
- Other consequences of downgrade?
- Inputs to ratings and analyst valuations Ongoing intense capital requirements?
- Cash discounted to zero for some aspects for Merchant Energy sector.

Mechanics of Domino Default



The “Dominoes”

Default can spread quickly through Energy and Financial markets



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Questions for the Panel

1. What roles should government agencies play to stabilize the energy industry?
 - FERC, DOE, CFTC and SEC
2. What can Congress do to help?
 - Bankruptcy reform
 - PUHCA, PURPA repeal/reform
 - Accounting Standards
3. What do Wall Street and the Ratings Agencies need to regain confidence?
 - Residual ratings triggers – what can be done?
 - How should participants react to downgrades?
 - How should merchant (and trading) value be analyzed in the ratings process and by equity analysts?
 - Ongoing capital requirements?
4. What can they do to restore confidence?
5. What and when will NAESB be needed?
6. Action Items