

PG&E CORP  
Form DEFA14A  
April 21, 2011

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of  
the Securities Exchange Act of 1934 (Amendment No. )

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

PG&E Corporation  
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 8-K  
CURRENT REPORT  
Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report:  
April 21, 2011  
(Date of earliest event reported)

PG&E CORPORATION  
(Exact Name of Registrant as specified in Charter)

California (State or other jurisdiction of incorporation)	1-12609 (Commission File Number)	94-3234914 (IRS Employer Identification No.)
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One Market, Spear Tower, Suite 2400, San Francisco,  
CA  
(Address of principal executive offices)

94105 (Zip code)
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415-267-7000  
(Registrant's Telephone Number, Including Area Code)

N/A  
(Former Name or Former Address, if Changed Since Last Report)

PACIFIC GAS AND ELECTRIC COMPANY  
(Exact Name of Registrant as specified in Charter)

California (State or other jurisdiction of incorporation)	1-2348 (Commission File Number)	94-0742640 (IRS Employer Identification No.)
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77 Beale Street, P. O. Box 770000, San Francisco, California  
(Address of principal executive offices)

94177 (Zip code)
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(415) 973-7000  
(Registrant's Telephone Number, Including Area Code)

N/A  
(Former Name or Former Address, if Changed Since Last Report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- Soliciting Material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

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Item 5.02. Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers.

On April 21, 2011, PG&E Corporation announced that Peter A. Darbee, Chairman of the Board, Chief Executive Officer and President of PG&E Corporation and a director of Pacific Gas and Electric Company (“Utility”) has decided to retire from all his positions with PG&E Corporation and the Utility effective April 30, 2011. A copy of the related press release is attached to this report as Exhibit 99.1.

The Board of Directors of PG&E Corporation is conducting a candidate search for Mr. Darbee’s successor. This process is already underway. Until the search has been completed and Mr. Darbee’s successor is in place, the Board of Directors of PG&E Corporation has appointed C. Lee Cox to serve as interim Chairman of the Board, Chief Executive Officer and President of PG&E Corporation. Mr. Cox, 70, has been a director of PG&E Corporation and the Utility since 1996 and non-executive Chairman of the Utility’s Board of Directors since January 2008. Mr. Cox also is the independent lead director of PG&E Corporation and the Utility. PG&E Corporation’s and the Utility’s most recent proxy statement filed with the Securities and Exchange Commission relating to the joint annual meeting of shareholders to be held on May 11, 2011, contains more information about Mr. Cox’s business experience and the various committee memberships and chairmanships he has held at PG&E Corporation and the Utility. (The Board of Directors of PG&E Corporation and the Board of Directors of the Utility are each referred to below as the “Board” and, collectively, as the “Boards.”)

As disclosed in the proxy statement, PG&E Corporation’s and the Utility’s Corporate Governance Guidelines set forth a policy that the chairs of certain Board committees (such as the Compensation Committee for which Mr. Cox serves as Chair) and at least 75 percent of the directors should be independent, as defined in the guidelines. (PG&E Corporation’s guidelines are attached as an appendix to the proxy statement. The Utility’s guidelines are substantially similar to PG&E Corporation’s guidelines.) The guidelines also require that certain Board committees (such as the Finance Committee of which Mr. Cox is a member) be composed entirely of independent directors and that each company have an independent lead director. While Mr. Cox is serving on an interim basis, he will not be considered to be an independent director. Consequently, each Board has appointed Maryellen C. Herringer, a current director of PG&E Corporation and the Utility, to replace Mr. Cox as the interim independent lead director. The PG&E Corporation Board also has appointed Barbara L. Rambo, a current director of PG&E Corporation and the Utility, to replace Mr. Cox as the interim Chair of the Compensation Committee. Both Ms. Herringer and Ms. Rambo qualify as independent as defined in the guidelines and applicable stock exchange rules. Mr. Cox also has resigned from the Finance Committee. Finally, under the rules of the California Public Utilities Commission, the same person may not serve as the Chairman of PG&E Corporation and the Chairman of the Utility. The Utility’s Board has appointed Ms. Herringer to serve as interim Chairman of the Utility’s Board. The newly constituted committees and Board structure comply with applicable stock exchange requirements and the Corporate Governance Guidelines. Mr. Cox remains a member of the Executive Committee of each Board.

Under the applicable stock exchange rules, interim service as chief executive officer or other executive officer will not disqualify a director from being considered independent following the interim service. The Boards have amended each company’s Corporate Governance Guidelines to state that service as an executive officer on an interim basis for no longer than one year will not disqualify a director from being considered independent. The guidelines also have been amended to state that compensation received for such interim service will not disqualify a director from being considered independent. The amended guidelines are effective April 21, 2011. PG&E Corporation’s amended guidelines are attached to this report as Exhibit 99.2.

Mr. Cox will receive monthly compensation of \$150,000 while he is serving in his interim position. While Mr. Cox serves in his interim position he will not be entitled to receive director retainer fees or Board meeting fees. As

disclosed in the proxy statement, the PG&E Corporation Long-Term Incentive Plan (“LTIP”) provides formula awards to each person who has been elected as a non-employee director at the annual meeting following the certification of the annual meeting results. If Mr. Cox is not eligible for an award following the next annual meeting because of his role as interim Chairman, Chief Executive Officer and President, the independent members of the PG&E Corporation Board have approved a substantially equivalent LTIP award for Mr. Cox that will be made following the certification of his election as a director at the next annual meeting. Mr. Cox’s LTIP award will consist of restricted stock units (“RSUs”) with an aggregate value of \$90,000 (as determined on the grant date) that vest in one year at the end of his elected term (or upon his death, disability, or a change in control).

In addition, on April 21, 2011, the independent members of the Utility Board approved a retention award for Christopher P. Johns, President of the Utility and a member of the Utility’s Board. The retention award will be made under the LTIP and will consist of RSUs with an aggregate value of \$1 million (as determined on the grant date). The grant date is expected to be May 6, 2011, as determined in accordance with PG&E Corporation’s Equity Grant Date Policy. One-half of the RSUs will vest on the second anniversary of the date of grant and the remainder will vest on the third anniversary of the date of grant provided that Mr. Johns remains an employee on each vesting date. The RSUs will vest sooner if Mr. Johns dies or becomes disabled. If Mr. Johns’ employment with the Utility is terminated without cause, his RSUs will vest to the extent provided under the PG&E Corporation Officer Severance Policy.

Since Mr. Darbee is retiring, he will not be entitled to any severance payment or other severance benefits. Mr. Darbee will be entitled to the retirement and pension benefits as disclosed in the most recent proxy statement.

#### Item 5.03. Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year

To eliminate the vacancy on each Board created by Mr. Darbee’s retirement, the Boards adopted resolutions to amend each company’s respective Bylaws to decrease the authorized number of directors to be elected at the joint annual meeting of shareholders to be held on May 11, 2011. As amended, the authorized number of directors of PG&E Corporation is ten and the authorized number of directors of the Utility is eleven. The amendments to the Bylaws are effective May 1, 2011. The text of the amendment to PG&E Corporation’s Bylaws is attached to this report as Exhibit 99.3, and the text of the amendment to the Utility’s Bylaws is attached to this report as Exhibit 99.4.

Mr. Darbee is no longer a nominee for election as a director at the joint annual meeting of shareholders to be held on May 11, 2011. Shareholders who have submitted proxies do not need to resubmit their proxy, unless they wish to revoke it. Shareholders who have not yet submitted their proxy may continue to use the same form of proxy that was delivered with the proxy statement (or made available on the internet) in accordance with the instructions in the proxy statement. The proxy holders will vote the shares as instructed by the shareholder with respect to the existing nominees other than votes with respect to Mr. Darbee which will be disregarded.

#### Item 9.01. Financial Statements and Exhibits

Exhibit 99.1 Press Release dated April 21, 2011

Exhibit 99.2 PG&E Corporation’s Corporate Governance Guidelines, as amended effective April 21, 2011

Exhibit 99.3 Text of the amendment to the Bylaws of PG&E Corporation effective May 1, 2011

Exhibit 99.4 Text of the amendment to the Bylaws of Pacific Gas and Electric Company effective May 1, 2011



SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrants have duly caused this report to be signed on their behalf by the undersigned hereunto duly authorized.

PG&E CORPORATION

Dated: April 21, 2011

By:

LINDA Y.H. CHENG  
LINDA Y.H. CHENG  
Vice President, Corporate Governance  
and  
Corporate Secretary

PACIFIC GAS AND ELECTRIC COMPANY

Dated: April 21, 2011

By:

LINDA Y.H. CHENG  
LINDA Y.H. CHENG  
Vice President, Corporate Governance  
and  
Corporate Secretary

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EXHIBIT INDEX

Number	Description
Exhibit 99.1	Press Release dated April 21, 2011
Exhibit 99.2	PG&E Corporation's Corporate Governance Guidelines, as amended effective April 21, 2011
Exhibit 99.3	Text of the amendment to the Bylaws of PG&E Corporation effective May 1, 2011
Exhibit 99.4	Text of the amendment to the Bylaws of Pacific Gas and Electric Company effective May 1, 2011

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Exhibit 99.1

PG&E Corporation to Elect New Chairman and CEO; Peter A. Darbee to Retire

(San Francisco) – The Board of Directors of PG&E Corporation (NYSE: PCG) today announced that it will elect a new Chairman, CEO and President in the weeks ahead to succeed current Chairman, CEO and President Peter A. Darbee, who will retire effective April 30, 2011.

On an interim basis, the board has named its Lead Director, Lee Cox, to serve as Chairman, CEO and President. Cox is the retired Vice Chairman of AirTouch Communications, Inc., and retired President and Chief Executive Officer of AirTouch Cellular. He has been a member of PG&E's board since 1996.

Cox said, "Peter concluded that a change in leadership would create the best opportunity for PG&E to move ahead after a challenging year. The board supported his decision. The search for Peter's replacement is already underway, and an announcement is expected soon."

Cox also noted that the company's utility unit, Pacific Gas and Electric Company, will continue to be led by President Christopher P. Johns.

He added, "Peter has demonstrated exceptional vision and leadership. He has guided PG&E to become one of the industry's most innovative and environmentally committed utilities. His contributions have helped move PG&E and the industry forward. We are grateful to him."

Darbee said, "It's been my extraordinary privilege to be a PG&E employee for more than a decade and to serve as CEO. No company has a more dedicated team of people working to deliver for its customers. I am deeply grateful for the support and inspiration our employees have given me over these many years."

Darbee joined PG&E Corporation in 1999 as Chief Financial Officer. He was appointed CEO in 2005 and assumed the additional role of Chairman of the Board in 2006.

PG&E Corporation is a Fortune 200 energy-based holding company, headquartered in San Francisco. It is the parent company of Pacific Gas and Electric Company, California's largest investor-owned utility. PG&E serves more than 15 million Californians throughout a 70,000 square-mile service area in northern and central California. For more information, visit the Web site at <http://www.pgecorp.com>.

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PG&E CORPORATION  
BOARD OF DIRECTORS  
CORPORATE GOVERNANCE GUIDELINES

April 21, 2011

1. Election of Directors

All members of the Board of Directors of PG&E Corporation (the “Corporation”) are elected each year and serve one-year terms. Directors are not elected for multiple-year, staggered terms.

2. Composition of the Board

The Board’s membership is composed of qualified, dedicated, ethical, and highly regarded individuals who have experience relevant to the Corporation’s operations and understand the complexities of the Corporation’s business environment. The Board seeks to include a diversity of backgrounds, perspectives, and skills among its members. No member of the Board of Directors may be an employee of NYSE AMEX Equities or a floor member of that exchange.

3. Independence of Directors

All members of the Board have a fiduciary responsibility to represent the best interests of the Corporation and all of its shareholders.

At least 75 percent of the Board is composed of independent directors, defined as directors who (1) are neither current nor former officers or employees of nor consultants to the Corporation or its subsidiaries (except that prior service as an interim Chairman of the Board, Chief Executive Officer, or other Section 16 Officer for a period of less than one year shall not, alone, compromise a director’s independence), (2) are neither current nor former officers or employees of any other corporation on whose board of directors any officer of the Corporation serves as a member, and (3) otherwise meet the definition of “independence” set forth in applicable stock exchange rules. The Board must affirmatively determine whether a director is independent, and may develop categorical standards to assist the Board in determining whether a director has a material relationship with the Corporation, and thus is not independent. Such standards are set forth in Exhibit A to these Corporate Governance Guidelines.

4. Selection of Directors

The Board nominates directors for election at the annual meeting of shareholders and selects directors to fill vacancies which occur between annual meetings. The Nominating and Governance Committee, in consultation with the Chairman of the Board and the Chief Executive Officer (CEO) (if the Chairman is not the CEO), reviews the qualifications of the Board candidates and presents recommendations to the full Board for action.

5. Characteristics of Directors

The Nominating and Governance Committee annually reviews with the Board, and submits for Board approval, the appropriate skills and characteristics required of Board members in the context of the current composition of the Board. In conducting this assessment, the Committee considers diversity, age, skills, and such other factors as it

deems appropriate given the current needs of the Board and the Corporation.

In general, the Nominating and Governance Committee will recommend, and the Board of Directors will re-nominate, an existing director for re-election to the Board of Directors if, among other things, the Committee and Board each believe that the individual would continue to be a productive and effective contributor to the Board, and that his or her continued service would serve the best interests of the Corporation.

6. Selection of the Chairman of the Board and the Chief Executive Officer

The Chairman of the Board and the Chief Executive Officer are elected by the Board.

Based on the circumstances existing at a time that there is a vacancy in the office of either the Chairman of the Board or the Chief Executive Officer, the Board will consider whether the role of Chief Executive Officer should be separate from that of Chairman of the Board, and, if the roles are separate, whether the Chairman should be selected from the independent directors or should be an employee of the Corporation.

At least annually, the Board will reassess the appropriateness of the Board leadership structure, based on the specific circumstances and characteristics of the Corporation at that time, including a review of whether the positions of Chairman and Chief Executive Officer should be separated.

7. Assessing the Board's and Committees' Performance

The Nominating and Governance Committee oversees the process for evaluating and assessing the performance of the Board, including Board committees. The Board or the Nominating and Governance Committee conduct an evaluation at least annually to determine whether the Board and its committees are functioning effectively. If the evaluation is conducted by the Nominating and Governance Committee, that Committee presents its conclusions to the full Board for review and concurrence. The Board evaluation includes an assessment of the Board's contribution as a whole and specific areas in which the Board and/or management believes a better contribution could be made. The purpose of the review is to increase the effectiveness of the Board as a whole. The Audit Committee, the Compensation Committee, and the Nominating and Governance Committee conduct annual evaluations, and any other standing Board committee that meets on a regular basis conducts periodic evaluations. The Board committees provide the results of any evaluation to the Nominating and Governance Committee. These results are considered in the Board evaluation.

8. Size of the Board

As provided in paragraph I of Article Third of the Corporation's Articles of Incorporation, the Board is composed of no less than 7 and no more than 13 members. The exact number of directors is determined by the Board based on its current composition and requirements, and is specified in Article II, Section 1 of the Corporation's Bylaws.

9. Advisory Directors

The Board may designate future directors as advisory directors in advance of their formal election to the Board. Advisory directors attend Board and committee meetings, and receive the same compensation as regular directors. They do not, however, vote on matters before the Board. In this manner, they become familiar with the Corporation's business before assuming the responsibility of serving as a regular director.

10. Directors Who Change Responsibilities

Directors shall offer their resignations when they change employment or the major responsibilities they held when they joined the Board. This does not mean that such directors should leave the Board. However, the Board, via the

Nominating and Governance Committee, should have the opportunity to review the appropriateness of such directors' nomination for re-election to the Board under these circumstances.

Directors who are officers of the Corporation also shall offer their resignations upon retirement or other termination of active PG&E Corporation employment.

11. Board of Directors Retirement Policy

The Board may not designate any person as a candidate for election or re-election as a director after such person has reached the age of 72; provided, however, if the Nominating and Governance Committee and Board determine that it is in the best interest of the Corporation to re-nominate a director who is 72 years old or older, or not re-nominate a director who is younger than 72 years, the Board retains the authority to do so.

12. Compensation of Directors

The Board sets the level of compensation for directors, based on the recommendation of the Compensation Committee, and taking into account the impact of compensation on director independence. Directors who are also current employees of the Corporation receive no additional compensation for service as directors.

The Compensation Committee reviews periodically the amount and form of compensation paid to directors, taking into account the compensation paid to directors of other comparable U.S. companies. The Committee conducts its review with the assistance of outside experts in the field of executive compensation.

13. Director Stock Ownership Guidelines

In order to more closely align the interests of directors and the Corporation's shareholders, directors are encouraged to own a significant equity interest in the Corporation within a reasonable time after election to the Board. A director should own shares of the Corporation's common stock having a dollar value of at least five times the value of the then-applicable annual retainer paid for service on the Board. Ownership will be measured annually as of December 31 of each calendar year, based on the average closing price of a share of PG&E Corporation common stock as traded on the New York Stock Exchange for the last 30 trading days of the year. A director should achieve this ownership target within five years from the date of his or her election to the Board or the adoption of these amended guidelines (December 15, 2010), whichever is later. For purposes of calculating a director's level of share ownership, the following are included: (1) shares of PG&E Corporation common stock beneficially owned by the director (as determined in accordance with the rules of the Securities and Exchange Commission), and (2) PG&E Corporation restricted stock units and common stock equivalents held by the director.

14. Meetings of the Board

As provided in Article II, Section 4 of the Corporation's Bylaws, the Board meets regularly on previously determined dates. Board meetings shall be held at least quarterly. As provided in Article II, Section 5 of the Bylaws, the Chairman of the Board, the Chief Executive Officer, the President, the Chair of the Executive Committee, or any five directors may call a special meeting of the Board at any time.

Each Board member is expected to regularly attend Board meetings and meetings of the committees on which the director serves (either in person or by telephone or other similar communication equipment), and to attend annual meetings of the Corporation's shareholders. Pursuant to proxy disclosure rules, the Corporation's proxy statement identifies each director who during the last fiscal year attended fewer than 75 percent of the aggregate of the total number of meetings of the Board and each Board committee on which the director served.

15. Lead Director

The lead director shall be elected from among the independent chairs of the standing Board committees, and shall be elected by the independent directors based upon the recommendation of the Nominating and Governance Committee. The lead director must have at least one year of experience as a director of the Corporation, shall be elected every three years, and shall serve a three-year term (except where such lead director is elected to serve on an interim basis). Any lead director may serve consecutive terms. The lead director shall act as a liaison between the Chairman of the Board and the independent directors, and shall preside at all meetings at which the Chairman is not present. The lead director approves the agendas and schedules for meetings of the Board to assure that there is sufficient time for discussion of all agenda items, and approves information sent to the members of the Board. The lead director has authority to call special meetings of the independent directors.

16. Meetings of Independent Directors

The independent directors meet at each regularly scheduled Board meeting in executive session. These executive session meetings are chaired by the lead director. Following each such meeting, the lead director, or one or more other independent directors designated by the lead director, has a discussion with the Chairman of the Board (if the Chairman is not an independent director) and the Chief Executive Officer (if the Chairman is not the CEO) regarding the executive session meeting.

The lead director establishes the agenda for each executive session meeting of independent directors, and also determines which, if any, other individuals, including members of management and independent advisors, should attend each such meeting.

17. Board Agenda Items

The Chairman of the Board, in consultation with the Chief Executive Officer (if the Chairman is not the CEO), establishes the agenda for each meeting.

Board members are encouraged to suggest the inclusion of items on the agenda.

18. Board Materials and Presentations

The agenda for each meeting is provided in advance of the meeting, together with written materials on matters to be presented for consideration, for the directors' review prior to the meeting. As a general rule, written materials are provided in advance on all matters requiring Board action. Written materials are concise summaries of the relevant information, designed to provide a foundation for the Board's discussion of key issues and make the most efficient use of the Board's meeting time. Directors may request from the Chairman of the Board and the Chief Executive Officer (if the Chairman is not the CEO) any additional information they believe to be necessary to perform their duties.

19. Regular Attendance of Non-Directors at Board Meetings

Members of management, as designated by the Chairman of the Board and the Chief Executive Officer (if the Chairman is not the CEO), attend each meeting of the Board.

20. Board Committees

The Board establishes committees to assist the Board in overseeing the affairs of the Corporation.

Currently, there are six standing committees. The Executive Committee exercises all powers of the Board (subject to the provisions of law and limits imposed by the Board) and meets only at such times as it is infeasible to convene a meeting of the full Board. The Audit Committee, the Compensation Committee, the Finance Committee, the

Nominating and Governance Committee, and the Public Policy Committee are each responsible for defined areas delegated by the Board.

The Board may establish other committees or dissolve committees from time to time, as it deems appropriate, and in conformance with applicable laws and regulations.

21. Membership of Board Committees

All permanent standing Board committees, other than the Executive Committee, are chaired by independent directors. Each such independent committee chair shall be appointed to serve a three-year term (except where such committee chair is elected to serve on an interim basis), provided that such committee chair continues to be re-elected to the Board during that term. Any such committee chair may serve consecutive terms. The terms for each of the committee chair positions shall be staggered such that roughly one-third of the positions are appointed each year. Each independent committee chair shall act as a liaison between the Chairman of the Board and the respective committee, and shall preside at all meetings of that committee. Each independent committee chair approves the agendas and schedules for meetings of the respective committee, and approves information sent to the committee members. Each independent committee chair has authority to call special meetings of the respective committee.

The Audit Committee, the Compensation Committee, the Finance Committee, the Nominating and Governance Committee, and the Public Policy Committee are composed entirely of independent directors, as defined in Section 3 of these guidelines.

Members of the Audit Committee also must satisfy the audit committee independence and qualification requirements established by the Securities and Exchange Commission and any stock exchange on which securities of the Corporation or Pacific Gas and Electric Company are listed. If an Audit Committee member simultaneously serves on the audit committees of three or more public companies other than the Corporation and its subsidiaries, that Committee member must inform the Corporation's Board of Directors and, in order for that member to continue serving on the Corporation's Audit Committee, the Board of Directors must affirmatively determine that such simultaneous service does not impair the ability of that member to serve effectively on the Corporation's Audit Committee.

22. Appointment of Committee Members

The composition of each committee is determined by the Board of Directors.

The Nominating and Governance Committee, after consultation with the Chairman of the Board and the Chief Executive Officer (if the Chairman is not the CEO) and with consideration of the wishes of the individual directors, recommends to the full Board the chairmanship and membership of each committee.

23. Committee Agenda Items

The chair of each committee, in consultation with the appropriate members of management, establishes the agenda for each meeting.

At the beginning of the year, each committee issues a work plan of subjects to be discussed during the year, to the extent such subjects can be foreseen. Copies of these annual work plans are provided to all directors.

24. Committee Materials and Presentations

The agenda for each committee meeting is provided in advance of the meeting, together with written materials on matters to be presented for consideration, for the committee members' review prior to the meeting. As a general rule,

written materials are provided in advance on all matters to be presented for committee action.

25. Attendance at Committee Meetings

The chair of each committee, after consultation with the Chairman of the Board and the Chief Executive Officer (if the Chairman is not the CEO), determines the appropriate members of management to attend each meeting of the Committee.

Any director or advisory director may attend any meeting of any committee with the concurrence of the committee chair.

26. Formal Evaluation of the Chief Executive Officer

The independent directors annually review and evaluate the performance of the Chief Executive Officer. The review is based upon objective criteria, including the performance of the business and accomplishment of objectives previously established in consultation with the Chief Executive Officer.

The results of the review and evaluation are communicated to the Chief Executive Officer by the Chair of the Compensation Committee, and are used by that Committee and the Board when considering the compensation of the CEO.

27. Management Development and Succession Planning

At least annually, the Board reviews a succession plan for the Chief Executive Officer (CEO) position. The plan addresses CEO succession both in the ordinary course of business and on an emergency basis. The Board develops a profile of appropriate responsibilities, attributes, and requirements for the position of CEO, which reflects the Corporation's and Pacific Gas and Electric Company's business functions, vision, and strategy. Candidates for CEO successor may be identified internally within the Corporation and its subsidiaries in consultation with the Compensation Committee and the CEO, as well as externally through various sources, including third-party consultants. The succession planning process also addresses the continuing development of appropriate leadership skills for internal candidates for CEO, as well as candidates for other leadership positions within the Corporation.

28. Communications with External Entities

The Chief Executive Officer is responsible for all communications with the media, the financial community, or other external entities pertaining to the affairs of the Corporation. Directors refer any inquiries from such entities to the CEO for handling.

29. Access to Independent Advisors

The Board of Directors and its committees have the right to retain independent outside financial, legal, or other advisors, as necessary and appropriate. The Corporation shall bear the costs of retaining such advisors.

30. Director Orientation and Continuing Education

The Corporation provides information to new directors on subjects that would assist them in discharging their duties, and periodically provides briefing sessions or materials for all directors on such subjects.

The Corporation also provides each director with information regarding opportunities for continuing education. The Corporation encourages each director to stay current on important developments pertaining to such director's function and duties to the Corporation by attending such programs as appropriate or otherwise.



31. Communications with Interested Parties (Including Shareholders)

The lead director shall be designated as the director who receives written communications from interested parties (including the Corporation's shareholders), in care of the Corporate Secretary. The Corporate Secretary shall forward to the lead director any communications addressed to the Board of Directors as a body or to all the directors in their entirety, and such other communications as the Corporate Secretary, in his or her discretion, determines is appropriate. The Corporate Secretary also shall receive communications directed to individual directors and forward those as appropriate. If requested by major shareholders, the lead director shall be available for consultation and direct communication with such major shareholders.

32. Legal Compliance and Business Ethics

The Board of Directors is responsible for exercising reasonable oversight with respect to the implementation and effectiveness of the Corporation's legal compliance and ethics program. In that role, the Board of Directors shall be knowledgeable about the content and operation of the Corporation's compliance and ethics program, but may delegate more detailed oversight to a committee of the Board of Directors.

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EXHIBIT A TO PG&E CORPORATION  
CORPORATE GOVERNANCE GUIDELINES

CATEGORICAL STANDARDS FOR IDENTIFYING  
“MATERIAL” RELATIONSHIPS THAT MAY AFFECT  
DIRECTOR INDEPENDENCE

Adopted: December 17, 2003  
Amended as of February 18, 2004, December 15, 2004,  
December 20, 2006, December 17, 2008, and April 21, 2011.

The following categories of relationships between a director and PG&E Corporation shall be considered “material.” The existence of a “material” relationship provides a rebuttable presumption that the affected director is not “independent,” absent a specific determination by the Board of Directors to the contrary.

A director has a “material” relationship with the Corporation in the following circumstances:

EMPLOYMENT

- If a director is a current or former employee of the Corporation. Service as an interim Chairman of the Board or Chief Executive Officer, or other Section 16 Officer, shall not disqualify a director from being considered independent following that service, so long as the duration of the interim service is less than one year.
- If a member of the director’s immediate family is or was employed as a Section 16 Officer of the Corporation, unless such employment ended more than three years ago.

DIRECT COMPENSATION FROM THE CORPORATION

- If a director is a consultant to the Corporation.
- If a director or his or her immediate family member receives, or during the past three years received, more than \$120,000 per year or rolling 12-month period in direct compensation from the Corporation. “Direct compensation” does not include director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service) or compensation received by a director’s immediate family member for service as an employee (unless the immediate family member received compensation for services as a Section 16 Officer, in which case the director has a material relationship with the Corporation). Compensation paid for service as an interim Chairman of the Board or Chief Executive Officer, or other Section 16 Officer, shall not disqualify a director from being considered independent following that service, so long as the duration of the interim service is less than one year.

INTERNAL OR EXTERNAL AUDITORS

- If a director is, or during the past three years was, affiliated with, or employed by, a firm that serves or served during the past three years as the Corporation’s internal or external auditor.
-

If a director's immediate family member (1) is a current partner of the Corporation's internal or external auditor, (2) is a current employee of such a firm and personally works on the Corporation's audit, or (3) was within the last three years a partner or employee of such a firm and personally worked on the Corporation's audit within that time.

#### DIRECTOR INTERLOCK

- If a director is a current or former officer or employee of any other company on whose board of directors any officer of the Corporation serves as a member.
- If a director's immediate family member is, or during the past three years was, employed by another company where any of the Corporation's present Section 16 Officers concurrently serves on that company's compensation committee.

#### BUSINESS RELATIONSHIPS

- If a director is a current Section 16 Officer or employee, or his or her immediate family member is a current Section 16 Officer, of a company (which does not include charitable, non-profit, or tax-exempt entities) that makes payments to, or receives payments from, the Corporation for property or services in an amount which, in any single fiscal year, exceeds the greater of \$1 million or 2 percent of such other company's consolidated gross revenues, during any of the past three years. The director is not "independent" until three years after falling below such threshold. (Both the payments and the consolidated gross revenues to be measured shall be those reported in the last completed fiscal year. The look-back provision for this test applies solely to the financial relationship between the Corporation and the director's or immediate family member's current employer; the Corporation need not consider former employment of the director or immediate family member.)

#### CHARITABLE RELATIONSHIPS

- If the director (or a relative) is a trustee, director, or employee of a charitable or non-profit organization that receives grants or endowments from the Corporation or its affiliates exceeding the greater of \$200,000 or 2 percent of the recipient's gross revenues during the Corporation's or the recipient's most recent completed fiscal year.

#### NOTES:

- "Immediate family member" includes a person's spouse, parents, children, siblings, mothers- and fathers-in-law, sons- and daughters-in-law, brothers- and sisters-in-law, and anyone (other than domestic employees) who shares such person's home, or is financially dependent on such person.
  - "Corporation" includes any consolidated subsidiaries or parent companies.
- "Section 16 Officer" means "officer" as defined in Rule 16a-1(f) under the Securities Exchange Act of 1934, and includes the president, the principal financial officer, the principal accounting officer, any vice president in charge of a principal business unit, division, or function (such as sales, administration, or finance), any other officer who performs a policymaking function, or any other person who performs similar policymaking functions for that company.

Amendment to Bylaws of PG&E Corporation Effective May 1, 2011

Article II.  
DIRECTORS.

1. Number. As stated in paragraph I of Article Third of this Corporation's Articles of Incorporation, the Board of Directors of this Corporation shall consist of such number of directors, not less than seven (7) nor more than thirteen (13). The exact number of directors shall be ten (10) until changed, within the limits specified above, by an amendment to this Bylaw duly adopted by the Board of Directors or the shareholders.
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Amendment to Bylaws of Pacific Gas and Electric Company Effective May 1, 2011

Article II.  
DIRECTORS.

1. Number. The Board of Directors of this Corporation shall consist of such number of directors, not less than nine (9) nor more than seventeen (17). The exact number of directors shall be eleven (11) until changed, within the limits specified above, by an amendment to this Bylaw duly adopted by the Board of Directors or the shareholders.
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n .0001pt;text-autospace:none;">\$

20.60

Nonvested, April 5, 2008

88

\$

16.42

## INCOME TAXES

Effective July 8, 2007, the Company adopted Financial Accounting Standards Board ( FASB ) Interpretation No. 48, Accounting for Uncertainty in Income Taxes ( FIN 48 ). The cumulative effect of adoption was a decrease to retained earnings of approximately \$0.6 million. As of July 8, 2007, the total unrecognized tax benefits were approximately \$5.2 million. Of this amount, approximately \$2.0 million would reduce our effective tax rate if recognized.

The Company accounts for interest and penalties related to unrecognized tax benefits as a component of income tax expense. As of the date of adoption, the Company had \$0.7 million of interest and penalties accrued associated with unrecognized tax benefits.

The Company could be subject to Federal and state tax examinations for years 2002 and forward. The Company may also be subject to audits in Canada for years 2000 and forward. The Company is currently under state income tax audit in Arizona, Texas and New York and expects the commencement of certain state tax audits in the near term. At this time, the Company does not believe that the outcome of any examination will have a material impact on the Company's financial statements.

As of July 8, 2007, the total amount of unrecognized tax benefits were approximately \$5.2 million. At the end of the third quarter, the Company recognized that there were \$2.5 million related to tax positions that were no longer uncertain. This amount is comprised of a \$2.2 million decrease in unrecognized tax benefits due to the filing of amended Canadian income tax returns and a \$0.3 million decrease in unrecognized tax benefits due to statute expirations.

## LEGAL MATTERS

A former employee sued bebe, purportedly on behalf of a class of all hourly, non-managerial employees similarly situated, in a complaint filed on April 28, 2005 in the United States District Court for the Northern District of California (case no. C050177) alleging violations under the Fair Labor Standards Act, specifically that bebe obligated her to buy and wear its brand clothing as a uniform, without reimbursement or credit, and the net effect of deducting the value of such required purchases from her wages would often result in her not being paid minimum wages. The lawsuit seeks compensatory, statutory and injunctive relief. On January 25, 2008, the Court preliminarily approved the confidential settlement we previously reached in this case and we moved forward with class notification. The process of class notification is now complete and the claims period is over. A hearing has been set for May 19, 2008 to determine whether the preliminarily approved settlement should be finally approved. We have accrued an amount that we believe reasonably estimates the potential liability, which does not have a material impact on our financial position or results of operations.

A former employee sued bebe in a complaint filed July 27, 2006 in the Superior Court of California, San Mateo County (case no. CIV 456550) alleging a failure to pay all wages, failure to pay overtime wages, failure to pay minimum wages, failure to provide meal periods, violation of Labor Code §450, violation of Labor Code §2802 and California Code of Regulations §11040(9)(A), statutory wage violations (late payment of wages), unlawful business practices under Business and Professions Code §16720 and §17200, conversion of wages and violation of Civil Code §52.1. The plaintiff purports to bring the action also on behalf of current and former California bebe employees who are similarly situated. The lawsuit seeks compensatory, statutory, punitive, restitution and injunctive relief. The Court has re-set the hearing date regarding whether class certification would be appropriate to September 2008.

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The previously reported complaint filed by a former employee on July 24, 2007 in the Superior Court of California, Orange County (case no. 07CC08220) alleging a failure to pay overtime wages, failure to provide for meal and rest breaks, and unfair business practices has been dismissed with no liability to us.

A former employee sued bebe in a complaint filed September 20, 2007 in the United States District Court for the District of New Jersey (case no. 07-cv-4514 (D.N.J.)) alleging various state and federal statutory breaches based on a failure to pay all wages, including overtime wages and bonus, failure to provide and/or pay for meal and rest break periods, failure to credit vacation time and other benefits and retaliation, wrongful termination, breach of contract, breach of covenant of good faith and fair dealing, and unjust enrichment. Plaintiff purports to bring the action on behalf of current and former store management employees who are or were similarly situated. The complaint seeks compensatory, statutory and punitive damages and equitable relief. We filed our answer in January 2008 and the matter is in the pre-discovery stage. The matter is in the early stages of discovery and the Court is considering whether conditional certification of a class is appropriate.

A customer sued the company in a complaint filed December 14, 2006 in the Superior Court of Contra Costa County (case no. C06-02630) alleging that we utilized a certain type of preprinted credit card form in a return transaction in violation of California Civil Code §1747.08. The plaintiff purports to bring the action also on behalf of other customers who are similarly situated. The lawsuit seeks compensatory, statutory, and injunctive relief. This matter is in the discovery stage.



On February 9, 2007, a customer, purportedly on behalf of other customers similarly situated, filed suit against bebe in the Central District of California (case no. CV-07-0972) alleging we violated the Fair Credit Reporting Act (the FCRA ) by printing on receipts more than the last five digits of the credit or debit card numbers and/or the expiration date. The suit seeks statutory and punitive damages, attorney's fees and injunctive relief. On October 11, 2007, the Court stayed this case in its entirety pending the outcome of an interlocutory appeal in the Ninth Circuit Court of Appeals involving class certification issues in a similar FCRA action entitled, Soualian v. International Coffee and Tea, LLC, Case No. CV-07-00502-RGK, United States District Court for the Central District of California, Appellate Case No. 07-56377.

We are also involved in various other legal proceedings arising in the normal course of business. None of these matters nor the matters listed above are expected, individually or in the aggregate, to have a material adverse effect on our business, financial condition or results of operations.

We intend to defend ourselves vigorously against each of these claims. However, the results of any litigation are inherently uncertain. We cannot assure you that we will be able to successfully defend ourselves in these lawsuits. Where required, and/or otherwise appropriate, we have recorded an estimate of potential liabilities that we believe is reasonable. Any estimates are revised as further information becomes available.

## **RECENT ACCOUNTING PRONOUNCEMENTS**

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements . SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements and accordingly does not require any new fair value measurements. The provisions of SFAS No. 157 are to be applied prospectively as of the beginning of the fiscal year in which it is initially applied, with any transition adjustment recognized as a cumulative-effect adjustment to the opening balance of retained earnings. The provisions of SFAS No. 157 are effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued Staff Position No. FAS 157-2 which delays the effective date of SFAS No. 157 for nonfinancial assets and liabilities except for items recognized or disclosed at fair value in the financial statements on a recurring basis to fiscal years beginning after November 15, 2008. The Company does not expect the adoption of SFAS No. 157 to have a material impact on our financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115 . SFAS No. 159 permits entities to choose to measure eligible items at fair value at specified election dates and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company does not expect the adoption of SFAS No. 159 to have a material impact on our financial position and results of operations.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements, which involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements. Statements that are predictive in nature, that depend upon or refer to future events or conditions or that include words such as expects, anticipates, intends, plans, believes, estimates, thinks, and similar expressions are forward-looking statements. Forward-looking statements include statements about our expected results of operations, capital expenditures and store openings. Although we believe that these statements are based upon reasonable assumptions, we cannot assure you that our goals will be achieved. These forward-looking statements are made as of the date of this Form 10-Q, and we assume no obligation to update or revise them or provide reasons why actual results may differ. Factors that

might cause such a difference include, but are not limited to, our ability to respond to changing fashion trends, miscalculation of the demand for our products, effective management of our growth, decline in comparable store sales performance, ongoing competitive pressures in the apparel industry, changes in the level of consumer spending or preferences in apparel, our ability to attract and retain key management personnel and/or other factors discussed in Risks Factors and elsewhere in this Form 10-Q.

## OVERVIEW

We design, develop and produce a distinctive line of contemporary women's apparel and accessories. While we attract a broad audience, our target customer is a 21 to 35-year-old woman who seeks current fashion trends to suit her lifestyle. The bebe look appeals to a hip, sexy, sophisticated, body-conscious woman who takes pride in her appearance. The bebe customer expects value in the form of current fashion and high quality at a competitive price.

Our distinctive product offering includes a full range of separates, tops, sweaters, dresses, active wear and accessories in the following lifestyle categories: career, evening, casual and active. We design and develop the majority of our merchandise in-house, which is manufactured to our specifications. The remainder of our merchandise is sourced directly from third-party manufacturers.

We market our products under the bebe, BEBE SPORT, bbsp and bebe O brand names through our 290 retail stores, of which 207 are bebe stores, 62 are BEBE SPORT stores, 20 are bebe outlet stores and 1 is a bebe accessories store as of April 5, 2008. These stores are located in 35 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and Canada. In addition, we have an on-line store at www.bebe.com and our licensees operate 20 international stores. During the three months ended April 5, 2008, we opened 4 stores, including 3 bebe stores and 1 BEBE SPORT store and closed 4 bebe stores. During the nine months ended April 5, 2008, we opened 21 stores, including 13 bebe stores and 8 BEBE SPORT stores and closed 4 bebe stores. We expect to open approximately 35 stores, including approximately 19 bebe stores, 9 BEBE SPORT stores and 7 bebe outlet stores during our fiscal 2008. We also plan to renovate 1 existing store and relocate or expand 6 existing stores, resulting in square footage growth of approximately 14%.

*bebe stores.* We were founded by Manny Mashouf, Chairman of the Board. We opened our first store in San Francisco, California in 1976, which was also the year we incorporated.

*BEBE SPORT.* We launched BEBE SPORT during fiscal 2003 to address the performance and active lifestyle needs of the bebe customer.

*bebe outlets.* We utilize the outlets as a clearance vehicle for merchandise from our retail stores. In addition, the inventory includes a strong presentation of bebe logo merchandise and special cuts produced under the bebe O label exclusively for the outlet stores. In the last quarter of 2008, we plan to open 7 new outlet stores under the new name 2b bebe and will continue to offer a selection of bebe logo product, bebe sale consolidations and an expanded assortment of product made exclusively for our outlet stores under the new name 2b bebe.

*On-line.* bebe.com is an extension of the bebe store experience and provides a complete assortment of bebe and BEBE SPORT merchandise. It is also used as an advertising vehicle to communicate with our customers. We are currently able to ship to customers in the United States and Canada.

*bebe accessories.* In September 2006, we opened our first accessory concept store featuring shoes imported from Italy, Brazil and China and a selection of fine leather goods, bebe logo merchandise, outerwear and gift items.

## **CRITICAL ACCOUNTING POLICIES**

Management's Discussion and Analysis of Financial Condition and Results of Operations are based upon our consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America.

The preparation of these financial statements requires the appropriate application of certain accounting policies, many of which require us to make estimates and assumptions about future events and their impact on amounts reported in our financial statements and related notes. Since future events and their impact cannot be determined with certainty, the actual results will inevitably differ from our estimates. Such differences

could be material to the financial statements. We believe our application of accounting policies, and the estimates inherently required therein, are reasonable. These accounting policies and estimates are constantly reevaluated, and adjustments are made when facts and circumstances dictate a change. Our accounting policies are more fully described in Note 1 to the consolidated financial statements in our annual report on Form 10-K for the fiscal year ended July 7, 2007.

We have identified certain critical accounting policies, which are described below:

*Revenue recognition.* We recognize revenue at the time the products are received by the customers in accordance with the provisions of Staff Accounting Bulletin ( SAB ) No. 101, Revenue Recognition in Financial Statements as amended by SAB No. 104, Revenue Recognition . We recognize revenue for store sales at the point at which the customer receives and pays for the merchandise at the register with either cash or credit card. For on-line sales, we recognize revenue at the time the customer receives the product. We estimate and defer revenue and the related product costs for shipments that are in transit to the customer. Customers typically receive goods within one week of shipment. Amounts related to shipping billed to customers are reflected in net sales and the related costs are reflected in cost of goods sold. Sales tax collected from customers on retail sales are recorded net of retail sales at the time of the transaction.

We record a reserve for estimated product returns based on historical return trends. As of April 5, 2008 and April 7, 2007, the reserve was \$1,283,000 and \$955,000, respectively. If actual returns are greater than those projected, additional sales returns may be recorded in the future.

Discounts offered to customers consist primarily of point of sale markdowns and are recorded at the time of the related sale as a reduction of revenue.

We include the value of points and rewards earned by our loyalty program members as a liability and a reduction of revenue at the time the points and rewards are earned based on historical conversion and redemption rates. We recognize revenue when the rewards are redeemed or expire.

We carry gift certificates sold as a liability and we recognize revenue when the gift certificate is redeemed or four years after issuance if the gift certificate is unredeemed. Similarly, customers may receive a store credit in exchange for returned goods. We carry store credits as a liability until redeemed or three years after issuance if the store credit is unredeemed.

We ship bebe goods to various international locations and recognize revenue from these wholesale sales when the licensee receives the shipment.

We record royalty revenue from product licensees as earned, which is based on the licensee's sales.

*Stock Based Compensation.* We account for stock options and awards issued to employees in accordance with the fair value recognition provisions of Financial Accounting Standards Board ( FASB ) Statement No. 123(R) ( SFAS No. 123(R) ), Share-Based Payment, using the modified prospective transition method. Under SFAS No. 123(R), stock-based awards to employees are required to be recognized as compensation expense, based on the calculated fair value on the date of grant. We determine the fair value using the Black Scholes option pricing model. This model requires subjective assumptions, including future stock price volatility and expected term, which affect the calculated values.

*Inventories.* Our inventories are stated at the lower of weighted average cost or market. Market is determined based on the estimated net realizable value, which is generally the merchandise selling price. To ensure that our raw material is properly valued we age the fabric inventory and record a reserve in accordance with our established policy, which is based on historical experience. To ensure our finished goods inventory is properly valued we review the age and turnover of our inventory and record a reserve if the selling price is marked down below cost. These assumptions can have an impact on current and future operating results and financial position. We estimate shrinkage for the period between the last physical count and balance sheet date based on historic shrinkage trends.

*Marketable securities.* We hold a variety of interest bearing auction rate securities ( ARS ) comprised of federally insured student loan backed securities and insured municipal authority bonds. As of April 5, 2008, our ARS portfolio totaled approximately \$264 million, of which \$251 million were classified as long term investments and \$13 million were classified as short term marketable securities because either the ARS was sold in a successful auction or was called by issuer. Our ARS portfolio includes approximately 83% federally insured student loan backed securities and 17% municipal authority bonds. Our ARS portfolio is comprised of approximately 85% AAA rated investments, 4% AA rated investments and 11% A rated investments. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The recent uncertainties in the credit markets have affected our holdings in ARS investments and auctions for the majority of our investments in these securities have failed to settle on their respective settlement dates. Consequently, the investments are not currently liquid and we will not be able to access these funds until a future auction of these investments is successful. Maturity dates for these ARS investments range from 2010 to 2045 with principal distributions occurring on certain securities prior to maturity. We currently have the ability and intent to hold these ARS investments until a recovery of the auction process or until maturity.

Typically the fair value of ARS investments approximates par value due to the frequent resets through the auction process. While we continue to earn interest on our ARS investments at the maximum contractual rate, these investments are not currently trading and therefore do not currently have a readily determinable market value. Accordingly, the estimated fair value of ARS no longer approximates par value.

We determined the estimated fair value of our investment in ARS as of April 5, 2008 using a discounted cash flow model to estimate the fair value of our investments in ARS. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, timing and amount of cash flows and expected holding periods of the ARS. Based on this assessment of fair value, as of April 5, 2008 we determined there was a decline in the fair value of our ARS investments of \$7.2 million, with no related tax benefit, of which all was deemed temporary and an impairment charge was recorded in the other comprehensive income component of shareholders' equity.

We review our impairments in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and related guidance issued by the FASB and SEC in order to determine the classification of the impairment as temporary or other-than-temporary. A temporary impairment charge results in an unrealized loss being recorded in the other comprehensive income component of shareholders' equity. Such an unrealized loss does not affect net income for the applicable accounting period. An other-than-temporary impairment charge is recorded as a realized loss in the condensed consolidated statement of income and reduces net income for the applicable accounting period. The differentiating factors between temporary and other-than-temporary impairment are primarily the length of the time and the extent to which the market value has been less than cost, the financial condition and near-term prospects of the issuer and our current intent and ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value.

The valuation of our investment portfolio is subject to uncertainties that are difficult to predict. Factors that may impact its valuation include changes to credit ratings of the securities as well as to the underlying assets supporting those securities, rates of default of the underlying assets, underlying collateral value, discount rates and ongoing strength and quality of market credit and liquidity.

*Long-lived assets.* We review long-lived assets for impairment whenever events or changes in circumstances, such as store closures or poor performing stores, indicate that the carrying value of an asset may not be recoverable. If the undiscounted cash flows from the long-lived assets are less than the carrying value we record an impairment charge equal to the difference between the carrying value and the asset's fair value. In addition, at the time a decision is made to close a store, we record an impairment charge, if appropriate, or accelerate depreciation over the revised useful life of the asset. Historically, our impairment charges have been immaterial. During the nine months ended April 5, 2008 and April 7, 2007 we recorded \$773,000 and \$0, respectively, of impairment charges. We believe at this time that the long-lived assets' carrying values and useful lives continue to be appropriate.

*Accrued Litigation.* We accrue estimates of probable liabilities associated with lawsuits and claims. The results of any litigation are inherently uncertain. As information becomes available, we assess the potential liabilities related to pending litigation and may revise our estimates as necessary. Such revisions of estimates could materially impact the results of operations and financial position.

*Self Insurance.* We use a combination of insurance and self insurance for employee related health care benefits. We record self insurance liabilities based on claims filed and an estimate of those claims incurred but not reported. Any projection of losses concerning our liability is subject to a high degree of variability. Among the causes of this variability are unpredictable external factors such as future inflation rates, changes in severity, benefit level changes, medical costs and claim settlement patterns. Should a different amount of claims occur compared to what was estimated or costs of the claims increase or decrease beyond what was anticipated, reserves may need to be adjusted in the future.

*Income Taxes.* On July 8, 2007, we adopted FIN 48. FIN 48 prescribes a recognition threshold that a tax position is required to meet before being recognized in the financial statements and provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition issues. To the extent that our estimates change or the final tax outcome of these matters is different than the amounts recorded, such differences will impact the income tax provision in the period in which such determinations are made. Our effective tax rate in a given financial statement period may be materially impacted by changes in the mix and level of earnings, changes in the expected outcome of audits or changes in the deferred tax valuation allowance.

## **RESULTS OF OPERATIONS**

Our fiscal year is a 52 or 53 week period, each period ending on the first Saturday after June 30. Fiscal years 2008 and 2007 include 52 weeks and 53 weeks, respectively. The three months ended April 5, 2008 and April 7, 2007 include 13 weeks and 14 weeks, respectively. The nine months ended April 5, 2008 and April 7, 2007 include 39 weeks and 40 weeks, respectively.

The following table sets forth certain financial data as a percentage of net sales for the periods indicated:

	Three Months Ended		Nine Months Ended	
	April 5, 2008	April 7, 2007	April 5, 2008	April 7, 2007
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales, including production and occupancy (1)	56.2	54.7	54.1	52.1
Gross margin	43.8	45.3	45.9	47.9
Selling, general and administrative expenses (2)	38.9	35.1	34.5	32.1
Operating income	4.9	10.2	11.4	15.8
Interest and other income, net	3.4	2.9	2.5	2.0
Income before income taxes	8.3	13.1	13.9	17.8
Provision for income taxes	2.8	4.7	4.8	6.5
Net income	5.5%	8.4%	9.1%	11.3%

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(1) Cost of sales includes the cost of merchandise, occupancy costs, distribution center and production costs.

(2) Selling, general and administrative expenses primarily consist of non-occupancy store costs, corporate overhead and advertising costs.



*Net Sales.* Net sales decreased to \$151.7 million during the three months ended April 5, 2008 from \$154.4 million for the comparable period of the prior year, a decrease of \$2.7 million, or 1.7%. The decrease in sales is primarily due to an additional \$10 million in sales in fiscal 2007 due to the extra week in fiscal January 2007. Net sales excluding the additional week in fiscal 2007 increased by \$7.3 million or 5.1%. The increase in sales is primarily due to a \$17.4 million increase in stores not included in the comparable store sales, an increase in on-line sales and an increase in wholesale sales to international licensees partially offset by a 7.6% decrease in comparable store sales totaling \$9.6 million. Same store sales exclude the additional week from January 2007.

For the nine months ended April 5, 2008, net sales increased to \$516.1 million from \$508.2 million for the comparable period of the prior year, an increase of \$7.9 million, or 1.6%. Net sales excluding the additional week in fiscal 2007 increased by \$17.9 million or 3.6%. The increase in sales is primarily due to a \$54.2 million increase in sales for stores not included in the comparable store sales base, an increase in on-line sales and an increase in wholesale sales to international licensees, partially offset by an 8.3% decrease in comparable store sales totaling \$36.8 million during the nine months ended April 5, 2008 as compared to the same period in the prior. Same store sales exclude the additional week from January 2007.

	Three Months Ended		Nine Months Ended	
	April 5, 2008	April 7, 2007	April 5, 2008	April 7, 2007
Net sales (In thousands)	\$ 151,729	\$ 154,354	\$ 516,140	\$ 508,215
Total net sales increase (decrease) percentage	(1.7)%	16.3%	1.6%	19.0%
Comparable store sales increase (decrease) percentage	(7.6)%	(0.4)%	(8.3)%	5.9%
Net sales per average square foot (1)	\$ 141	\$ 162	\$ 495	\$ 550
Square footage at end of period (In thousands)	1,060	942	1,060	942
Number of store locations:				
Beginning of period	290	258	273	242
New store locations	4	6	21	22
Closed store locations	4	5	4	5
Number of stores open at end of period	290	259	290	259

(1) We calculate net sales per average square foot using net store sales and a monthly average store square footage.

*Gross Margin.* Gross margin decreased to \$66.3 million during the three months ended April 5, 2008 from \$69.9 million for the comparable period of the prior year, a decrease of \$3.6 million, or 5.2%. As a percentage of net sales, gross margin decreased to 43.8% for the three months ended April 5, 2008 from 45.3% in the comparable period of the prior year. The decrease in gross margin as a percentage of net sales resulted primarily due to unfavorable occupancy leverage partially offset by higher merchandise margin as a result of lower markdowns. In addition, gross margin in the third quarter of fiscal 2007 included substantial raw material reserves reversals.

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For the nine months ended April 5, 2008, gross margin decreased to \$236.9 million from \$243.5 million for the comparable period of the prior year, a decrease of \$6.6 million, or 2.7%. As a percentage of net sales, gross margin decreased to 45.9% for the nine months ended April 5, 2008 from 47.9% in the comparable period of the prior year. The decrease in gross margin as a percentage of net sales resulted primarily due to higher markdowns and unfavorable occupancy leverage, partially offset by a decrease in inventory reserves.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses, which primarily consist of non-occupancy store costs, corporate overhead and advertising costs, increased to \$59.0 million during the three months ended April 5, 2008 from \$54.1 million for the comparable period of the prior year, an increase of \$4.9 million, or 9.1%. As a percentage of net sales, selling, general and administrative expenses increased to 38.9% during the three months ended April 5, 2008 from 35.1% in the comparable period of the prior year. The increase in selling, general and administrative expenses as a percentage of net sales from the prior year of 3.8% was primarily due to higher total compensation expense, advertising expense and the recording of an impairment charge for three underperforming store locations.

Selling, general and administrative expenses increased to \$177.9 million during the nine months ended April 5, 2008 from \$163.4 million for the comparable period of the prior year, an increase of \$14.5 million, or 8.9 %. As a percentage of net sales, these expenses increased to 34.5% during the nine months ended April 5, 2008 from 32.1% in the comparable period of the prior year. The increase as a percentage of net sales from the prior year of 2.4% was primarily due to an increase in total compensation expense, including stock based compensation, advertising expense and depreciation expense.

*Interest and Other Income, Net.* We generated approximately \$5.2 million of interest and other income (net of other expenses) during the three months ended April 5, 2008 compared to approximately \$4.4 million in the comparable period of the prior year. The increase was primarily the result of higher interest rates on our tax-exempt investments and \$0.6 million in foreign currency gains related to settling intercompany inventory accounts due from Canada.

For the nine months ended April 5, 2008, we generated approximately \$13.0 million of interest and other income (net of other expenses), compared to \$10.1 million in the comparable period of the prior year. The increase was primarily the result of higher interest rates on our tax-exempt investments and \$0.6 million in foreign currency gains related to settling intercompany inventory accounts due from Canada.

*Provision for Income Taxes.* Our effective tax rate decreased to 33.6% for the three months ended April 5, 2008 from 35.9% for the comparable period in the prior year primarily due to an increase in tax-exempt interest income as a percent of total pretax income and an increase in our allowable domestic manufacturing deduction.

For the nine months ended April 5, 2008, our effective tax rate decreased to 34.5% from 36.1% for the comparable period in the prior year primarily due to an increase in tax-exempt interest income as a percentage of total pretax income and an increase in our allowable domestic manufacturing deduction.

### **Seasonality of Business and Quarterly Results**

Our business varies with general seasonal trends that are characteristic of the retail and apparel industries. As a result, our typical store generates a higher percentage of our annual net sales and profitability in the second quarter of our fiscal year, which includes the holiday selling season, compared to the other quarters of our fiscal year. If for any reason our sales were below seasonal norms during the second quarter of our fiscal year, our annual operating results would be negatively impacted. Because of the seasonality of our business, results for any quarter are not necessarily indicative of results that may be achieved for a full fiscal year.

### **LIQUIDITY AND CAPITAL RESOURCES**

Our working capital requirements vary widely throughout the year and generally peak during the first and second fiscal quarters. At April 5, 2008, we had approximately \$347.4 million of cash and equivalents and investments on hand of which approximately, \$264 million, net of a temporary impairment charge of \$7.2 million, were invested in auction rate securities ( ARS ). Due to the recent failures of these auctions we have classified \$251 million of these investments as long term investments. We do not anticipate the lack of liquidity in the ARS to impact our liquidity and believe we have sufficient cash and equivalents to fund ongoing operations. In addition, we had a revolving line of credit, under

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which we could borrow or issue letters of credit up to a combined total of \$25 million. As of April 5, 2008, there were no cash borrowings outstanding under the line of credit, and letters of credit outstanding totaled \$1.9 million.

Net cash provided by operating activities for the nine months ended April 5, 2008 was \$64.7 million versus \$62.7 million for the nine months ended April 7, 2007. Cash provided by operating activities for the period was primarily generated by net income of \$47.1 million adjusted for stock compensation of \$8.5 million, depreciation of \$16.9 million, deferred rent of \$5.3 million, deferred income taxes of \$2.4 million and net loss on disposal of property of \$0.8 million, as well as changes in working capital. The changes in working capital were primarily due to an increase in prepaid expenses and other assets of \$6.0 million, an increase in receivables of \$5.1 million, a decrease in accounts payable of \$1.9 million and an increase in inventory of \$0.5 million, partially offset by an increase in accrued liabilities of \$2.0 million.

Net cash provided by investing activities for the nine months ended April 5, 2008 was \$28.5 million versus net cash used by investing activities of \$53.9 million for the nine months ended April 7, 2007. Cash provided by investing activities for the period was primarily due to the sales of marketable securities of \$393.0 million, partially offset by purchases of marketable securities of \$337.0 million and capital expenditures of \$28.0 million related to the opening of new stores. We opened 21 new stores in the nine months ended April 5, 2008 and expect to open approximately 35 stores during fiscal 2008. We estimate that total capital expenditures will be approximately \$45 million in fiscal 2008.

Net cash used by financing activities was \$78.0 million for the nine months ended April 5, 2008 versus net cash provided by financing activities of \$3.0 million for the nine months ended April 7, 2007. Cash used by financing activities for the period was primarily due to the purchase of 5 million shares of our outstanding common stock totaling \$66.9 million and payments of quarterly dividends for the fourth quarter of fiscal 2007 and the first and second quarters of fiscal 2008 totaling \$13.8 million, partially offset by proceeds received from stock option exercises of \$2.2 million and the related tax benefit of \$0.6 million.

As of April 5, 2008, we had a balance of approximately \$264 million in investments in ARS, of which \$251 million were classified as long term investments and \$13 million were classified as short term marketable securities because either the ARS was sold in a successful auction or was called by issuer. Our ARS portfolio includes approximately 83% federally insured student loan backed securities and 17% municipal authority bonds. Our ARS portfolio is comprised of approximately 85% AAA rated investments, 4% AA rated investments and 11% A rated investments. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The recent uncertainties in the credit markets have affected our holdings in ARS investments and auctions for the majority of our investments in these securities have failed to settle on their respective settlement dates. Consequently, the investments are not currently liquid and we will not be able to access these funds until a future auction of these investments is successful. Maturity dates for these ARS investments range from 2010 to 2045 with principal distributions occurring on certain securities prior to maturity. We currently have the ability and intent to hold these ARS investments until a recovery of the auction process or until maturity.

During our first quarter of fiscal 2008, we entered into an agreement with our former Vice Chairperson Neda Mashouf to purchase 5 million shares of our common stock beneficially owned by Ms. Mashouf at a price per share of \$13.39, an aggregate purchase price of \$66,950,000. We may purchase additional shares from Ms. Mashouf or other shareholders in the future.

We believe that our cash on hand, together with our cash flows from operations, will be sufficient to meet our capital and operating requirements for at least the next twelve months. Our future capital requirements, however, will depend on numerous factors, including without limitation, liquidity of our auction rate securities, the size and number of new and expanded stores and/or store concepts, investment costs for management information systems, potential acquisitions and/or joint ventures, repurchase of stock and future results of operations.

#### **Inflation**

We do not believe that inflation has had a material effect on the results of operations in the recent past. However, we cannot assure you that our business will not be affected by inflation in the future.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to market risks, which include changes in U.S. interest rates and, to a lesser extent, foreign exchange rates. We do not engage in financial transactions for trading or speculative purposes.

#### *Interest Rate Risk*

We currently maintain a portfolio of variable interest rate investments consisting of cash equivalents, and short term marketable securities and long term investments comprised of auction rate securities ( ARS ). Our ARS portfolio includes approximately 83% federally insured student loan backed securities and 17% municipal authority bonds. Our ARS portfolio includes approximately 85% AAA rated investments, 4% AA rated investments and 11% A rated investments. According to our investment policy, we may invest in taxable and tax-exempt instruments. In addition, the policy establishes limits on credit quality, maturity, issuer and type of instrument. Marketable securities are classified as available for sale . We do not use derivative financial instruments in our investment portfolio.

All highly liquid investments with a maturity of three months or less at the date of purchase are considered to be cash equivalents. Investments are considered short term marketable securities if the original maturity is between three months and twelve months, or long term investments if the original maturity is greater than twelve months. Typically the fair value of ARS investments approximates par value due to the frequent resets through the auction process. While we continue to earn interest on our ARS investments at the maximum contractual rate, these investments are not currently trading and therefore do not currently have a readily determinable market value. Accordingly, the estimated fair value of ARS no longer approximates par value. We determined the estimated fair value of our investment in ARS as of April 5, 2008 using a discounted cash flow model to estimate the fair value of our investments in ARS. The assumptions used in preparing the discounted cash flow model include estimates for interest rates, timing and amount of cash flows and expected holding periods of the ARS. Based on this assessment of fair value, as of April 5, 2008 we determined there was a decline in the fair value of our ARS investments of \$7.2 million, with no related tax benefit, of which all was deemed temporary and an impairment charge was recorded in the other comprehensive income component of shareholders' equity. As of April 5, 2008, we reclassified \$251 million of our short term marketable securities to long term investments on our condensed consolidated balance sheet because of our inability to determine when our investments in ARS will settle. We have also modified our current investment strategy and increased our investments in more liquid money market investments. An immediate and uniform increase in market interest rate of 100 basis points from levels at April 5, 2008 would cause an additional decline of approximately 3%, or \$7.3 million, in the fair market value of our investments in ARS.

The following table lists our cash equivalents and investments at April 5, 2008:

	<b>Book Value</b>		<b>Fair Value</b>
	<b>(Dollars in thousands)</b>		
Cash equivalents	\$	64,342	\$ 64,342
Weighted average interest rate (1)		2.94%	
Short term marketable securities	\$	13,400	\$ 13,400
Weighted average interest rate (1)		6.29%	
Long term investments	\$	250,503	\$ 250,503
Weighted average interest rate (1)		5.53%	
Total	\$	328,245	\$ 328,245

(1) Represents the weighted average interest rate for tax-exempt municipal bonds, municipal preferreds, corporate preferreds and taxable and tax-exempt institutional money market instruments.

The interest payable on outstanding cash borrowings under our bank line of credit is based on variable interest rates and therefore affected by changes in market interest rates. As we have no outstanding cash borrowings, if interest rates rose significantly, our results from operations and cash flows would not be affected.

#### *Foreign Currency Risks*

We enter into a significant amount of purchase obligations outside of the United States, substantially all of which are negotiated and settled in U.S. Dollars and, therefore, have only minimal exposure to foreign currency exchange risks. We also operate a subsidiary for which the functional currency is the Canadian Dollar. In accordance with SFAS No. 52, *Foreign Currency Translation*, assets and liabilities of Canada's operations are translated into U.S. dollars at quarter-end rates, while income and expenses are translated at the weighted average exchange rates for the quarter. The related translation adjustments are recorded in accumulated other comprehensive income as a separate component of shareholders' equity. Fluctuations in exchange rates therefore impact our financial condition and results of operations, as reported in U.S. Dollars. We do not hedge against foreign currency risks and believe that foreign currency exchange risk is immaterial.

#### **ITEM 4. CONTROLS AND PROCEDURES**

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report at the reasonable assurance level.

There has been no change in our internal control over financial reporting during the quarter ended April 5, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

See the Legal Matters section of the Notes to the Condensed Consolidated Financial Statements for a discussion of legal proceedings.

**ITEM 1A. RISK FACTORS**

Our past performance may not be a reliable indicator of future performance because actual future results and trends may differ materially depending on a variety of factors, including, but not limited to, the risks and uncertainties discussed below. In addition, historical trends should not be used to anticipate results or trends in future periods.



Factors that might cause our actual results to differ materially from the forward looking statements discussed elsewhere in this report, as well as affect our ability to achieve our financial and other goals, include, but are not limited to, those set forth below. There have been no material changes in our risk factors from those disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended July 7, 2007, other than with respect to our investments in auction rate securities.

RISKS RELATING TO OUR BUSINESS:

**1. The success of our business depends in large part on our ability to identify fashion trends as well as to react to changing customer demand in a timely manner.** Consequently, we depend in part upon the customer response to the creative efforts of our merchandising, design and marketing teams and their ability to anticipate trends and fashions that will appeal to our consumer base. If we miscalculate our customers' product preferences or the demand for our products, we may be faced with excess inventory. Historically, this type of occurrence has resulted in excess fabric for some products and markdowns and/or write-offs, which has impaired our profitability, and may do so in the future. Similarly, any failure on our part to anticipate, identify and respond effectively to changing consumer demands and fashion trends will adversely affect our sales.

**2. If we are unable to obtain raw materials, or unable to find manufacturing facilities or if our manufacturers perform unacceptably, our sales may be negatively affected and our financial condition may be harmed.** We do not own any manufacturing facilities and therefore depend on contractors and third parties to manufacture our products. We place all of our orders for production of merchandise and raw materials by purchase order and do not have any long-term contracts with any manufacturer or supplier. If we fail to maintain favorable relationships with our manufacturers and suppliers or are unable to obtain sufficient quantities of quality raw materials on commercially reasonable terms, it could harm our business and results of operations. We cannot assure you that contractors and third-party manufacturers (1) will not supply similar products to our competitors, (2) will not stop supplying products to us completely or (3) will supply products in a timely manner. Untimely receipt of products may result in lower than anticipated sales and markdowns which would have a negative impact on earnings. Furthermore, we have received in the past, and may receive in the future, shipments of products from manufacturers that fail to conform to our quality control standards. In such event, unless we are able to obtain replacement products in a timely manner, we may lose sales. Certain of our third-party manufacturers store our raw materials. In the event our inventory is damaged or destroyed while in storage and we are unable to obtain replacement raw materials, our earnings may be negatively impacted.

**3. Our success depends on our ability to attract and retain qualified employees in order to support our existing business and future expansion.** From time to time we actively recruit qualified candidates to fill key executive positions from within the Company. There is substantial competition for experienced personnel, which we expect will continue. We compete for experienced personnel with companies who have greater financial resources than we do. In the past, we have experienced significant turnover of our executive management team and retail store personnel. We are also exposed to employment practice litigation due to the large number of employees and high turnover of our sales associates. If we fail to attract, motivate, and retain qualified personnel, it could harm our business and limit our ability to expand.

In addition, we depend on the expertise and execution of our key employees, particularly Manny Mashouf, our founder and Chairman of the Board, and Gregory Scott, our Chief Executive Officer and member of the Board of Directors. If we lose the services of Mr. Mashouf or

Mr. Scott, or any key officers or employees, it could harm our business and results of operations.

**4. If we are not able to successfully develop new concepts, including BEBE SPORT and 2b bebe, our revenue base and earnings may be impaired.** From time to time, we may pursue new concepts. If the BEBE SPORT and 2b bebe or other new concepts are not successful, our financial condition may be harmed.

**5. We cannot assure you that future store openings will be successful, and new store openings may impact existing stores.** We expect to open approximately 35 stores in fiscal 2008, of which 19 will be bebe stores, 9 will be BEBE SPORT stores and 7 will be 2b bebe stores. We cannot assure you that the stores that we plan to open in fiscal 2008, or any other stores that we might open in the future, will be successful or that our overall operating profit will increase as a result of opening these stores. During fiscal 2008 we closed 4 bebe stores and do not anticipate closing any additional stores for the remainder of the fiscal year. For fiscal 2008, we plan to grow our operations primarily through the opening of new stores. Most of our new store openings in fiscal 2008 will be in existing markets. These openings may affect the existing stores' net sales and profitability. Our failure to predict accurately the demographic or retail environment at any future store location could have a material adverse effect on our business, financial condition and results of operations.

Our ability to effectively obtain real estate to open new stores depends upon the availability of real estate that meets our criteria, including traffic, square footage, co-tenancies, average sales per square foot, lease economics, demographics, and other factors, and our ability to negotiate terms that meet our financial targets. In addition, we must be able to effectively renew our existing store leases. Failure to secure real estate locations adequate to meet annual targets as well as effectively managing the profitability of our existing fleet of stores could have a material adverse effect on our results of operations.

**6. We are subject to risks associated with our on-line sales.** We operate an on-line store at [www.bebe.com](http://www.bebe.com) to sell our merchandise.

Although our on-line sales encompass a relatively small percentage of our total sales, our on-line operations are subject to numerous risks, including unanticipated operating problems, reliance on third-party computer hardware and software providers. The on-line operations also involve other risks that could have an impact on our results of operations including but not limited to diversion of sales from our stores, rapid technological change, liability for on-line content, security breaches, consumer privacy concerns, credit card fraud, and risks related to the failure of the computer systems that operate the website and its related support systems. In addition, given our use of a third party platform, we do not have direct control of certain aspects of our on-line business. We cannot assure you that our on-line store will continue to achieve sales and profitability growth or even remain at its current level.

**7. Any serious disruption at our major facilities could have a harmful effect on our business.** We currently operate a corporate office in Brisbane, California, a distribution facility in Benicia, California, and a design studio and production facility in Los Angeles, California. Any serious disruption at these facilities whether due to construction, relocation, fire, earthquake, terrorist acts or otherwise would harm our operations and could have a harmful effect on our business and results of operations. Furthermore, we have little experience operating essential functions away from our main corporate offices and are uncertain what effect operating such satellite facilities might have on business, personnel and results of operations.

**8. We rely on information technology, the disruption of which could adversely impact our business.** We rely on various information systems to manage our operations and regularly make investments to upgrade, enhance or replace such systems. To support our growth we initiated a three year IS&T strategic plan and we are currently entering year three of this plan. If we fail to successfully implement the plan, our business could be adversely affected.

**9. We face significant competition in the retail and apparel industry, which could harm our sales and profitability.** The retail and apparel industries are highly competitive and are characterized by low barriers to entry. We expect competition in our markets to increase. The primary competitive factors in our markets are: brand name recognition, sourcing, product styling, quality, presentation and pricing, timeliness of product development and delivery, store ambiance, customer service and convenience. We compete with traditional department stores, specialty store retailers, business to consumer websites, off-price retailers and direct marketers for, among other things, raw materials, market share, retail space, finished goods, sourcing and personnel. Because many of these competitors are larger and have substantially greater financial, distribution and marketing resources than we do, we may lack the resources to adequately compete with them. If we fail to remain competitive in any way, it could harm our business, financial condition and results of operations.

**10. Purchases of the merchandise we sell are generally discretionary and are therefore particularly susceptible to economic conditions.** The outlook for the United States economy is uncertain and is directly affected by global factors that are beyond our control. Such factors include disposable consumer income, oil prices, recession and fears of recession, war and fears of war, terrorist attacks, inclement weather, consumer debt, interest rates, sales tax rates, consumer confidence in future economic conditions and political conditions, and consumer perceptions of personal well-being and security. Consumers are generally more willing to make discretionary purchases, including purchases of fashion products, during periods in which favorable economic conditions prevail. If economic conditions change, our business, financial

condition and results of operations could be adversely affected. We cannot predict the indirect effects such as rising oil and freight prices, consumer spending or other economic factors that natural disasters will have on our results of operations.

**11. Our business could be adversely impacted by unfavorable international political conditions.** Due to our international operations, our sales and operating results are, and will continue to be, affected by international social, political, legal and economic conditions. In particular, our business could be adversely impacted by instability or changes resulting in the disruption of trade with the countries in which our contractors, suppliers or customers are located, significant fluctuations in the value of the dollar against foreign currencies or restrictions on the transfer of funds, or additional trade restrictions imposed by the United States and other foreign governments. Trade restrictions, including increased tariffs or quotas, embargoes, and customs restrictions could increase the cost or reduce the supply of merchandise available to the company and adversely affect its financial condition and results of operations. In addition, we purchase a substantial amount of our raw materials from China and our business and operating results may be affected by changes in the political, social or economic environment in China.

**12. If we are not able to successfully protect our intellectual property our ability to capitalize on the value of our brand name may be impaired.** Even though we take actions to establish, register and protect our trademarks and other proprietary rights, we cannot assure you that we will be successful or that others will not imitate our products or infringe upon our intellectual property rights. In addition, we cannot assure that others will not resist or seek to block the sale of our products as infringements of their trademark and proprietary rights.

We are seeking to register our trademarks domestically and internationally. Obstacles may exist that may prevent us from obtaining a trademark for the bebe name or related names. We may not be able to register certain trademarks, purchase the right or obtain a license to use the bebe name or related names on commercially reasonable terms. If we fail to obtain trademark, ownership or license the requisite rights, it would limit our ability to expand. In some jurisdictions, despite successful registration of our trademarks, third parties may allege infringement and bring actions against us. In addition, if our licensees fail to use our intellectual property correctly, the reputation and value associated with our trademarks may be diluted. Furthermore, if we do not demonstrate use of our trademarks, our trademark rights may lapse over time.

**13. We may be required to record impairment charges in future quarters as a result of the decline in value of our investments in auction rate securities.** We hold a variety of interest bearing auction rate securities ( ARS ) comprised of federally insured student loan backed securities and insured municipal authority bonds. These ARS investments are intended to provide liquidity via an auction process that resets the applicable interest rate at predetermined calendar intervals, allowing investors to either roll over their holdings or gain immediate liquidity by selling such interests at par. The recent uncertainties in the credit markets have affected our holdings in ARS investments and the majority of auctions for our investments in these securities have failed to settle on their respective settlement dates. Consequently, \$251 million of our ARS are not currently liquid and we will not be able to access these funds until a future auction of these investments is successful or a buyer is found outside of the auction process. Maturity dates for these ARS investments range from 2010 to 2045 with principal distributions occurring on certain securities prior to maturity.

The valuation of our investment portfolio is subject to uncertainties that are difficult to predict. Factors that may impact its valuation include changes to credit ratings of the securities as well as to the underlying assets supporting those securities, rates of default of the underlying assets, underlying collateral value, discount rates and ongoing strength and quality of market credit and liquidity.

Although we currently have the ability and intent to hold these ARS investments until a recovery of the auction process or until maturity, if the current market conditions deteriorate further, or the anticipated recovery in market values does not occur, we may be required to record additional unrealized losses in other comprehensive income or impairment charges in future quarters.

**14. If an independent manufacturer violates labor or other laws, or is accused of violating any such laws, or if their labor practices diverge from those generally accepted as ethical, it could harm our business and brand image.** While we maintain a policy to monitor the operations of our independent manufacturers by having an independent firm inspect these manufacturing sites, and all manufacturers are contractually required to comply with such labor practices, we cannot control the actions or the public's perceptions of such manufacturers, nor can we assure that these manufacturers will conduct their businesses using ethical or legal labor practices. Apparel companies can be held jointly liable for the wrongdoings of the manufacturers of their products. While we do not control their employees' employment conditions or the manufacturers' business practices, and the manufacturers act in their own interest, they may act in a manner that result in negative public perceptions of us and/or employee allegations or court determinations that we are jointly liable.

#### RISKS RELATING TO OUR COMMON STOCK:

**1. Our stock price may fluctuate because of the relatively low number of shares that can be publicly traded.** The vast majority of our outstanding shares of our common stock are subject to trading restrictions. As of April 5, 2008, of the approximately 89,000,000 shares of our common stock then outstanding, approximately 27,000,000 shares were available to be publicly traded, and as a result, our stock price is vulnerable to market swings due to large purchases, sales and short sales of our common stock.

**2. Because Manny Mashouf beneficially owns a substantial portion of the outstanding shares, other shareholders may not be able to influence the direction the company takes.** As of April 30, 2008, Manny Mashouf, the Chairman of the Board, beneficially owned approximately 56% of the outstanding shares of our common stock. As a result, he can control the election of directors and the outcome of all issues submitted to the shareholders. This may make it more difficult for a third party

to acquire shares, may discourage acquisition bids, and could limit the price that certain investors might be willing to pay for shares of common stock. This concentration of stock ownership may have the effect of delaying, deferring or preventing a change in control of our company.

**3. Our significant shareholders hold a substantial portion of our stock which may result in the trading volatility or may adversely affect our common stock.** As of April 30, 2008, Ms. Neda Mashouf currently owned approximately 13% of the outstanding shares of our common stock. As a result, any change in ownership of a significant portion of these shares, including sales by Ms. Mashouf, may result in trading volatility in our common stock or may adversely affect our stock price.

**4. Our sales, margins and operating results are subject to seasonal and quarterly fluctuations.** Our business varies with general seasonal trends that are characteristic of the retail and apparel industries, such as the timing of seasonal wholesale shipments and other events affecting retail sales. As a result, our stores typically generate a higher percentage of our annual net sales and profitability in the second quarter of our fiscal year, which includes the holiday selling season, compared to other quarters.

In addition, our comparable store sales have fluctuated significantly in the past, and we expect that they will continue to fluctuate in the future. A variety of factors affect comparable store sales, including fashion trends, competition, current economic conditions, the timing of release of new merchandise and promotional events, changes in our merchandise mix, the success of marketing programs and weather conditions. Our ability to deliver strong comparable store sales results and margins depends in large part on accurately forecasting demand and fashion trends, selecting effective marketing techniques, providing an appropriate mix of merchandise for our customer base, managing inventory effectively, and optimizing store performance by closing underperforming stores. Such fluctuations may adversely affect the market price of our common stock.

**5. Failure to comply with Section 404 of the Sarbanes-Oxley Act of 2002 could negatively impact investor confidence.** In order to meet the requirements of the Sarbanes-Oxley Act of 2002 in future periods, we must continuously document, test, monitor and enhance our internal control over financial reporting. We cannot assure you that the periodic evaluation of our internal controls required by Section 404 of the Sarbanes-Oxley Act will not result in the identification of significant control deficiencies and/or material weaknesses or that our auditors will be able to attest to the effectiveness of our internal control over financial reporting.

Failure to maintain the effectiveness of our internal control over financial reporting or to comply with the requirements of this Act could have a material adverse effect on our reputation, financial condition and market price of our common stock.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Not applicable.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Not applicable.

**ITEM 5. OTHER INFORMATION**

Not applicable.

**ITEM 6. EXHIBITS**

(a) Exhibits. The following is a list of exhibits filed as part of this Report on Form 10-Q.

<b>Exhibit</b>	<b>Description</b>
31.1	Section 302 Certification of Chief Executive Officer.
31.2	Section 302 Certification of Chief Financial Officer.
32.1	Section 906 Certification of Chief Executive Officer.
32.2	Section 906 Certification of Chief Financial Officer.





**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated May 15, 2008

bebe stores, inc.

/s/ Walter Parks  
Walter Parks, Chief Operating Officer and Chief Financial  
Officer

EXHIBIT INDEX

<b>Exhibit Number</b>	<b>Description</b>
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
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32.2	Section 906 Certification of Chief Financial Officer