SEMPRA ENERGY

1999 ANNUAL REPORT

It is not the changing industry that defines us.

It is the changing customer.

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Based in San Diego, California, Sempra Energy is a Fortune 500 corporation with 12,000 employees serving the largest customer base of any energy services company in the United States. The Sempra Energy family of companies provides an integrated package of energy-related products and services. Sempra Energy common shares trade on the New York Stock Exchange under the symbol "SRE." The company's Web site address is www.sempra.com.

Welcome to the new world of energy services.

It is a world in which new technologies are empowering individuals and businesses with knowledge, choices and opportunity as never before. A world in which consumers, for the first time in the history of the energy industry, have a direct influence on the products and services that are ultimately developed.

At Sempra Energy, we embrace this new and challenging world and pledge our services to the customers who are defining it.

Financial Highlights

At December 31 or for the years then ended (dollars in millions except per share amounts)	1999	1998	Change
CONSOLIDATED FINANCIAL DATA			
Revenues and Other Income	$ 5,435	$ 5,015	+8.4%
Net Income	$ 394	$ 294	+34.0%
Net Income Per Share of Common Stock			
Basic	$ 1.66	$ 1.24	+33.9%
Diluted	$ 1.66	$ 1.24	+33.9%
Diluted, Excluding Business-Combination Costs	$ 1.72	$ 1.60	+7.5%
Weighted Average Number of Common Shares Outstanding (diluted, in millions)	237.6	237.1	+.2%
Total Assets	$11,270	$10,456	+6.5%
Common Dividends Declared Per Share	$ 1.56	$ 1.56	–
Dividend Payout Ratio (diluted)	94.0%	125.8%	–25.3%
Debt to Total Capitalization	50.4%	50.4%	–
Book Value Per Share	$ 12.58	$ 12.29	+2.4%
STATISTICS			
Natural Gas Throughput (in billions of cubic feet)	1,018	962	+5.8%
Average Cost of Natural Gas Purchased (per thousand cubic feet)	$ 2.33	$ 2.22	+5.0%
Electric Energy On-System Sales (in billions of kilowatt hours)	17.9	17.2	+4.1%
Average Cost of Electric Energy (per kilowatt hour)	3.26¢	3.07¢	+6.2%
Number of Customers[(a)] (in millions of meters served)			
Natural Gas	5.7	5.6	+1.8%
Electricity	1.2	1.2	–
Return on Common Equity[(b)]			
SoCalGas	15.2%	14.1%	+7.8%
SDG&E	15.8%	17.5%	–9.7%
Number of Employees[(c)]	11,248	11,148	+0.9%

(a) Majority-owned affiliates.

(b) Excluding business-combination costs.

(c) Excludes contract and part-time employees.

To our shareholders, customers and employees:

In the past year, we met or exceeded all our primary performance objectives. But it's not enough.

By almost every measure, we enjoyed a highly successful year in 1999. This was gratifying in light of the challenging goals we set for ourselves when we formed Sempra Energy in 1998.

We set out to achieve earnings growth of 5 percent to 6 percent. With net earnings, excluding business-combination costs, of $408 million, or $1.72 per diluted share, in 1999—an increase of nearly 8 percent—we exceeded that. We projected that our unregulated businesses would become collectively profitable in the year 2000. We achieved that in 1999, a full year ahead of schedule. We are still on track to reach our goal to derive one-third of our earnings from these businesses by the end of 2003, as we had initially forecast.

Richard D. Farman, Chairman and Chief Executive Officer (left), and Stephen L. Baum, Vice Chairman, President and Chief Operating Officer

Our regulated California utilities continued their excellent performance as well, exceeding their authorized rates of return. Also in 1999, we increased our international reach with new initiatives in Nova Scotia and Latin America. Throughout all of our activities, we maintained consistently high credit ratings.

It was a successful year, indeed. Yet despite our solid financial performance, we nevertheless fell short in the one area that matters most: translating these achievements into an increase in total return to our shareholders.

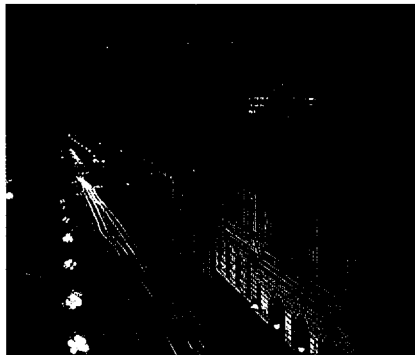
A new look at how we operate

Over the past year, the entire energy sector has been adversely impacted by investors' current focus on high-technology stocks and ongoing skepticism on Wall Street about the financial impact of energy deregulation on companies such as ours. When we look at the market opportunities before us, however, we can't help but be optimistic.

We feel confident that the future energy services environment is a market that will be ruled by the customer. Thanks to technology, competition and a greater energy knowledge and sophistication on the part of institutions, individuals and businesses large and small, customers will be calling the shots. And we believe this is the way it should be.

That's why we have undertaken a major initiative in realigning our business with this fundamental principle. We are making the transition from a regional utility to a global, competitive energy services company—with the goal of becoming, as we have stated, one of the top five such companies in North America over the next decade in the creation of shareholder value.

◄ UTILITIES. **The California utilities—San Diego Gas & Electric and Southern California Gas Company—remain the foundation of Sempra Energy. Their focus in the future will be to provide world-class energy-delivery services, building on their century-plus heritage of superior customer service, and to promote a competitive energy market in California. These initiatives will create increasingly higher value for Sempra Energy's energy-delivery systems.**



◄ INTERNATIONAL. **Sempra Energy International is well positioned to capitalize on new energy markets in Latin America, which—driven by industrialization, rising standards of living and more intensive use of electricity—are growing rapidly. In 1999, the company expanded operations in Mexico and South America, and initiated a new project to build a $700 million natural gas distribution system in Nova Scotia.**

To that end, we have committed ourselves to the strategy of acting with urgency to lead the transformation of retail energy markets, by creating innovative solutions that revolutionize the customer experience. We intend to leverage the creativity of our people and our understanding of customer needs, through new technologies and strategic alliances, to deliver outstanding value to our shareholders, customers and employees.

Henceforth, Sempra Energy will be defined more by growth—a company that will prosper by successfully meeting our customers' changing energy needs. We will be a company that asks you now to judge our performance against this challenging new benchmark. We invite you to read the pages following this letter for more details about this strategy.

Making it work

Fulfilling our organization's potential for growth creates a new set of business assumptions that impacts all of our key stakeholders, including you, our shareholders. In January 2000, we announced a reduction in our quarterly dividend to $0.25 from $0.39 and a self-tender offer to repurchase approximately 15 percent of our common shares.

These initiatives give us increased financial flexibility to invest in our growing domestic and international businesses, bring our dividend payout ratio in line with other companies in our industry and boost our compound average annual growth rate in earnings per share over the next three years to 8 percent to 10 percent. Collectively, these actions give us the impetus to grow our company as we envisioned when Sempra Energy was created nearly two years ago—and, more importantly, to deliver a better total return on your investment.

Steps toward progress

What are the signs that we are moving in the right direction as a diversified energy services company? Sempra Energy achieved a number of key growth milestones in 1999. Internationally, we expanded into Chile and Peru, with our joint acquisitions of Chilquinta Energía and Luz del Sur, we embarked on a valuable $700 million natural gas distribution project in Nova Scotia and continued to grow in Mexico with the addition of a new gas distribution project in Torreón. Meanwhile, our Sempra Energy Trading unit produced a dramatic $32 million rise in net income over 1998, fueled by expansion into Europe with the opening of new offices in London, Dusseldorf, Germany, and Oslo, Norway.

Domestically, our Energy America retail marketing joint venture continued to be among the most successful energy mass-market ventures in the United States—and, we believe, the only profitable one. Energy America now has more than 400,000 residential and small-business customers in six states.

We also jointly launched an Internet-based information services venture—called Soliance—with units of Titan Corporation and Modis Professional Services. Representing a new e-business venture to meet the requirements of our information-based economy, Soliance is designed to help mid-sized utilities and other businesses adapt their customer-information systems in a quick, cost-effective manner

◀ WHOLESALE TRADING. **Sempra Energy Trading provides a key link between the world's top energy producers and retailers, and is a significant participant in marketing and trading physical and financial energy products, including natural gas, power and crude oil. With its opening of three offices in Europe in 1999, Sempra Energy Trading is expanding its presence in this important and growing natural gas and power market.**

◀ RETAIL. **Through Sempra Energy Solutions, the company has developed a broad, integrated portfolio of energy-related services to develop tailored solutions for commercial and industrial customers. Services range from energy procurement and delivery to bill analysis and central plant management. Through Energy America, Sempra Energy has devised a successful formula for reaching the mass market for energy sales in the United States.**

as energy markets deregulate. Also, with construction completed on our 480-megawatt El Dorado Energy merchant power plant outside Las Vegas, we now can generate electricity for Western power markets.

Our California utilities continued to set new benchmarks for excellence. San Diego Gas & Electric succeeded in recovering the majority of its stranded costs—and in lifting its rate cap—more than two years ahead of schedule and achieved its best year ever for electric-system reliability. Southern California Gas Company surpassed its financial goals, improved operating efficiencies companywide and recorded the best safety record in its 133-year history.

Finally, in 1999 we terminated our planned merger with KN Energy when it became clear that the combined company would not be able to realize the business objectives that we originally anticipated. We will continue to seek new opportunities to enhance shareholder value wherever they present themselves, but we believe we can execute our current strategy without making another large-scale transforming transaction.

Goals for 2000

This year will bring more changes for Sempra Energy, starting in the executive offices, where the company's board of directors has reaffirmed the management succession plan involving the two of us. The plan, which was announced at the time Sempra Energy was created, calls for Steve to become chief executive officer at the end of June and then to become chairman at the beginning of September, when Dick retires.

Our shared goals for the company in 2000 and beyond remain focused on building on our considerable strengths and assets in energy services; enhancing our already strong financial performance; shaping our culture to deliver on our new mission, thereby aligning our employees, compensation plans, our organizational structure and corporate values; and measuring ourselves against the benchmarks of our new, more aggressive strategy.

Finally, as we look ahead, we embrace the challenges of a new world in which it is not the changing industry that defines us, but rather the changing customer.

As always, we thank you for your continued support.

Richard D. Farman
Chairman of the Board and Chief Executive Officer

Stephen L. Baum
Vice Chairman, President and Chief Operating Officer

What our customers need us to be

A company that listens well and responds; one that can develop and deliver creative solutions to meet our customers' specific needs.

How we intend to make that happen

We will build on our appreciation of the needs of our customers by utilizing the tools of innovation, technology and strategic partnerships to create value.

"We are acting to lead the transform of retail

Customers first. Plain and simple. Our goal is to become the recognized leader in the delivery of innovative solutions for retail energy customers. ¶ How to do that? First and foremost, by encouraging competition. By working with regulators and customers to transform the market—wholesale and retail, electric and gas—so that the ongoing restructuring of local energy markets can move forward effectively. We believe that, unlike the model for the utility monopolies of the past, today's customers and markets will

with urgency

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energy markets...

determine which energy service providers are successful. We embrace this idea, because it represents a fair playing field, and we believe we have the assets, the strength and the intelligence to compete effectively. ¶ Consistent with this strategy, we want to attain the best energy-delivery system in the United States. Toward that end, our two utilities—San Diego Gas & Electric and Southern California Gas Company—will continue to challenge themselves to maintain and enhance their excellent reputations for customer service and reliability in a restructured energy marketplace. ¶ Our offerings in the unregulated sector are under the leadership of our Sempra Energy Solutions unit, which integrates all existing commercial and industrial retail nonutility capabilities located throughout the corporation, including commodity-, efficiency-, information-, and facility-management services. This coordination will enable us to provide a truly seamless delivery model for consumers, shifting a customer's major interactions from the utility to the energy service provider. ¶ Which is exactly where it should be.

...by creating that revolutionize experience.

▲ VILLA ALEMANA. In the city of Villa Alemana, Chile, our Chilquinta Energía subsidiary (jointly owned with PSEG Global) replaced nearly 5,000 streetlights with energy-efficient sodium light bulbs. By providing the same amount of light while using less energy—and with an unbreakable cover to protect them from damage—the bulbs lowered the city's overall energy bill, while helping it save on maintenance costs.

▼ PETCO ANIMAL SUPPLIES. Sempra Energy Solutions works with nearly 200 PETCO stores nationwide to identify opportunities for lowering energy costs. Through its Encharge℠ service, Sempra Energy Solutions helps PETCO shrink utility costs and analyze how stores use energy. For every dollar PETCO spent on the service, Sempra Energy Solutions found $3.15 in energy-bill savings.

▲ LÁZARO CÁRDENAS GENERAL HOSPITAL. In 1999, Sempra Energy International's ECOGAS Chihuahua, Mexico, subsidiary tailored a natural gas conversion package that enabled the Lázaro Cárdenas General Hospital to save 75 percent over the cost of diesel heating fuel. In addition, the 480-bed hospital was able to recoup its investment in new heating equipment in just eight months.

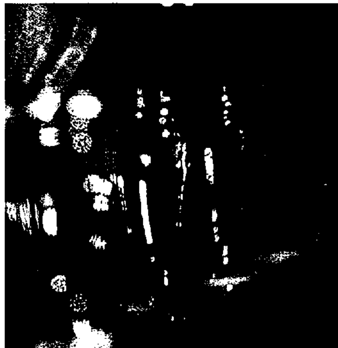
▼ SEAWORLD. SeaWorld San Diego utilizes sophisticated filtration and temperature-control systems to support its variety of marine life, including Shamu, the killer whale. Sempra Energy's SDG&E unit helped SeaWorld find ways to improve the operation of the park's electric cogeneration plants, which provide backup power for critical life-sustaining systems during emergencies.

innovative solutions the customer

It's not about selling gas anymore: It's about providing a comfortable climate—one that is easily changed when circumstances demand. And it's not about selling electricity, either: It's about offering lighting that matches a customer's needs—reliably, efficiently and cost-effectively. ¶ That's why, at Sempra Energy, we are developing a broad set of services: energy procurement and delivery; energy-portfolio management; pricing- and risk-management services; financial services; integrated energy and information solutions, including diagnostics, equipment replacement and energy audits; and infrastructure services, such as central-plant operations and maintenance, and substation management. ¶ With all these capabilities to offer, we can tailor a unique and comprehensive solution to each customer's need. And, in the mass market of residential and small-commercial customers, our low-overhead Energy America program has proved to be an important success, allowing us to extend this offering more broadly, as well as use its model to build next-generation marketing initiatives. ¶ After all, it's not about conducting transactions. It's about making things better for our customers.

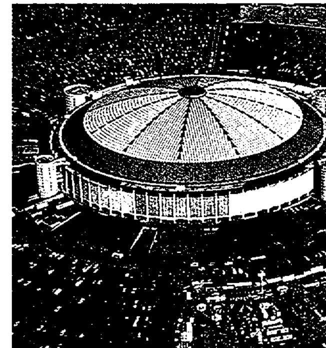
▲ ALGOMA STEEL. Algoma Steel, Canada's third-largest steel producer, turned to Sempra Energy Trading to help manage its natural gas needs. The result? Increased savings and more efficient usage of gas storage, transportation and delivery services at its Sault St. Marie mill in Ontario.

▼ VENETIAN RESORT-HOTEL-CASINO. As part of a joint venture, Sempra Energy Solutions finances, owns, operates and maintains the Venetian Resort-Hotel-Casino's $70 million energy system. This arrangement is expected to reduce energy-system operating costs by as much as 20 percent at the posh, $2.5 billion mega-resort on Las Vegas' famed "Strip."



▲ LIBBEY INC. To lower energy costs for Libbey—one of North America's largest producers of glass tableware—Sempra Energy Solutions supplies competitively priced natural gas and electricity to Libbey manufacturing plants in four states. This includes a corporate commodity program that encompasses delivery, procurement and other services.

▼ VILLAGE GREEN. The builders of Village Green, a 186-single-family-home project in Sylmar, Calif., were looking for ways to make their development one of the most energy efficient in the nation. Sempra Energy's SoCalGas unit helped them install natural gas air conditioners, which cost 15 percent to 25 percent less to operate than electrical units.



▲ ASTRODOMAIN COMPLEX. For Houston's new Astrodomain Complex—which includes a new NFL stadium, convention center, the Astrodome, Astrohall and Astroarena—Sempra Energy Solutions is building a new $25 million central energy plant with significantly more efficient heating and air conditioning.

▼ FERNANDO RAMOS, project manager, Sempra Energy International, Rosarito, Mexico. Fernando oversees construction of a 10,000-horsepower compressor station that, in conjunction with a new pipeline, will bring clean-burning natural gas to the power plant in Rosarito, Mexico. "Cleaner air is important to people here," says Fernando. "Natural gas will help the environment by greatly reducing plant emissions."

▼ HERB FRANKLIN, energy technician, SoCalGas, Corona, Calif. When Herb is trouble-shooting gas appliances for customers, he sees himself as more of a "customer satisfaction engineer." "It's something I'm very proud of," says Herb. "Happy customers are good not only for me, they're good for the company, too."

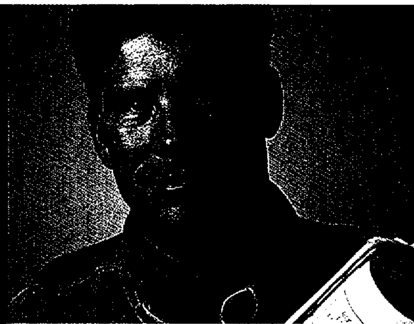
▲ JULIA BERTSCH, energy information specialist, Sempra Energy Solutions, San Diego. Julia and her team analyze thousands of utility bills for national retail chains, checking for errors, identifying trends and reporting tariff savings. "We prove to our customers that energy is no longer a fixed cost of doing business," says Julia.

▲ SARATHI ROY, vice president and chief economist, Sempra Energy Trading, London. For six months, Sarathi lived and worked in London to help establish the firm's European headquarters. "Our experience in North America's energy marketplace, combined with the talented European trading professionals we recruited, allowed us to be profitable and generate awareness of Sempra Energy in Europe," says Sarathi.

We leverage of our **people** understanding of

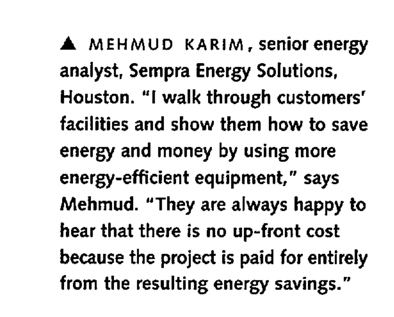
Despite all we may say about our cash flow, information systems, and our transmission and distribution networks, our greatest resource truly is our people. ¶ Sempra Energy's people are among the most talented, experienced and creative in the industry—in all areas of their work. And while that may make us a better company, it is our customers who ultimately benefit from this expertise. ¶ Such

▼ CAROLINE KELSEY, manager of electric reliability improvement, SDG&E, San Diego. Caroline has a big responsibility—continuously improving electric service for customers. "We make a difference," says Caroline. "Last year, we had one of the best reliability performances in corporate history. Our customers can count on us, whether they're a family or a high-technology manufacturing plant."

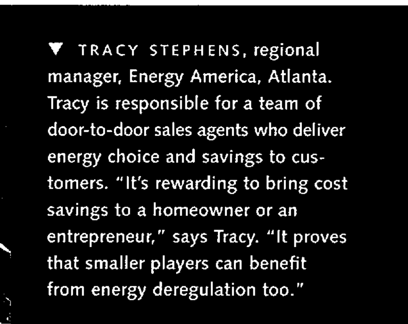


▼ TRACY STEPHENS, regional manager, Energy America, Atlanta. Tracy is responsible for a team of door-to-door sales agents who deliver energy choice and savings to customers. "It's rewarding to bring cost savings to a homeowner or an entrepreneur," says Tracy. "It proves that smaller players can benefit from energy deregulation too."

▲ MEHMUD KARIM, senior energy analyst, Sempra Energy Solutions, Houston. "I walk through customers' facilities and show them how to save energy and money by using more energy-efficient equipment," says Mehmud. "They are always happy to hear that there is no up-front cost because the project is paid for entirely from the resulting energy savings."



▲ STEVE FEINER, project engineer, Sempra Energy Resources, San Diego. Steve works at Sempra Energy Resources' joint-venture El Dorado Energy power plant near Las Vegas, one of several plants being developed for the deregulated electricity marketplace. "This plant's advanced gas-turbine technology helps us compete by providing some of the cleanest, safest and most economical power in the nation," says Steve.



the creativity and our customer needs...

expertise is built around a wide spectrum of capabilities and values. Our key account sales and management relationships, for example, are less about making sales than about making connections—true bonds, in fact, that transform what used to be transactions into long-term partnerships with the customers we serve. This expertise is manifested as well by our specialized experience in trading, where our strong reputation has been built on our use and offering of advanced systems, tight controls and overall corporate risk-management services. ¶ And, this expertise is exhibited by insight, such as our knowing that, because ownership of generation assets is important for some commercial and industrial customers, it's critical for us to support this. ¶ From understanding, after all, comes creativity.

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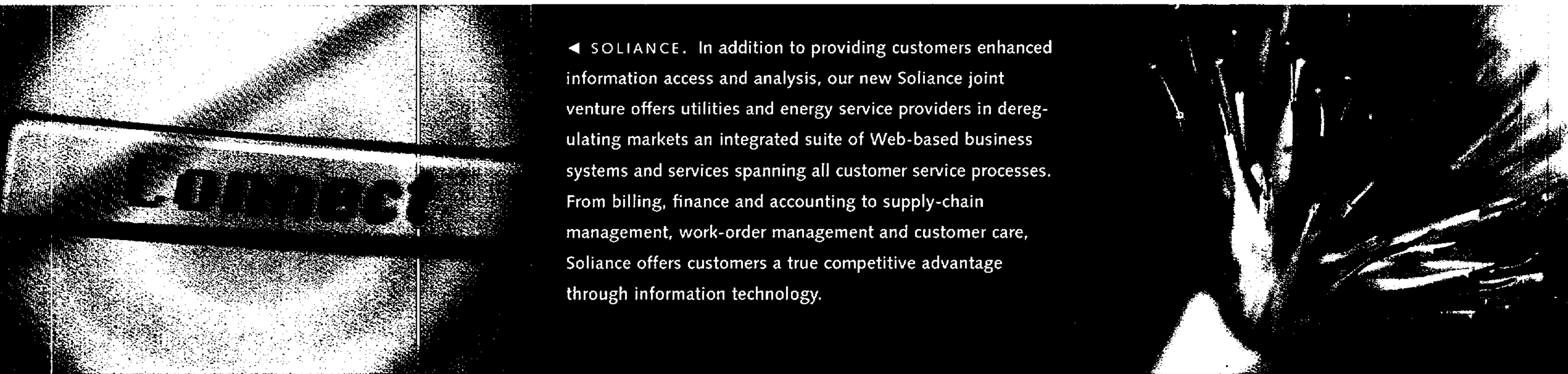

◀ SOLIANCE. In addition to providing customers enhanced information access and analysis, our new Soliance joint venture offers utilities and energy service providers in deregulating markets an integrated suite of Web-based business systems and services spanning all customer service processes. From billing, finance and accounting to supply-chain management, work-order management and customer care, Soliance offers customers a true competitive advantage through information technology.

Today's evolving world of energy services includes a concept that's new to most service providers: e-energy. ¶ At Sempra Energy, as part of our overall strategy to capitalize on opportunities within the deregulated energy marketplace, we're well on our way toward creating the infrastructure we need to compete in the promising information-services sector. And, certainly, to be a 21st-century, information-based company ourselves. ¶ To these ends, we are committed to making information technology central to both the operation of our business and to the delivery of our services and the satisfaction of our customers. The explosion of e-commerce, after all, is a clear sign that consumers have heightened expectations for innovative and creative solutions—through more information, more control and more services. ¶ In conjunction with our efforts in these areas, we also will develop more visionary products, and partner with companies outside our industry to offer seamless, efficient Internet-delivered services, intelligent home devices, and a variety of other products designed to make life easier and more efficient for our customers.

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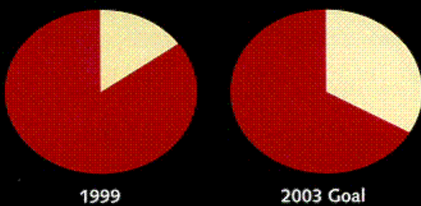
strategic alliances...

◄ SEMPRA COMMUNICATIONS. Our Sempra Communications affiliate is pursuing opportunities created by the convergence of the telecommunications and energy businesses. These opportunities include partnerships to provide new and better services such as high-speed broadband and wireless solutions for homes and businesses. Sempra Communications will compete both on a wholesale and retail basis to extend and enhance the connectivity options we offer our customers.

◄ WEB TECHNOLOGIES. Through our Sempra Energy Solutions unit, we are actively marketing a Web-based service to commercial and industrial customers nationwide to help them analyze and control their utility costs. In the process, we have compiled the largest online utility tariff library in the United States. With vast applications in the energy services industry, the Internet offers forward-looking companies a unique opportunity to capture competitive advantage in a customer-centric environment.

...to deliver outstanding to shareholders, employees."

Sources of Earnings



◄ SHAREHOLDERS. To those who put their financial trust in us, we are committed to increasing the value of total return on their investment. Consistent with our belief that the industry is changing to a market-driven model, we have restructured ourselves to capitalize on this growth; our unregulated businesses are indeed becoming an ever-increasing portion of our earnings, indicating the path toward greater rewards for our investors.

U.S. and International Customer Base

In millions of gas and electric meters served, at year's end

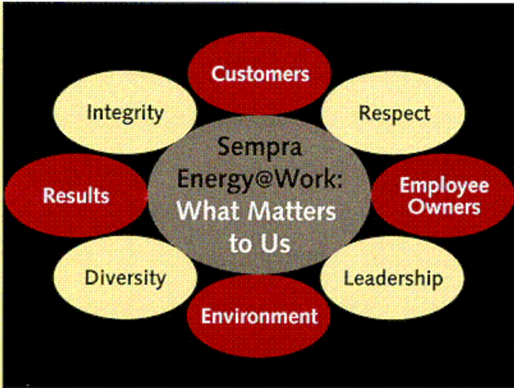
C1

value

customers and

Delivering value. There is no better measure of a public company. In a real sense, in fact, it is the only measure. ¶ As these pages illustrate, we at Sempra Energy have rededicated ourselves to the proposition of enhancing the value we offer to our many and varied constituencies. To accomplish this for our shareholders, we have undertaken significant financial initiatives toward the goal of becoming a leading energy services provider in the competitive marketplace. These efforts are designed to help us achieve the long-term earnings growth we believe will ultimately validate the success of our business model. ¶ And it is this business model that delivers value to our customers—a model in which energy customers define the products and services they want, and Sempra Energy effectively positions its business to provide them. ¶ We believe that our success will be determined by the quality of the people charged with realizing our goals: our employees and partners, who are farsighted enough to create the vision, thoughtful enough to design the blueprint and practical enough to build the solutions. ¶ Finally, at Sempra Energy, we strive to provide these individuals with a good and satisfying place to work, so that we will all be successful in the new world of energy services.

◄ CUSTOMERS. From the offices and plants of the world's largest corporations to homes in the smallest towns, Sempra Energy customers have one thing in common: a new ability to choose their energy supplier. At Sempra Energy, we are committed to promoting many new choices for our customers. Because after all, in the new marketplace of energy services, when our customers win, so do we.



◄ EMPLOYEES. At Sempra Energy, two of the basic requirements for any job in our company are commitment and creativity. Why? Because these two skills are part of the resourcefulness our employees demonstrate day-in and day-out to find innovative solutions to our customers' problems. Customer focus is nothing new at Sempra Energy—we're simply more committed today than ever before.

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SAN DIEGO GAS & ELECTRIC
San Diego Gas & Electric provides electric and natural gas delivery service to more than 3 million people in San Diego and southern Orange counties.

SOUTHERN CALIFORNIA GAS COMPANY
Southern California Gas Company is the nation's largest natural gas distribution utility, serving 18 million people from central California to the Mexican border.

SEMPRA ENERGY INTERNATIONAL
Sempra Energy International develops energy-infrastructure projects, including natural gas and electric transmission and distribution systems and power generation facilities, outside the United States.

SEMPRA ENERGY TRADING
Sempra Energy Trading is a wholesale trader of physical and financial energy products, including natural gas, power, crude oil and associated commodities.

SEMPRA ENERGY SOLUTIONS
Sempra Energy Solutions provides energy-related products and services to commercial, industrial, government, institutional and consumer markets.

SEMPRA ENERGY RESOURCES
Sempra Energy Resources acquires and develops power plants for the competitive market and operates natural gas storage, production and transportation assets.

SEMPRA COMMUNICATIONS
Sempra Communications is pursuing opportunities created by the convergence of the telecommunications and energy businesses, including partnerships to provide services, such as high-speed broadband and wireless solutions.

SEMPRA ENERGY FINANCIAL
Sempra Energy Financial enhances the earnings of Sempra Energy by investing as a limited partner in affordable housing and alternative fuels.

INTRODUCTION

This section includes management's discussion and analysis of operating results from 1997 through 1999, and provides information about the capital resources, liquidity and financial performance of Sempra Energy and its subsidiaries (the company). This section also focuses on the major factors expected to influence future operating results and discusses investment and financing plans. It should be read in conjunction with the consolidated financial statements included in this Annual Report.

The company is a California-based Fortune 500 energy services company whose principal subsidiaries are San Diego Gas & Electric (SDG&E), which provides electric and natural gas service in San Diego County and southern Orange County, and Southern California Gas Company (SoCalGas), the nation's largest natural gas distribution utility, serving 5 million meters throughout most of Southern California and part of central California. Together, the two utilities serve approximately 7 million meters. In addition, Sempra Energy owns and operates other regulated and unregulated subsidiaries. Sempra Energy Trading is engaged in the wholesale trading and marketing of natural gas, power and petroleum. Sempra Energy International develops, operates and invests in energy-infrastructure systems and power-generation facilities outside the United States. Sempra Energy Financial invests in limited partnerships that own 1,250 affordable-housing properties throughout the United States. Through other subsidiaries, the company owns and operates centralized heating and cooling for large building complexes, and is involved in nonutility electric generation, domestic energy-utility operations and other energy-related products and services.

STRATEGIC DIRECTION

Diversified utility companies, including the company, have experienced and will continue to experience a significant increase in the level of competition in the utility and energy services markets over time. A steady move away from a regulated-monopoly, energy-supply structure toward a more competitive structure has affected the utility industry for nearly two decades. During the past decade, various state and federal regulatory changes have occurred and a significant number of states have begun to implement legislative initiatives to permit retail customers to choose their energy supply provider.

The company continues to refine its business strategies for the following segments of the energy services industry: regulated delivery services, international, wholesale trading, retail energy services, electric generation and technology ventures.

The company plans to pursue the following initiatives to enhance its business model and create sustainable earnings growth. SDG&E and SoCalGas plan to focus on their core distribution businesses, promoting competition in retail markets and efficiency in the delivery-services business. Sempra Energy International will continue to develop electric and gas distribution systems in Nova Scotia, Mexico and portions of South America, while evaluating opportunities to enhance its existing businesses with additional investments. Sempra Energy Trading plans to continue to build and enhance its natural gas, petroleum and electric-wholesale-trading capability in North America, Europe and Asia. In addition, the company and its nonutility subsidiaries plan to provide integrated energy services to mass-market, commercial and industrial retail customers in domestic and international markets. To support its customer-focused activities, the company plans to continue to invest in electric-generation assets, either through development or acquisition. The company also has made investments and is developing new businesses in the information-systems and communications fields. The company believes that all of these businesses will complement and broaden its offerings to utility customers in retail markets. One of the company's objectives is to generate one-third of its consolidated earnings from its unregulated businesses by the end of 2003. The company cannot provide assurance that this objective will be achieved.

Based upon this integrated approach to the energy marketplace, the company will seek to achieve long-term returns on shareholder capital that exceed the returns that have been historically available for state-regulated utility businesses. At the same time, the company's business risks are expected to increase, resulting in an increase in the potential volatility in revenue and income streams.

As a complement to its business strategy, the company has developed financial initiatives that are intended to increase the company's financial and operating flexibility and to further position the company for the increasingly

competitive utility and energy services markets. Accordingly, the company reduced the quarterly dividend payable on shares of its common stock, commencing with the dividend payable in the second quarter of 2000, to $0.25 per share ($1.00 annualized rate) from its previous level of $0.39 per share ($1.56 annualized rate). Reducing the dividend rate improves the company's financial flexibility going forward. It also positions the company's common stock for potential increased growth in market value by retaining a proportionately higher level of earnings for reinvestment in the business.

On March 6, 2000, as a result of a "Dutch Auction," the company repurchased approximately 36 million shares of its common stock, representing approximately 15 percent of its outstanding common stock, at a price of $20 per share. The stock repurchase was financed by issuing approximately $700 million in additional long-term senior notes of the company and mandatorily redeemable trust-preferred securities through underwritten public offerings. It financed the remaining $35 million necessary to repurchase the shares with the issuance by a subsidiary, Sempra Energy Holdings, of short-term commercial paper notes, guaranteed by the company. These transactions increased the financial leverage employed by the company in its capital structure. The company expects to maintain a strong investment grade credit rating on its debt and preferred securities and, following the announcement of the tender offer for the approximately 36 million shares and the related financing, rating agencies reaffirmed the ratings for the company's securities and those of its utility subsidiaries. However, these ratings are subject to periodic review by the rating agencies and may change from time to time.

BUSINESS-COMBINATION COSTS

Sempra Energy was formed to serve as a holding company for Pacific Enterprises ("PE," the parent corporation of SoCalGas) and Enova Corporation ("Enova," the parent corporation of SDG&E) in connection with a business combination that became effective on June 26, 1998 (the PE/Enova business combination). In connection with the PE/Enova business combination, the holders of common stock of PE and Enova became the holders of the company's common stock. The preferred stock of PE remained outstanding. The combination was a tax-free transaction.

In January 1998, PE and Enova jointly acquired CES/Way International, Inc., which was subsequently renamed Sempra Energy Services, as described under "Investments."

On June 21, 1999, the company terminated its agreement to acquire KN Energy, Inc.

Expenses incurred in connection with these events are $14 million, aftertax, and $85 million, aftertax, for the years ended December 31, 1999 and 1998, respectively. The costs consist primarily of employee-related costs, and investment banking, legal, regulatory and consulting fees. See Note 1 of the notes to Consolidated Financial Statements for additional information.

CAPITAL RESOURCES AND LIQUIDITY

The company's utility operations continue to be a major source of liquidity. In addition, working capital and other requirements are met primarily through the issuance of short-term and long-term debt. Cash requirements at the utilities primarily consist of investments in plant. Nonutility cash requirements include investments in Sempra Energy Trading, Sempra Energy International and other ventures.

Additional information on sources and uses of cash during the last three years is summarized in the following condensed statements of consolidated cash flows:

SOURCES AND (USES) OF CASH Year Ended December 31 (Dollars in millions)	1999	1998	1997
Operating Activities	**$1,188**	$ 1,323	$ 918
Investing Activities:			
Net proceeds from sale of assets	**466**	–	–
Capital expenditures	**(589)**	(438)	(397)
Acquisitions of subsidiaries	**(639)**	(191)	(206)
Other	**(27)**	(50)	1
Total Investing Activities	**(789)**	(679)	(602)
Financing Activities:			
Common dividends	**(368)**	(325)	(301)
Sale of common stock	**3**	34	17
Repurchase of common stock	–	(1)	(122)
Redemption of preferred stock	–	(75)	–
Long-term debt – net	**(110)**	(356)	382
Short-term debt – net	**139**	(311)	92
Total Financing Activities	**(336)**	(1,034)	68
Increase (decrease) in cash and cash equivalents	**$ 63**	$ (390)	$ 384

CASH FLOWS FROM OPERATING ACTIVITIES

The decrease in cash flows from operating activities in 1999 was primarily due to the completion of the recovery of SDG&E's stranded costs and to reduced revenues – both the result of the sale of SDG&E's fossil power plants and combustion turbines in the second quarter of 1999 – and a return to ratepayers of the previously overcollected regulatory balancing accounts of SoCalGas. This decrease was partially offset by lower business-combination expenses and lower income-tax payments in 1999. See additional discussion on the sale of the power plants in Note 14 of the notes to Consolidated Financial Statements for additional information.

The increase in cash flows from operating activities in 1998 was primarily due to lower working-capital requirements for natural gas operations. This was caused by higher throughput compared to 1997, combined with natural gas costs that were lower than amounts being collected in rates, resulting in overcollected regulatory balancing accounts at year-end 1998. This increase was partially offset by business-combination expenses. The fluctuation in cash flows from operations was also affected by electric-industry restructuring and increased revenue offset by the 10-percent rate reduction reflected in customers' bills in 1998. These are discussed in Note 14 of the notes to Consolidated Financial Statements.

CASH FLOWS FROM INVESTING ACTIVITIES

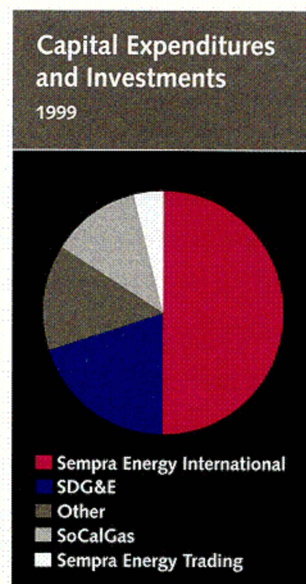
Cash flows from investing activities primarily represent capital expenditures and investments in new businesses. For 1999, cash flows from investing activities include proceeds from the sale of SDG&E assets. The South Bay Power Plant was sold to the San Diego Unified Port District for $110 million. The Encina Power Plant and 17 combustion-turbine generators were sold to Dynegy, Inc. and NRG Energy, Inc. for $356 million. See additional discussion in Note 14 of the notes to Consolidated Financial Statements.

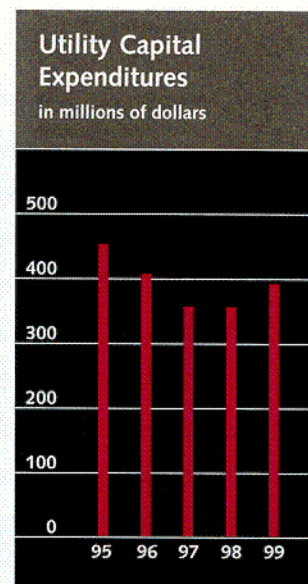
Capital Expenditures

Capital expenditures were $151 million higher in 1999 compared to 1998 due to investments in gas distribution facilities in Mexico, a gas system expansion at SDG&E and additional improvements to the electric-distribution system.

Capital expenditures were $41 million higher in 1998 than in 1997 due to greater capital spending at the company's corporate center related to facility improvements and equipment purchases, and at SDG&E related to industry restructuring and improvements to the electric-distribution system. This increase was partially offset by lower capital spending at SoCalGas.

Capital expenditures at the utilities are estimated to be $525 million in 2000 and will be financed primarily by internally generated funds.





Investments

In June 1999, the company and PSEG Global (PSEG) jointly acquired 90 percent of Chilquinta Energía S.A. (Energía). In January 2000, the company and PSEG purchased an additional 9.75 percent of Chilquinta Energía S.A., increasing their total holdings to 99.98 percent, at a total cost of $840 million. In September 1999, the company and PSEG completed their acquisition of 47.5 percent of Luz Del Sur S.A., a Peruvian electric company, for $108 million. This acquisition, combined with the 37 percent already owned through Energía, increased the companies' total joint ownership to 84.5 percent of Luz del Sur S.A.

In March 1998, the company increased its existing investment in two Argentine natural gas utility holding companies (Sodigas Pampeana S.A. and Sodigas Sur S.A.) from 12.5 percent to 21.5 percent by purchasing an additional

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interest for $40 million. In June 1999, the company contributed capital to Sodigas Pampeana S.A. and Sodigas Sur S.A. to retire $32 million of debt. See further discussion of international operations in "International Operations" below and in Note 3 of the notes to Consolidated Financial Statements.

In December 1997, PE and Enova jointly acquired Sempra Energy Trading for $225 million. In July 1998, Sempra Energy Trading purchased a subsidiary of Consolidated Natural Gas, a wholesale-trading and commercial-marketing operation, for $36 million to expand its operation in the eastern United States.

As noted above, Sempra Energy acquired CES/Way International, Inc. (CES/Way) in 1998. CES/Way provides energy-efficiency services, including energy audits, engineering design, project management, construction, financing and contract maintenance. In the latter half of 1999, CES/Way's name was changed to Sempra Energy Services.

Sempra Energy's level of investments, excluding capital expenditures, in the next few years may vary substantially and will depend on the level of opportunities available in unregulated business that are expected to provide desirable rates of return.

CASH FLOWS FROM FINANCING ACTIVITIES

Net cash used in financing activities decreased in 1999 from 1998 levels primarily due to lower long-term and short-term debt repayments, greater long-term and short-term debt issuances and the repurchase of preferred stock in 1998.

Net cash used in financing activities increased in 1998 from 1997 levels due to greater short-term and long-term debt repayments and the redemption of preferred stock in 1998, and the issuance of rate-reduction bonds in 1997, partially offset by the repurchase of common stock in 1997.

Long-Term and Short-Term Debt

In 1999, cash was used for the repayment of $28 million of first-mortgage bonds, $66 million of rate-reduction bonds and $82 million in unsecured notes. The long-term debt issued in 1999 related primarily to the purchase of Chilquinta Energía S.A. See additional discussion in Note 3 of the notes to Consolidated Financial Statements. The increase in short-term debt primarily represents borrowing through Sempra Energy Holdings (SEH), the intermediate holding company for many of the company's nonutility subsidiaries, to partially finance acquisitions by Sempra Energy International (SEI).

In 1998, cash was used for the repayment of $247 million of first-mortgage bonds and $66 million of rate-reduction bonds. Short-term debt repayments included repayment of $94 million of debt issued to finance SoCalGas' Comprehensive Settlement as discussed in Note 14 of the notes to Consolidated Financial Statements.

In 1997, cash was used for the repayment of $96 million of debt issued to finance the Comprehensive Settlement and repayment of $252 million of SoCalGas' first-mortgage bonds. This was partially offset by the issuance of $120 million in medium-term notes and short-term borrowings used to finance working capital requirements at SoCalGas.

In December 1997, $658 million of rate-reduction bonds were issued on SDG&E's behalf at an average interest rate of 6.26 percent. A portion of the bond proceeds was used to retire variable-rate, taxable Industrial Development Bonds (IDBs). Additional information concerning the rate-reduction bonds is provided below under "Electric-Industry Restructuring."

In connection with the issuance of the rate-reduction bonds, SDG&E has $58 million of temporary investments that will be maintained into the future to offset, for regulatory purposes, a like amount of long-term debt since this was more cost-effective than redeeming low-rate debt. The specific debt series being offset consists of variable-rate IDBs. The California Public Utilities Commission (CPUC) has approved specific ratemaking treatment that allows SDG&E to offset IDBs as long as there is at least a like amount of temporary investments. If and when SDG&E requires all or a portion of the $58 million of IDBs to meet future needs for long-term debt, such as to finance new construction, the amount of investments which are being maintained will be reduced below $58 million and the level of IDBs being offset will be reduced by the same amount.

Stock Purchases and Redemptions

In February 2000, the company repurchased approximately 36 million shares of its common stock at a price of $20.00 per share. This is more fully described above under "Strategic Direction."

The company, through PE and Enova, repurchased $1 million and $122 million of common stock in 1998 and 1997, respectively. There were no common stock repurchases in 1999.

On February 2, 1998, SoCalGas redeemed all outstanding shares of its 7¾ percent Series Preferred Stock at a cost of $25.09 per share, or $75 million including accrued dividends.

Dividends

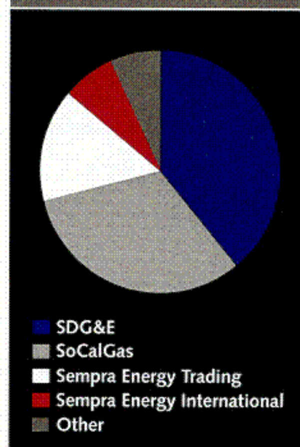
Dividends paid on common stock amounted to $368 million in 1999, compared to $325 million in 1998 and $301 million in 1997. The increases in 1999 and 1998 are the result of the company's paying dividends on its common stock at the rate previously paid by Enova, which, on an equivalent-share basis, is higher than the rate previously paid by PE.

On January 26, 2000, the company announced a reduction in the quarterly dividend payable on shares of its common stock to $0.25 per share ($1.00 annualized rate) from its previous level of $0.39 per share ($1.56 annualized rate), commencing with the dividend for the second quarter of 2000.

Dividends are paid quarterly to shareholders. The payment of future dividends and the amount thereof are within the discretion of the board of directors.

CAPITALIZATION

Total capitalization at December 31, 1999, was $6.4 billion. The debt-to-capitalization ratio was 50 percent at December 31, 1999. Activities in 1999 include an increase in debt related to the acquisition of Chilquinta Energía S.A., offset by an increase in common equity due to the settlement related to the 1992 quasi-reorganization (QR) of Pacific Enterprises. See Notes 2 and 17 of the notes to Consolidated Financial Statements for further discussion of the QR and concerning the recent change in the debt-to-capitalization ratio, respectively. If the stock repurchase and the related financing had occurred at December 31, 1999, the debt-to-capitalization ratio would have been 62 percent.



CASH AND CASH EQUIVALENTS

Cash and cash equivalents were $487 million at December 31, 1999. This cash is available for investment in domestic and international projects consistent with the company's strategic direction, the retirement of debt, the repurchase of common stock, the payment of dividends and other corporate purposes.

The company anticipates that operating cash required in 2000 for capital expenditures, common stock dividends and debt payments will be provided by cash generated from operating activities and existing cash balances. Cash needed for the tender offer was obtained through the issuance of $500 million of long-term notes and $200 million of mandatorily redeemable trust-preferred securities. The dividend reduction, combined with fewer shares outstanding (due to the company's tender offer), will result in additional cash flow in 2000. This increased cash flow will be partially offset by higher debt-service costs.

In addition to cash from ongoing operations, the company has multiyear credit agreements that permit term borrowings of up to $1.4 billion, of which $182 million is outstanding at December 31, 1999. For further discussion, see Note 4 of the notes to Consolidated Financial Statements.

Management believes that the sources of funding described above are sufficient to meet short-term and long-term liquidity needs.

RESULTS OF OPERATIONS

1999 Compared to 1998

Net income for 1999 increased to $394 million, or $1.66 per share of common stock (diluted), from $294 million, or $1.24 per share of common stock (diluted), for 1998.

The increase is primarily due to higher earnings at the California utilities (due to lower business-combination

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costs), Sempra Energy Trading, Sempra Energy Financial and Sempra Energy International. See additional discussion in "California Utility Operations," "Other Operations" and "International Operations."

For the fourth quarter of 1999, net income increased to $105 million, or $0.44 per share of common stock (diluted), from $85 million, or $0.36 per share of common stock (diluted), for the fourth quarter of 1998. The increase is primarily due to higher earnings at Sempra Energy Trading and Sempra Energy International.

In 1999, book value per share increased to $12.58 from $12.29 in 1998, primarily due to the settlement of QR issues previously discussed.

1998 Compared to 1997

Net income for 1998 decreased to $294 million, or $1.24 per share of common stock (diluted), from $432 million, or $1.82 per share of common stock (diluted), for 1997.

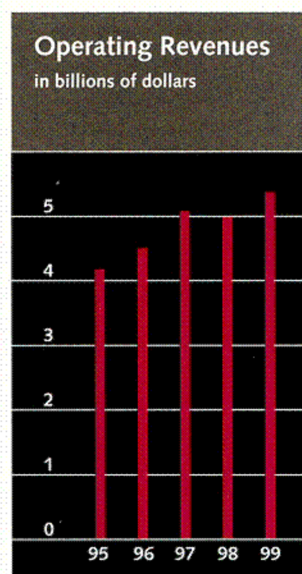
The decrease in net income is primarily due to the business-combination costs and a lower base margin established at SoCalGas in its Performance-Based Regulation (PBR) decision which became effective on August 1, 1997, as further described in Note 14 of the notes to Consolidated Financial Statements. Business-combination expenses were $85 million ($0.36 per share) and $20 million ($0.08 per share), aftertax, for 1998 and 1997, respectively.

For the fourth quarter of 1998, net income decreased from the fourth quarter of 1997, due to awards for PBR and demand-side management programs in 1997, electric seasonality effects compared to 1997, and the factors that affected the annual comparison.

In 1998, book value per share decreased to $12.29 from $12.56, due to common dividends' exceeding net income, which was lower than normal due to the business-combination expenses.

California Utility Operations

To understand the operations and financial results of SoCalGas and SDG&E, it is important to understand the ratemaking procedures that SoCalGas and SDG&E follow.



SoCalGas and SDG&E are regulated by the CPUC. It is the responsibility of the CPUC to determine that utilities operate in the best interests of their customers and have the opportunity to earn a reasonable return on investment. In response to utility-industry restructuring, SoCalGas and SDG&E received approval from the CPUC for Performance-Based Ratemaking (PBR). Under PBR, income potential is tied to achieving or exceeding specific performance and productivity measures, rather than to expanding utility plant in a market where a utility already has a highly developed infrastructure. See additional discussion of PBR in Note 14 of the notes to Consolidated Financial Statements.

In September 1996, California enacted a law restructuring California's electric-utility industry. The legislation adopted the December 1995 CPUC policy decision restructuring the industry to stimulate competition and reduce rates. Beginning on March 31, 1998, customers were able to buy their electricity through the California Power Exchange (PX), which obtains power from qualifying facilities, from nuclear units and, lastly, from the lowest-bidding suppliers. The PX serves as a wholesale power pool, allowing all energy producers to participate competitively. An Independent System Operator (ISO) schedules power transactions and access to the transmission system.

The natural gas industry experienced an initial phase of restructuring during the 1980s by deregulating natural gas sales to noncore customers. The CPUC is studying the issue of restructuring for sales to core customers.

See additional discussion of electric-industry and natural gas-industry restructuring below in "Industry Restructuring" and in Note 14 of the notes to Consolidated Financial Statements.

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GAS SALES, TRANSPORTATION & EXCHANGE

(Dollars in millions, volumes in billion cubic feet)	Gas Sales		Transportation & Exchange		Total	
	Throughput	Revenue	Throughput	Revenue	Throughput	Revenue
1999:						
Residential	**313**	**$2,091**	**3**	**$ 10**	**316**	**$2,101**
Commercial and Industrial	**105**	**560**	**338**	**258**	**443**	**818**
Utility Electric Generation*	**18**	**7**	**218**	**83**	**236**	**90**
Wholesale			**23**	**11**	**23**	**11**
	436	**$2,658**	**582**	**$362**	**1,018**	**3,020**
Balancing accounts and other						**(96)**
Total						**$2,924**
1998:						
Residential	304	$2,234	3	$ 11	307	$2,245
Commercial and Industrial	102	571	329	277	431	848
Utility Electric Generation*	57	9	139	66	196	75
Wholesale			28	7	28	7
	463	$2,814	499	$361	962	3,175
Balancing accounts and other						(403)
Total						$2,772
1997:						
Residential	268	$1,957	3	$ 10	271	$1,967
Commercial and Industrial	102	617	332	273	434	890
Utility Electric Generation*	49	14	158	76	207	90
Wholesale			18	12	18	12
	419	$2,588	511	$371	930	2,959
Balancing accounts and other						5
Total						$2,964

*The portion representing SDG&E's sales to its electric generation operations includes margin only.

ELECTRIC DISTRIBUTION

(Dollars in millions, volumes in millions of Kwhrs)	1999		1998		1997	
	Volumes	**Revenue**	Volumes	Revenue	Volumes	Revenue
Residential	**6,327**	**$ 663**	6,282	$ 637	6,125	$ 684
Commercial	**6,284**	**592**	6,821	643	6,940	680
Industrial	**2,034**	**154**	3,097	233	3,607	268
Direct access	**3,212**	**118**	964	44	–	–
Street and highway lighting	**73**	**7**	85	8	76	7
Off-system sales	**383**	**10**	706	15	4,919	116
	18,313	**1,544**	17,955	1,580	21,667	1,755
Balancing accounts and other		**274**		285		14
Total	**18,313**	**$1,818**	17,955	$1,865	21,667	$1,769

1999 Compared to 1998

Utility natural gas revenues increased 5 percent in 1999 primarily due to lower overcollections in 1999 (see discussion of balancing accounts under "Accounting Standards" herein and in Note 2 of the notes to Consolidated Financial Statements) and higher utility electric-generation (UEG) revenues, partially offset by a decrease in residential and commercial and industrial revenues. The increase in UEG revenues was primarily due to the 1999 sale of SDG&E's fossil fuel generating plants, since revenue now includes the selling price of the natural gas instead of just the margin, because the sales are now to unrelated parties. The decrease in residential and commercial and industrial revenues is due to lower natural gas rates.

Electric revenues decreased 3 percent in 1999 compared to 1998, primarily due to the decrease in base electric rates from the completion of stranded cost recovery (described in Note 14 of the notes to Consolidated Financial Statements).

The company's cost of natural gas distributed increased 22 percent in 1999, largely due to an increase in the average price of natural gas purchased.

As discussed in Note 14 of the notes to Consolidated Financial Statements, PX/ISO power revenues have been netted against purchased-power expense, including purchases from the PX/ISO. The PX/ISO began operations on March 31, 1998.

Depreciation and amortization expense decreased 4 percent in 1999, primarily due to the midyear completion of the accelerated recovery of generation assets.

Operating expenses decreased 9 percent in 1999, primarily due to the lower business-combination costs (none in 1999 compared to $117 million in 1998).

1998 Compared to 1997

Utility natural gas revenues decreased 6 percent in 1998 primarily due to the lower natural gas margin established in the SoCalGas PBR Decision, a decrease in the average price of natural gas and a decrease in sales to utility electric-generation customers, partially offset by increased sales to residential customers due to colder weather in 1998.

Electric revenues increased 5 percent in 1998 compared to 1997, primarily due to the recovery of stranded costs via the Competitive Transition Cost (CTC), and to alternate costs incurred (including fuel and purchased power) due to the delay from January 1 to March 31, 1998, in the start-up of operations of the PX and ISO. These increases were partially offset by a decrease in retail revenue as a result of the 10-percent small-customer rate reduction, which became effective in January 1998, and a decrease in sales to other utilities, due to the start-up of the PX. The 10-percent rate reduction and PX are described further under "Factors Influencing Future Performance" and in Note 14 of the notes to Consolidated Financial Statements.

The company's cost of natural gas distributed decreased 18 percent in 1998, largely due to a decrease in the average price of natural gas purchased, partially offset by increases in sales volume.

Depreciation and amortization expense increased 49 percent in 1998, primarily due to the accelerated recovery of stranded costs via the CTC. The earnings impact of the increase is offset by CTC revenue as discussed above.

Operating expenses increased 16 percent in 1998, primarily due to the higher business-combination costs ($117 million in 1998, compared to $11 million in 1997).

INTERNATIONAL OPERATIONS

Sempra Energy International (SEI) was formed in June 1998 to develop, operate and invest in energy-infrastructure systems and power-generation facilities outside the United States. SEI now has interests in natural gas and/or electric transmission and distribution projects in Mexico, Argentina, Chile, Peru, Uruguay and Canada, and is pursuing other projects in Latin America.

As previously discussed, SEI and PSEG announced the completion of the joint purchase of Chilquinta Energía S.A. and the acquisition of an additional 47.5 percent of the outstanding shares of Luz del Sur S.A., a Peruvian electric company. See Note 3 of the notes to Consolidated Financial Statements for a discussion of the acquisition of Chilquinta Energía S.A. and Luz del Sur S.A.

As noted above under "Investments," PE increased its investment in Sodigas Pampeana S.A. and Sodigas Sur S.A. in 1998 and 1999. These natural gas distribution

companies serve 1.2 million customers in central and southern Argentina, respectively, and have a combined sendout of 650 million cubic feet per day.

SEI owns 60 percent of Distribuidora de Gas Natural de Mexicali, S. de R.L. de C.V. (DGN-Mexicali), a Mexican company that holds the first license awarded to a private company to build a natural gas distribution system in Mexico. On August 20, 1997, DGN-Mexicali began to deliver natural gas to customers in Mexicali, Baja California. It will invest up to $25 million to provide service to 25,000 customers during the first five years of operation.

SEI owns 95 percent of Distribuidora de Gas Natural de Chihuahua, S. de R.L. de C.V. (DGN-Chihuahua), which distributes natural gas to the city of Chihuahua, Mexico, and surrounding areas. On July 9, 1997, it acquired ownership of a 16-mile transmission pipeline serving 20 industrial customers. It will invest nearly $50 million to provide service to 50,000 customers in the first five years of operation.

In May 1999, SEI was awarded a 30-year license to build and operate a natural gas distribution system in the La Laguna-Durango zone in north-central Mexico. SEI will invest over $40 million in the project during the first five years of operation.

In August 1998, SEI was awarded a 10-year agreement by the Mexican Federal Electric Commission to provide natural gas for the *Presidente Juárez* power plant in Rosarito, Baja California. The contract provides for delivery of up to 300 million cubic feet per day of natural gas and construction of a 23-mile pipeline from the U.S.-Mexico border to the plant. Construction of the pipeline is anticipated to be completed by mid-2000 at a cost of $35 million. The pipeline will also serve as a link for a natural gas distribution system in Tijuana, Baja California, between San Diego and Rosarito.

Net income for international operations in 1999 was $10 million compared to net losses of $4 million and $9 million, aftertax, for 1998 and 1997, respectively. The increase in net income for 1999 was primarily due to income from Chilquinta Energía S.A., and lower operating costs and increased sales (as a result of colder weather) in Argentina.

OTHER OPERATIONS

Sempra Energy Trading (SET), a leading natural gas, petroleum and power marketing firm headquartered in Stamford, Conn., was acquired on December 31, 1997. In addition to the transactions described in "Market Risk" herein, SET also enters into long-term structured transactions, such as the one supporting the SEI agreement referred to in "International Operations" above. For the year ended December 31, 1999, SET recorded net income of $32 million from operations and net income of $19 million after amortization of acquisition costs. This is compared to 1998 net income of $1 million from operations and a net loss of $13 million after amortization of acquisition costs. The increase in net income is primarily due to greater penetration of all customer segments, resulting in higher volumes traded in 1999. In addition, new European crude oil and natural gas trading contributed significantly to SET's 1999 earnings.

Sempra Energy Financial (SEF) invests as a limited partner in affordable-housing properties and alternative-fuel projects. SEF's portfolio includes 1,250 properties throughout the United States, Puerto Rico and the Virgin Islands. These investments are expected to provide income-tax benefits (primarily from income-tax credits) over a 10-year period. SEF recorded net income of $28 million and $20 million in 1999 and 1998, respectively. This is expected to decline as the various 10-year periods expire, unless SEF makes sufficient new investments. SEF's future investment policy is dependent on the company's future income-tax position.

OTHER INCOME, INTEREST EXPENSE AND INCOME TAXES

Other Income

Other income, which primarily consists of interest income from short-term investments, equity earnings from unconsolidated South American subsidiaries and interest on regulatory-balancing accounts, increased to $75 million in 1999 from $34 million in 1998. The increase is primarily due to equity earnings from unconsolidated subsidiaries. Other income decreased in 1998 to $34 million from $46 million in 1997, a result of lower interest income from short-term investments.

Interest Expense

Interest expense for 1999 increased to $229 million in 1999 from $197 million in 1998. The increase is primarily due to interest expense on the excess rate-reduction bond liability (see additional discussion in "Factors Influencing Future Performance – Electric Rates" below). Interest expense for 1998 increased slightly to $197 million from $194 million in 1997.

Income Taxes

Income-tax expense was $179 million, $138 million and $301 million for 1999, 1998 and 1997, respectively. The effective income-tax rates were 31 percent, 32 percent and 41 percent for the same periods. The increase in income-tax expense for 1999 compared to 1998 is due to the increase in income before taxes, partially offset by the charitable contribution to the San Diego Unified Port District in connection with the sale of the South Bay generating plant. The decrease in income-tax expense for 1998 compared to 1997 is primarily due to the decrease in income before taxes, combined with an increase in affordable-housing tax credits.

FACTORS INFLUENCING FUTURE PERFORMANCE

Base results of the company in the near future will depend primarily on the results of SDG&E and SoCalGas. Earnings growth and fluctuations will depend on changes in the utility industry and activities at SEI, SET and other businesses. Because of the ratemaking and regulatory process, electric- and natural gas-industry restructuring, the changing energy marketplace and these other businesses, there are several factors that will influence future financial performance. These factors are summarized below.

Chilquinta Energía S.A. and Luz del Sur S.A. Acquisitions

In June 1999, SEI and PSEG announced the completion of the joint purchase of Chilquinta Energía S.A. In September 1999, SEI and PSEG completed the acquisition of 47.5 percent of the outstanding shares of Luz del Sur S.A. See "Business Combinations" above, Note 3 of the notes to Consolidated Financial Statements and "International Operations" below for a discussion of the acquisition of Chilquinta Energía S.A. and Luz del Sur S.A.

Nova Scotia

In December 1999, Sempra Atlantic Gas (SAG), a subsidiary of SEI, was awarded a 25-year franchise by the provincial government of Nova Scotia to build and operate a natural gas-distribution system in Nova Scotia. SAG plans to invest $700 million to $800 million over the next seven years to build the system, which will make natural gas available to 78 percent of the 350,000 households in Nova Scotia. Construction of the system is expected to begin in mid-2000, and delivery of natural gas is expected to begin by the end of 2000.

Industry Restructuring

As discussed above, in September 1996, California enacted a law restructuring California's electric-utility industry (AB 1890). Consumers now have the opportunity to continue to purchase their electricity from the local utility under regulated tariffs, to enter into contracts with other energy service providers (direct access) or to buy their power from the PX. The PX serves as a wholesale power pool allowing all energy producers to participate competitively.

Thus far, electric-industry deregulation has been confined to generation. Transmission and distribution have remained subject to traditional cost-of-service and performance-based-ratemaking regulation. However, the CPUC is exploring the possibility of opening up electric distribution to competition. During 2000, the CPUC will consider whether any changes should be made in electric-distribution regulation. A CPUC staff report on this issue will be submitted to the CPUC in the second quarter of 2000. SDG&E and SoCalGas will actively participate in this effort. See Note 14 of the notes to Consolidated Financial Statements for additional information.

On December 20, 1999, the Federal Energy Regulatory Commission (FERC) issued "Order 2000" concerning the formation of Regional Transmission Organizations (RTOs). The rule generally requires all public utilities that own, operate or control interstate transmission to file by October 15, 2000, a proposal for an RTO. Public utilities that are members of an existing, FERC-approved regional entity must file by January 15, 2001. The rule states that RTOs will be operational by December 15, 2001, and will address many issues to improve the transmission of energy. See additional discussion in Note 14 of the notes to Consolidated Financial Statements.

The natural gas industry experienced an initial phase of restructuring during the 1980s by deregulating natural gas sales to noncore customers. On January 21, 1998, the CPUC released a staff report initiating a proceeding to assess the current market and regulatory framework for California's natural gas industry. The general goals of the plan are to consider reforms to the current regulatory framework emphasizing market-oriented policies benefiting California's natural gas consumers.

In August 1998, California enacted a law prohibiting the CPUC from enacting any natural gas industry-restructuring decision for core (residential and small-commercial) customers prior to January 1, 2000. During the implementation moratorium, the CPUC has held hearings throughout the state and intends to give the legislature a draft ruling before adopting a final market-structure policy. SDG&E and SoCalGas have been actively participating in this effort and have argued in support of competition intended to maximize benefits to customers rather than to protect competitors.

In October 1999, the state of California enacted a law (AB 1421) that requires that gas utilities provide "bundled basic gas service" (including transmission, storage, distribution, purchasing, revenue-cycle services and after-meter services) to all core customers, unless the customer chooses to purchase gas from a nonutility provider. The law prohibits the CPUC from unbundling distribution-related gas services (including meter reading and billing) and after-meter services (including leak investigation, inspecting customer piping and appliances, pilot relighting and carbon monoxide investigation) for most customers. The objective is to preserve both customer safety and customer choice.

Transition Costs

AB 1890 allows utilities, within certain limits, the opportunity to recover their stranded costs incurred for certain above-market CPUC-approved facilities, contracts and obligations through the establishment of the CTC.

In June 1999, SDG&E completed the recovery of a majority of its stranded costs. The recovery was affected by, among other things, the sale of SDG&E's fossil power plants and combustion turbines during the quarter ended June 30, 1999. Costs related to the above-market portion of qualifying facilities and other purchased-power contracts that were in effect at December 31, 1995, and the San Onofre Nuclear Generating Station (SONGS) will continue to be recovered in rates. See Note 14 of the notes to Consolidated Financial Statements for additional information.

Electric-Generation Assets

In 1998, Sempra Energy Resources and Reliant Energy Power Generation formed a joint venture to build, own and operate a natural gas power plant (El Dorado) in Boulder City, Nevada. The joint venture plans to sell the plant's electricity into the wholesale market from which utilities throughout the Western United States purchase. The new plant will employ an advanced combined-cycle gas-turbine technology, enabling it to become one of the most efficient and environmentally friendly power plants in the nation. Its proximity to existing natural gas pipelines and electric transmission lines will allow El Dorado to actively compete in the deregulated electric-generation market. The project, funded equally by the company and Reliant, is expected to be operational in the second quarter of 2000.

Electric Rates

AB 1890 provided for a 10-percent reduction in rates for residential and small-commercial customers beginning in January 1998 and for the issuance of rate-reduction bonds by an agency of the state of California to enable its investor-owned utilities (IOUs) to achieve this rate reduction. In December 1997, $658 million of rate-reduction bonds were issued on behalf of SDG&E at an average interest rate of 6.26 percent. These bonds are being repaid over 10 years by SDG&E's residential and small-commercial customers via a nonbypassable charge on their electricity bills. SDG&E formed a subsidiary, SDG&E Funding LLC, to facilitate the issuance of the rate-reduction bonds. In exchange for the bond proceeds, SDG&E sold to SDG&E Funding LLC all of its rights to the revenue streams. Consequently, the revenue streams are not the property of SDG&E and are not available to creditors of SDG&E.

The sizes of the rate-reduction bond issuances were set so as to make the IOUs neutral as to the 10-percent rate reduction, and were based on a four-year period to recover stranded costs. Because SDG&E recovered its stranded costs in only 18 months (due to the greater-than-anticipated plant-sale proceeds), the bond proceeds were greater than needed. Accordingly, SDG&E will return to its customers over $400 million that it has collected or will collect from its customers. The timing of the return will differ from the timing of the collection, but the specific timing of the repayment and the interest rate thereon are the subject of a CPUC proceeding and are expected to be resolved in the second quarter of 2000. This refund will not affect SDG&E's net income, except to the extent that the interest cost associated with the refund (12.63 percent if not reduced as a result of the CPUC proceeding) differs from the return earned by the company on the funds. The bonds and their repayment schedule are unaffected by this refund.

AB 1890 also includes a rate freeze for all IOU customers during the CTC period. In connection with completion of its stranded cost recovery (described above and in Note 14 of the notes to Consolidated Financial Statements), SDG&E filed with the CPUC for a mechanism to structure electric rates after the end of the rate freeze. SDG&E received approval to reduce base rates (the noncommodity portion of rates) to all electric customers effective July 1, 1999. The portion of the electric rate representing the commodity cost is simply passed through to customers and will fluctuate with the price of electricity from the PX. Except for the interim protection mechanism described below, customers will no longer be protected from commodity price spikes.

In April 1999, SDG&E filed an all-party settlement (including energy service providers, the CPUC's Office of Ratepayer Advocates and the Utility Consumers Action Network) detailing proposed implementation plans for lifting the rate freeze. A CPUC decision adopting the all-party settlement was issued in May 1999 and became effective July 1, 1999. Included in the settlement is an interim customer-protection mechanism for residential and small-commercial customers that capped rates between July 1999 and September 1999, regardless of how high the PX price moved during the period. The resulting undercollection (which amounted to less than $1 million) is being recovered through a balancing account mechanism. The interim rate-freeze period runs until the CPUC issues its decision on the pending legal and policy issues of ending the rate freeze. This decision is expected during the second quarter of 2000.

Performance-Based Regulation (PBR)

To promote efficient operations and improved productivity and to move away from reasonableness review and disallowances, the CPUC has been directing utilities to use PBR. PBR has replaced the general rate case and certain other regulatory proceedings for both SoCalGas and SDG&E. Under PBR, regulators require future income potential to be tied to achieving or exceeding specific performance and productivity goals, as well as cost reductions, rather than by relying solely on expanding utility plant in a market where a utility already has a highly developed infrastructure. See additional discussion of PBR in Note 14 of the notes to Consolidated Financial Statements.

Accounting Standards

SoCalGas and SDG&E are accounting for the economic effects of regulation on all of their utility operations, except for electric generation, in accordance with Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation." Under SFAS No. 71, a regulated entity records a regulatory asset if it is probable that, through the ratemaking process, the utility will recover the asset from customers. Regulatory liabilities represent future reductions in revenues for amounts due to customers. See Notes 2 and 14 of the notes to Consolidated Financial Statements for additional information.

Affiliate Transactions

On December 16, 1997, the CPUC adopted rules establishing uniform standards of conduct governing the manner in which California IOUs conduct business with their affiliates. The objective of these rules, which became effective January 1, 1998, is to ensure that the utilities' energy affiliates do not gain an unfair advantage over other competitors in the marketplace and that utility customers do not subsidize affiliate activities.

The CPUC excluded utility-to-utility transactions between SDG&E and SoCalGas from the affiliate-transaction rules in its March 1998 decision approving the PE/Enova business combination. See Notes 1 and 14 of the notes to Consolidated Financial Statements for additional information.

Allowed Rate of Return

For 2000, SoCalGas is authorized to earn a rate of return on rate base of 9.49 percent and a rate of return on common equity of 11.6 percent, which is unchanged from 1999. SDG&E is authorized to earn a rate of return on rate base of 8.75 percent and a rate of return on common equity of 10.6 percent, compared to 9.35 percent and 11.6 percent prior to July 1, 1999, respectively. Either utility can earn more than the authorized rate by controlling costs below approval levels, by experiencing increased volumes of sales not subject to balancing accounts (both of which are subject to revenue sharing, as described in Note 14 of the notes to Consolidated Financial Statements) or by achieving favorable results in certain areas, such as incentive mechanisms, that are not subject to revenue sharing. See additional discussion in Note 14 of the notes to Consolidated Financial Statements.

Management Control of Expenses and Investment

In the past, management has been able to control operating expenses and investment within the amounts authorized to be collected in rates.

It is the intent of management to control operating expenses and investments within the amounts authorized to be collected in rates in the PBR decisions. The utilities intend to make the efficiency improvements, changes in operations and cost reductions necessary to achieve this objective and earn at least their authorized rates of return. However, in view of the earnings-sharing mechanism and other elements of the PBR, it is more difficult to exceed authorized returns to the degree experienced prior to the inception of PBR. See additional discussion of PBR above and in Note 14 of the notes to Consolidated Financial Statements.

Noncore Bypass

SoCalGas is fully at risk for reductions in noncore volumes due to bypass. However, significant bypass would require construction of additional facilities by competing pipelines. SoCalGas has not had a material reduction in earnings from bypass and it is continuing to reduce its costs to remain competitive and retain its transportation customers.

Noncore Pricing

To respond to bypass, SoCalGas has received authorization from the CPUC for expedited review of long-term natural gas transportation-service contracts with some noncore customers at lower-than-tariff rates. In addition, the CPUC approved changes in the methodology that eliminates subsidization of core-customer rates by noncore customers. This allocation flexibility, together with negotiating authority, has enabled SoCalGas to better compete with new interstate pipelines for noncore customers.

Noncore Throughput

SoCalGas' earnings will be impacted if natural gas throughput to its noncore customers varies from estimates adopted by the CPUC in establishing rates. There is a continuing risk that an unfavorable variance in noncore volumes may result from external factors such as weather, electric deregulation, the increased use of hydroelectric power, competing pipeline bypass of SoCalGas' system and a downturn in general economic conditions. In addition, many noncore customers are especially sensitive to the price relationship between natural gas and alternate fuels, as they are capable of readily switching from one fuel to another, subject to air-quality regulations. SoCalGas is at risk for the lost revenue.

Through July 31, 1999, any favorable earnings effect of higher revenues resulting from higher throughput to noncore customers was limited as a result of the

Comprehensive Settlement. The settlement addressed a number of regulatory issues and was approved by the CPUC in July 1994. This treatment will be replaced by the PBR mechanism as adopted in the 1999 BCAP, whereby revenue fluctuations will impact earnings (positively or negatively). See Note 14 of the notes to Consolidated Financial Statements for additional discussion.

Excess Interstate-Pipeline Capacity

Existing interstate-pipeline capacity into California exceeds current demand by over 1 billion cubic feet (Bcf) per day. This situation has reduced the market value of the capacity well below FERC's tariffs. SoCalGas has exercised its step-down option on both the El Paso and Transwestern systems, thereby reducing its firm interstate capacity obligation from 2.25 Bcf per day to 1.45 Bcf per day.

FERC-approved settlements have resulted in a reduction in the costs that SoCalGas possibly may have been required to pay for the capacity released back to El Paso and Transwestern that cannot be remarketed. Of the remaining 1.45 Bcf per day of capacity, SoCalGas' core customers use 1.05 Bcf per day at the full FERC tariff rate. The remaining 0.40 Bcf per day of capacity is marketed at significant discounts. Under existing California regulation, unsubscribed capacity costs associated with the remaining 0.40 Bcf per day are recoverable in customer rates. While including the unsubscribed pipeline cost in rates may impact SoCalGas' ability to compete in competitive markets, SoCalGas does not believe its inclusion will have a significant impact on volumes transported or sold.

ENVIRONMENTAL MATTERS

The company's operations are subject to federal, state and local environmental laws and regulations governing such things as hazardous wastes, air and water quality, land use, solid-waste disposal, and the protection of wildlife.

Most of the potential situations in which the company is faced with environmental issues occur at SoCalGas or SDG&E. For these utilities, capital costs to comply with environmental requirements are generally recovered through the depreciation components of customer rates.

The utilities' customers also generally are responsible for 90 percent of the noncapital costs associated with hazardous substances and the normal operating costs associated with safeguarding air and water quality, disposing properly of solid waste, and protecting endangered species and other wildlife. Therefore, the likelihood of the company's financial position or results of operations being adversely affected in a significant amount is remote.

The environmental issues currently facing the company or resolved during the latest three-year period include investigation and remediation of SoCalGas' and SDG&E's manufactured-gas sites (14 completed as of December 31, 1999, and 31 to be completed), asbestos and other cleanup at SDG&E's former fossil-fueled power plants (all sold in 1999 and actual or estimated cleanup costs included in the transactions), cleanup of third-party waste-disposal sites used by the company, which has been identified as a Potentially Responsible Party (investigations and remediations are continuing), and mitigation of damage to the marine environment caused by the cooling-water discharge from the San Onofre Nuclear Generating Station (SONGS) Units 2 and 3 (the requirements for enhanced fish protection, a 150-acre artificial reef and restoration of 150 acres of coastal wetlands are in process).

MARKET RISK

The company's policy is to use derivative financial instruments to reduce its exposure to fluctuations in interest rates, foreign-currency exchange rates and energy prices. The company also uses and trades derivative financial instruments in its energy trading and marketing activities. Transactions involving these financial instruments are with reputable firms and major exchanges. The use of these instruments exposes the company to market and credit risks. At times, credit risk may be concentrated with certain counterparties, although counterparty nonperformance is not anticipated.

Sempra Energy Trading (SET) derives a substantial portion of its revenue from risk management and trading activities in natural gas, petroleum and electricity. Profits are

earned as SET acts as a dealer in structuring and executing transactions that assist its customers in managing their energy-price risk. In addition, SET may, on a limited basis, take positions in energy markets based on the expectation of future market conditions. These positions include options, forwards, futures and swaps. See Note 10 of the notes to Consolidated Financial Statements and the following "Market-Risk-Management Activities" section for additional information regarding SET's use of derivative financial instruments.

The company's California utilities periodically enter into interest-rate swap and cap agreements to moderate exposure to interest-rate changes and to lower the overall cost of borrowing. These swap and cap agreements generally remain off the balance sheet as they involve the exchange of fixed-rate and variable-rate interest payments without the exchange of the underlying principal amounts. The related gains or losses are reflected in the income statement as part of interest expense. The company would be exposed to interest-rate fluctuations on the underlying debt should other parties to the agreement not perform. Such nonperformance is not anticipated. At December 31, 1999, the notional amount of swap transactions associated with the regulated operations totaled $45 million. See Note 10 of the notes to Consolidated Financial Statements for further information regarding these swap transactions.

The company's California utilities use energy derivatives to manage natural gas price risk associated with servicing their load requirements. In addition, they make limited use of natural gas derivatives for trading purposes. These instruments include forward contracts, futures, swaps, options and other contracts, with maturities ranging from 30 days to 12 months. In the case of both price-risk-management and trading activities, the use of derivative financial instruments by the company's California utilities is subject to certain limitations imposed by company policy and regulatory requirements. See Note 10 of the notes to Consolidated Financial Statements and the "Market-Risk-Management Activities" section below for further information regarding the use of energy derivatives by the company's California utilities.

Market-Risk-Management Activities

Market risk is the risk of erosion of the company's cash flows, net income and asset values due to adverse changes in interest and foreign-currency rates, and in prices for equity and energy. The company has adopted corporate-wide policies governing its market-risk-management and trading activities. An Energy Risk Management Oversight Committee, consisting of senior officers, oversees company-wide energy-price risk-management and trading activities to ensure compliance with the company's stated energy-risk-management and trading policies. In addition, all affiliates have groups that monitor and control energy-price risk management and trading activities independently from the groups responsible for creating or actively managing these risks.

Along with other tools, the company uses Value at Risk (VaR) to measure its exposure to market risk. VaR is an estimate of the potential loss on a position or portfolio of positions over a specified holding period, based on normal market conditions and within a given statistical confidence level. The company has adopted the variance/covariance methodology in its calculation of VaR, and uses a 95-percent confidence level. Holding periods are specific to the types of positions being measured, and are determined based on the size of the position or portfolios, market liquidity, purpose and other factors. Historical volatilities and correlations between instruments and positions are used in the calculation.

The following is a discussion of the company's primary market-risk exposures as of December 31, 1999, including a discussion of how these exposures are managed.

Interest-Rate Risk

The company is exposed to fluctuations in interest rates primarily as a result of its fixed-rate long-term debt. The company has historically funded utility operations through long-term bond issues with fixed interest rates. With the restructuring of the regulatory process, greater flexibility has been permitted within the debt-management process. As a result, recent debt offerings have been selected with short-term maturities to take advantage of yield curves or have used a combination of fixed-rate and floating-rate debt. Subject to regulatory constraints, interest rate swaps may be used to adjust interest-rate exposures when appropriate, based upon market conditions.

A portion of the company's borrowings are denominated in foreign currencies, which expose the company to market risk associated with exchange-rate movements. The company has hedged this foreign currency cash exposure through a swap transaction entered into with a major international bank.

The VaR on the company's fixed-rate long-term debt is estimated at approximately $194 million as of December 31, 1999, assuming a one-year holding period.

Energy-Price Risk

Market risk related to physical commodities is based upon potential fluctuations in natural gas, petroleum and electricity prices and basis. The company's market risk is impacted by changes in volatility and liquidity in the markets in which these instruments are traded. The company's regulated and unregulated affiliates are exposed, in varying degrees, to price risk in the natural gas, petroleum and electricity markets. The company's policy is to manage this risk within a framework that considers the unique markets, operating and regulatory environment of each affiliate.

Sempra Energy Trading

Sempra Energy Trading derives a substantial portion of its revenue from risk-management and trading activities in natural gas, petroleum and electricity. As such, SET is exposed to price volatility in the domestic and international natural gas, petroleum and electricity markets. SET conducts these activities within a structured and disciplined risk-management and control framework that is based on clearly communicated policies and procedures, position limits, active and ongoing management monitoring and oversight, clearly defined roles and responsibilities, and daily risk measurement and reporting.

Market risk of SET's portfolio is measured using a variety of methods, including VaR. SET computes the VaR of its portfolio based on a one-day holding period. As of December 31, 1999, the diversified VaR of SET's portfolio was $2.6 million.

SDG&E and SoCalGas

SDG&E and SoCalGas may, at times, be exposed to limited market risk in their natural gas purchase, sale and storage activities as a result of activities under SDG&E's gas PBR or SoCalGas' Gas Cost Incentive Mechanism. They manage their risk within the parameters of the company's market-risk-management and trading framework. As of December 31, 1999, the total VaR of the utilities' natural gas positions was not material.

Credit Risk

Credit risk relates to the risk of loss that would be incurred as a result of nonperformance by counterparties pursuant to the terms of their contractual obligations. The company avoids concentration of counterparties and maintains credit policies with regard to counterparties that management believes significantly minimize overall credit risk. These policies include an evaluation of potential counterparties' financial condition (including credit rating), collateral requirements under certain circumstances, and the use of standardized agreements that allow for the netting of positive and negative exposures associated with a single counterparty.

The company monitors credit risk through a credit-approval process and the assignment and monitoring of credit limits. These credit limits are established based on risk and return considerations under terms customarily available in the industry.

Foreign-Currency-Rate Risk

Foreign-currency-rate risk exists by nature of the company's global operations. The company has investments in entities whose functional currency is not the U.S. dollar, which exposes the company to foreign exchange movements, primarily in Latin American currencies. When appropriate, the company may attempt to limit its exposure to changing foreign exchange rates through both operational and financial market actions. These actions may include entering into forward, option and swap contracts to hedge existing exposures, firm commitments and anticipated transactions. As of December 31, 1999, the company had not entered into any such actions.

YEAR 2000 ISSUES

There were only a few, very minor Year 2000 interruptions to the company's automated systems and applications, suppliers and customers. The company incurred expenses of $48 million (including $7.6 million in 1999) for its Year 2000 readiness effort and expects to incur no additional costs.

NEW ACCOUNTING STANDARDS

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 133 "Accounting for Derivative Instruments and Hedging Activities." In June 1999, the effective date of this statement was deferred for one year. As amended, SFAS 133, which is effective for the company on January 1, 2001, requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position, measure those instruments at fair value and recognize changes in the fair value of derivatives in earnings in the period of change unless the derivative qualifies as an effective hedge that offsets certain exposures. The effect of this standard on the company's Consolidated Financial Statements has not yet been determined.

INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report contains statements that are not historical fact and constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The words "estimates," "believes," "expects," "anticipates," "plans," "intends," "may" and "should" or similar expressions, or discussions of strategy or of plans are intended to identify forward-looking statements that involve risks, uncertainties and assumptions. Future results may differ materially from those expressed in these forward-looking statements.

These statements are necessarily based upon various assumptions involving judgments with respect to the future and other risks, including, among others, local, regional, national and international economic, competitive, political and regulatory conditions and developments, technological developments; capital market conditions; inflation rates; interest rates; exchange rates; energy markets, including the timing and extent of changes in commodity prices; weather conditions; business, regulatory or legal decisions; the pace of deregulation of retail natural gas and electricity delivery; the timing and success of business-development efforts; and other uncertainties – all of which are difficult to predict and many of which are beyond the control of the company. Readers are cautioned not to rely unduly on any forward-looking statements and are urged to review and consider carefully the risks, uncertainties and other factors which affect the company's business described in this Annual Report and other reports filed by the company from time to time with the Securities and Exchange Commission.

Five-Year Summary

At December 31 or for the years ended December 31 (Dollars in millions except per-share amounts)	1999	1998	1997	1996	1995
REVENUES AND OTHER INCOME:					
Gas	$ 2,924	$ 2,772	$ 2,964	$2,710	$2,542
Electric	1,818	1,865	1,769	1,591	1,504
Other	693	378	382	223	155
Total	$ 5,435	$ 5,015	$ 5,115	$4,524	$4,201
Operating income	$ 802	$ 629	$ 927	$ 927	$ 886
Net income	$ 394	$ 294	$ 432	$ 427	$ 401
Net income per common share:					
Basic	$ 1.66	$ 1.24	$ 1.83	$ 1.77	$ 1.67
Diluted	$ 1.66	$ 1.24	$ 1.82	$ 1.77	$ 1.67
Dividends declared per common share	$ 1.56	$ 1.56	$ 1.27	$ 1.24	$ 1.22
Pretax income/revenue	10.7%	8.7%	14.5%	16.2%	16.0%
Return on common equity	13.3%	10.0%	14.7%	14.9%	14.6%
Effective income tax rate	31.2%	31.9%	41.1%	41.3%	39.7%
Dividend payout ratio:					
Basic	94.0%	125.8%	69.4%	70.1%	73.1%
Diluted	94.0%	125.8%	69.8%	70.1%	73.1%
Price range of common shares	26–17⅛	29 5/16–23¾	*	*	*
AT DECEMBER 31					
Current assets	$ 3,040	$ 2,458	$ 2,761	$1,592	$1,520
Total assets	$11,270	$10,456	$10,756	$9,762	$9,837
Current liabilities	$ 3,327	$ 2,466	$ 2,211	$1,572	$1,578
Long-term debt (excludes current portion)	$ 2,902	$ 2,795	$ 3,175	$2,704	$2,721
Shareholders' equity	$ 2,986	$ 2,913	$ 2,959	$2,930	$2,815
Common shares outstanding (in millions)	237.4	237.0	235.6	240.0	240.6
Book value per common share	$ 12.58	$ 12.29	$ 12.56	$12.21	$11.70
Price/earnings ratio	10.5	20.5	*	*	*
Number of meters (in thousands):					
Natural gas	5,725	5,639	5,551	5,501	5,436
Electricity	1,218	1,192	1,178	1,164	1,151

*Not presented as the formation of Sempra Energy was not completed until June 26, 1998.

Statement of Management Responsibility for Consolidated Financial Statements

The consolidated financial statements have been prepared by management in accordance with generally accepted accounting principles. The integrity and objectivity of these financial statements and the other financial information in the Annual Report, including the estimates and judgments on which they are based, are the responsibility of management. The financial statements have been audited by Deloitte & Touche LLP, independent certified public accountants appointed by the board of directors. Their report is shown on the next page. Management has made available to Deloitte & Touche LLP all of the company's financial records and related data, as well as the minutes of shareholders' and directors' meetings.

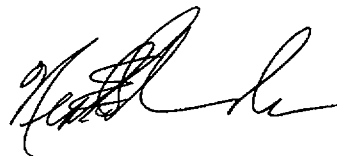
Management maintains a system of internal accounting control which it believes is adequate to provide reasonable, but not absolute, assurance that assets are properly safeguarded and accounted for, that transactions are executed in accordance with management's authorization and are properly recorded and reported, and for the prevention and detection of fraudulent financial reporting. The concept of reasonable assurance recognizes that the cost of a system of internal controls should not exceed the benefits derived and that management makes estimates and judgments of these cost/benefit factors.

Management monitors the system of internal control for compliance through its own review and a strong internal auditing program which also independently assesses the effectiveness of the internal controls. In establishing and maintaining internal controls, the company must exercise judgment in determining whether the benefits derived justify the costs of such controls.

Management acknowledges its responsibility to provide financial information (both audited and unaudited) that is representative of the company's operations, reliable on a consistent basis, and relevant for a meaningful financial assessment of the company. Management believes that the control process enables it to meet this responsibility.

Management also recognizes its responsibility for fostering a strong ethical climate so that the company's affairs are conducted according to the highest standards of personal and corporate conduct. This responsibility is characterized and reflected in the company's code of corporate conduct, which is publicized throughout the company. The company maintains a systematic program to assess compliance with this policy.

The board of directors has an Audit Committee composed solely of directors who are not officers or employees. The committee recommends for approval by the full Board the appointment of the independent auditors. The committee meets regularly with management, with the company's internal auditors and with the independent auditors, as well as in executive session. The independent auditors and the internal auditors periodically meet alone with the Audit Committee and have free access to the Audit Committee at any time.



Neal E. Schmale
Executive Vice President and
Chief Financial Officer

Frank H. Ault
Vice President and Controller

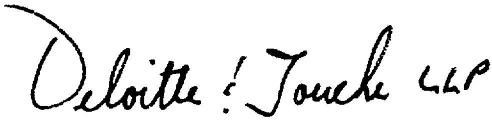
Independent Auditors' Report

To the Board of Directors and Shareholders of Sempra Energy:

We have audited the accompanying consolidated balance sheets of Sempra Energy and subsidiaries (the "company") as of December 31, 1999 and 1998, and the related statements of consolidated income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 1999. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Sempra Energy and subsidiaries as of December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999, in conformity with generally accepted accounting principles.



San Diego, California
February 4, 2000 (February 25, 2000 as to Note 17)

Statements of Consolidated Income

For the years ended December 31 (Dollars in millions except per-share amounts)	1999	1998	1997
REVENUES AND OTHER INCOME			
Utility revenues:			
Natural gas	$2,924	$2,772	$2,964
Electric	1,818	1,865	1,769
Other operating revenues	618	344	336
Other income	75	34	46
Total	5,435	5,015	5,115
EXPENSES			
Cost of natural gas distributed	1,164	954	1,168
Purchased power – net	467	260	441
Electric fuel	69	177	164
Operating expenses	1,862	1,872	1,615
Depreciation and amortization	879	929	604
Franchise payments and other taxes	181	182	178
Preferred dividends by subsidiaries	11	12	18
Total	4,633	4,386	4,188
Income Before Interest and Income Taxes	802	629	927
Interest	229	197	194
Income Before Income Taxes	573	432	733
Income taxes	179	138	301
Net Income	$ 394	$ 294	$ 432
Net Income Per Share of Common Stock (Basic)	$ 1.66	$ 1.24	$ 1.83
Net Income Per Share of Common Stock (Diluted)	$ 1.66	$ 1.24	$ 1.82
Common Dividends Declared Per Share	$ 1.56	$ 1.56	$ 1.27

See notes to Consolidated Financial Statements.

Consolidated Balance Sheets

At December 31 (Dollars in millions)	1999	1998
ASSETS		
Current assets:		
Cash and cash equivalents	$ 487	$ 424
Accounts receivable – trade	428	586
Accounts and notes receivable – other	129	159
Income taxes receivable	144	–
Deferred income taxes	–	93
Energy trading assets	1,539	906
Inventories	148	151
Other	165	139
Total current assets	3,040	2,458
Investments and other assets:		
Regulatory assets	670	1,056
Nuclear-decommissioning trusts	551	494
Investments	1,164	548
Other assets	451	459
Total investments and other assets	2,836	2,557
Property, plant and equipment:		
Property, plant and equipment	11,127	11,235
Less accumulated depreciation and amortization	(5,733)	(5,794)
Total property, plant and equipment – net	5,394	5,441
Total assets	$11,270	$10,456

See notes to Consolidated Financial Statements.

At December 31 (Dollars in millions)	1999	1998
LIABILITIES		
Current liabilities:		
Short-term debt	$ 182	$ 43
Accounts payable	737	702
Accrued income taxes	–	27
Deferred income taxes	67	–
Energy trading liabilities	1,365	805
Dividends and interest payable	154	168
Regulatory balancing accounts – net	357	120
Long-term debt due within one year	155	330
Other	310	271
Total current liabilities	3,327	2,466
Long-term debt	2,902	2,795
Deferred credits and other liabilities:		
Customer advances for construction	72	72
Post-retirement benefits other than pensions	204	240
Deferred income taxes	615	634
Deferred investment tax credits	106	147
Deferred credits and other liabilities	854	985
Total deferred credits and other liabilities	1,851	2,078
Preferred stock of subsidiaries	204	204
Commitments and contingent liabilities (Note 13)		
SHAREHOLDERS' EQUITY		
Common stock	1,966	1,883
Retained earnings	1,101	1,075
Deferred compensation relating to ESOP	(42)	(45)
Accumulated other comprehensive income	(39)	–
Total shareholders' equity	2,986	2,913
Total liabilities and shareholders' equity	$11,270	$10,456

See notes to Consolidated Financial Statements.

Statements of Consolidated Cash Flows

For the years ended December 31 (Dollars in millions)	1999	1998	1997
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 394	$ 294	$ 432
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	879	929	604
Portion of depreciation arising from sales of generating plants	(303)	–	–
Application of balancing account to stranded costs	(66)	(86)	–
Deferred income taxes and investment tax credits	(43)	(199)	(16)
Other – net	(87)	(94)	62
Net change in other working capital components	414	479	(164)
Net cash provided by operating activities	1,188	1,323	918
CASH FLOWS FROM INVESTING ACTIVITIES			
Net proceeds from sales of generating plants	466	–	–
Expenditures for property, plant and equipment	(589)	(438)	(397)
Acquisitions of businesses	(639)	(191)	(206)
Other	(27)	(50)	1
Net cash used in investing activities	(789)	(679)	(602)
CASH FLOWS FROM FINANCING ACTIVITIES			
Common dividends	(368)	(325)	(301)
Sale of common stock	3	34	17
Repurchase of common stock	–	(1)	(122)
Redemption of preferred stock	–	(75)	–
Issuances of other long-term debt	160	75	140
Issuance of rate-reduction bonds	–	–	658
Payments on long-term debt	(270)	(431)	(416)
Increase (decrease) in short-term debt – net	139	(311)	92
Net cash provided by (used in) financing activities	(336)	(1,034)	68
Increase (Decrease) in Cash and Cash Equivalents	63	(390)	384
Cash and Cash Equivalents, January 1	424	814	430
Cash and Cash Equivalents, December 31	$ 487	$ 424	$ 814

See notes to Consolidated Financial Statements.

For the years ended December 31 (Dollars in millions)	1999	1998	1997
CHANGES IN OTHER WORKING CAPITAL COMPONENTS			
(Excluding cash and cash equivalents, short-term debt and long-term debt due within one year)			
Accounts and notes receivable	$188	$ 90	$(129)
Net trading assets	(73)	(71)	–
Inventories	3	(40)	(2)
Regulatory balancing accounts	303	417	48
Other current assets	(26)	(26)	41
Accounts payable and other current liabilities	19	109	(122)
Net change in other working capital components	$414	$479	$(164)
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Cash paid during the year for:			
Interest (net of amounts capitalized)	$281	$211	$ 193
Income taxes (net of refunds)	$168	$366	$ 274
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES			
Acquisition of Sempra Energy Trading :			
Assets acquired	–	–	$ 609
Cash paid	–	–	(225)
Liabilities assumed	–	–	$ 384
Liabilities assumed for real estate investments	$ 34	$ 36	$ 126
Nonutility electric generation assets sold:			
Book value of assets sold	–	–	$ 77
Cash received	–	–	(20)
Loss on sale	–	–	(6)
Note receivable obtained	–	–	$ 51

See notes to Consolidated Financial Statements.

Statements of Consolidated Changes in Shareholders' Equity

For the years ended December 31, 1999, 1998 and 1997 (Dollars in millions)	Comprehensive Income	Common Stock	Retained Earnings	Deferred Compensation Relating to ESOP	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 1996		$1,953	$1,026	$(49)	$ –	$2,930
Net income/comprehensive income	$ 432		432			432
Common stock dividends declared			(301)			(301)
Sale of common stock		17				17
Repurchase of common stock		(122)				(122)
Long-term incentive plan		1				1
Common stock released from ESOP				2		2
Balance at December 31, 1997		1,849	1,157	(47)	–	2,959
Net income/comprehensive income	294		294			294
Common stock dividends declared			(376)			(376)
Sale of common stock		34				34
Repurchase of common stock		(1)				(1)
Long-term incentive plan		1				1
Common stock released from ESOP				2		2
Balance at December 31, 1998		1,883	1,075	(45)	–	2,913
Net income	394		394			394
Comprehensive income adjustment:						
Foreign-currency translation losses	(42)				(42)	(42)
Available-for-sale securities	12				12	12
Pension	(9)				(9)	(9)
Comprehensive income	$ 355					
Common stock dividends declared			(368)			(368)
Quasi-reorganization adjustment (Note 2)		80				80
Sale of common stock		2				2
Long-term incentive plan		1				1
Common stock released from ESOP				3		3
Balance at December 31, 1999		$1,966	$1,101	$(42)	$(39)	$2,986

See notes to Consolidated Financial Statements.

1 BUSINESS COMBINATION

Sempra Energy (the company) was formed as a holding company for Enova Corporation (Enova) and Pacific Enterprises (PE) in connection with a business combination of Enova and PE that was completed on June 26, 1998. As a result of the combination each outstanding share of common stock of Enova was converted into one share of common stock of Sempra Energy, and each outstanding share of common stock of PE was converted into 1.5038 shares of common stock of Sempra Energy. The preferred stock and preference stock of the combining companies and their subsidiaries remained outstanding.

The Consolidated Financial Statements are those of the company and its subsidiaries and give effect to the business combination using the pooling-of-interests method and, therefore, are presented as if the companies were combined during all periods included therein.

2 SIGNIFICANT ACCOUNTING POLICIES

EFFECTS OF REGULATION The accounting policies of the company's principal subsidiaries, San Diego Gas & Electric (SDG&E) and Southern California Gas Company (SoCalGas), conform with generally accepted accounting principles for regulated enterprises and reflect the policies of the California Public Utilities Commission (CPUC) and the Federal Energy Regulatory Commission (FERC).

SDG&E and SoCalGas prepare their financial statements in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation," under which a regulated utility records a regulatory asset if it is probable that, through the ratemaking process, the utility will recover that asset from customers. Regulatory liabilities represent future reductions in rates for amounts due to customers. To the extent that portions of the utility operations were to be no longer subject to SFAS No. 71, or recovery was to be no longer probable as a result of changes in regulation or the utility's competitive position, the related regulatory assets and liabilities would be written off. In addition, SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," affects utility plant and regulatory assets such that a loss must be recognized whenever a regulator excludes all or part of an asset's cost from rate base. The application of SFAS No. 121 continues to be evaluated in connection with industry restructuring. Information concerning regulatory assets and liabilities is described below in "Revenues and Regulatory Balancing Accounts" and industry restructuring is described in Note 14.

REVENUES AND REGULATORY BALANCING ACCOUNTS Revenues from utility customers consist of deliveries to customers and the changes in regulatory balancing accounts. The amounts included in regulatory balancing accounts at December 31, 1999, represent net payables of $165 million and $192 million for SoCalGas and SDG&E, respectively. The corresponding amounts at December 31, 1998, were $129 million net payable and $9 million net receivable for SoCalGas and SDG&E, respectively.

Prior to 1998, fluctuations in utility earnings from changes in the costs of fuel oil, purchased energy and natural gas, and consumption levels for electricity and the majority of natural gas were eliminated by balancing accounts authorized by the CPUC. However, as a result of California's electric-restructuring law, overcollections recorded in SDG&E's Energy Cost Adjustment Clause and Electric Revenue Adjustment Mechanism balancing accounts were transferred to the Interim Transition Cost Balancing Account, which was applied to transition cost recovery, and fluctuations in certain costs and consumption levels can now affect earnings from electric operations. In addition, fluctuations in certain costs and consumption levels can affect earnings from SDG&E's gas operations. Additional information on regulatory matters is included in Note 14.

Sempra Energy Trading (SET) derives a substantial portion of its revenue from market making and trading activities, as a principal, in natural gas, petroleum and electricity. It also earns trading profits as a dealer by structuring and executing transactions that permit its counterparties to manage their risk profiles, and takes positions in energy markets based on the expectation of future market conditions. These positions include options, forwards, futures and swaps. SET adjusts these derivatives to market each month with gains and losses recognized in earnings. See "Trading Instruments" below and Note 10 for additional information.

REGULATORY ASSETS Regulatory assets include unrecovered premium on early retirement of debt, postretirement benefit costs, deferred income taxes recoverable in rates and other regulatory-related expenditures that the utilities expect to recover in future rates. See Note 14 for additional information.

TRADING INSTRUMENTS Trading assets and trading liabilities are recorded on a trade-date basis at fair value and include option premiums paid and received, and unrealized gains and losses from exchange-traded futures and options, over the counter (OTC) swaps, forwards, and options. Unrealized gains and losses on OTC transactions reflect amounts which would be received from or paid to a third party upon settlement of the contracts. Unrealized gains and losses on OTC transactions are reported separately as assets and liabilities unless a legal right of setoff exists under a master netting arrangement enforceable by law. Revenues are recognized on a trade-date basis and include realized gains and losses, and the net change in unrealized gains and losses.

Futures and exchange-traded option transactions are recorded as contractual commitments on a trade-date basis and are carried at fair value based on closing exchange quotations. Commodity swaps and forward transactions are accounted for as contractual commitments on a trade-date basis and are carried at fair value derived from dealer quotations and underlying commodity-exchange quotations. OTC options are carried at fair value based on the use of valuation models that utilize, among other things, current interest, commodity and volatility rates, as applicable. For long-dated forward transactions, where there are no dealer or exchange quotations, fair values are derived using internally developed valuation methodologies based on available market information. Where market rates are not quoted, current interest, commodity and volatility rates are estimated by reference to current market levels. Given the nature, size and timing of transactions, estimated values may differ from realized values. Changes in the fair value are recorded currently in income.

INVENTORIES Included in inventories at December 31, 1999, are $68 million of utility materials and supplies ($70 million in 1998), and $80 million of natural gas and fuel oil ($81 million in 1998). Materials and supplies are generally valued at the lower of average cost or market; fuel oil and natural gas are valued by the last-in first-out method.

PROPERTY, PLANT AND EQUIPMENT This primarily represents the buildings, equipment and other facilities used by SoCalGas and SDG&E to provide natural gas and electric utility service.

The cost of utility plant includes labor, materials, contract services and related items, and an allowance for funds used during construction. The cost of retired depreciable utility plant, plus removal costs minus salvage value, is charged to accumulated depreciation. Information regarding electric-industry restructuring and its effect on utility plant is included in Note 14. Utility plant balances by major functional categories at December 31, 1999, are: natural gas operations $7.1 billion, electric distribution $2.5 billion, electric transmission $0.7 billion, and other electric $0.4 billion. The corresponding amounts at December 31, 1998, were essentially the same, except that other electric decreased by $0.5 billion in 1999 in connection with electric-industry restructuring, as described in Note 14. Accumulated depreciation and decommissioning of natural gas and electric utility plant in service at December 31, 1999, are $3.8 billion and $1.9 billion, respectively, and at December 31, 1998, were $3.5 billion and $2.2 billion, respectively. Depreciation expense is based on the straight-line method over the useful lives of the assets or a shorter period prescribed by the CPUC. The provisions for depreciation as a percentage of average depreciable utility plant (by major functional categories) in 1999, 1998 and 1997, respectively are: natural gas operations 4.32, 4.32, 4.31, electric generation 8.70, 6.49, 5.60, electric distribution 4.69, 4.49, 4.39, electric transmission 3.50, 3.31, 3.28, and other electric 8.21, 6.29, 6.02. The increases for electric generation reflect the accelerated recovery of generation facilities and the increase in depreciation rates resulting from the 1999 Cost of Service proceeding. See Note 14 for additional discussion of generation facilities and industry restructuring. The remaining cost amounts

($0.4 billion at December 31, 1999, and $0.2 billion at December 31, 1998) consist of various items of property at various other consolidated entities, with various depreciation rates depending on the nature of the items.

NUCLEAR-DECOMMISSIONING LIABILITY Deferred credits and other liabilities at December 31, 1999, include $165 million ($146 million in 1998) of accumulated decommissioning costs associated with SDG&E's interest in San Onofre Nuclear Generating Station (SONGS) Unit 1, which was permanently shut down in 1992. Additional information on SONGS Unit 1 decommissioning costs is included in Note 6. The corresponding liability for Units 2 and 3 is included in accumulated depreciation and amortization.

FOREIGN CURRENCY TRANSLATION The assets and liabilities of the company's foreign operations are generally translated into U.S. dollars at current exchange rates, and revenues and expenses are translated at average exchange rates for the year. Resulting translation adjustments are reflected in a component of shareholders' equity ("accumulated other comprehensive income"). Foreign currency transaction gains and losses are included in consolidated net income.

COMPREHENSIVE INCOME SFAS No. 130, "Reporting Comprehensive Income," requires reporting of comprehensive income and its components (revenues, expenses, gains and losses) in any complete presentation of general-purpose financial statements. Comprehensive income describes all changes, except those resulting from investments by owners and distributions to owners, in the equity of a business enterprise from transactions and other events including, as applicable, foreign-currency items, minimum pension liability adjustments and unrealized gains and losses on marketable securities that are classified as available-for-sale. Securities are so classified if the company uses the securities in its cash/asset management program whereby the securities may be sold in connection with interest rate changes and cash requirements. At December 31, 1999, the company had one such investment, which increased in value during 1999. That increase is recognized in the "Statement of Consolidated Changes in Shareholders' Equity."

QUASI-REORGANIZATION In 1993, PE divested its merchandising operations and most of its oil and gas exploration and production business. In connection with the divestitures, PE effected a quasi-reorganization for financial reporting purposes, effective December 31, 1992.

Certain of the liabilities established in connection with the quasi-reorganization were favorably resolved in November 1999, including unitary tax issues. Excess reserves of $80 million resulting from the favorable resolution of these issues have been added to shareholders' equity.

Other liabilities established in connection with discontinued operations and the quasi-reorganization will be resolved in future years. Management believes the provisions previously established for these matters are adequate.

USE OF ESTIMATES IN THE PREPARATION OF THE FINANCIAL STATEMENTS The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

CASH AND CASH EQUIVALENTS Cash equivalents are highly liquid investments with original maturities of three months or less at the date of purchase, or investments that are readily convertible to cash.

BASIS OF PRESENTATION Certain prior-year amounts have been reclassified to conform to the current year's presentation.

NEW ACCOUNTING STANDARD In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 133 "Accounting for Derivative Instruments and Hedging Activities," which is effective for the company on January 1, 2001. The statement requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position, measure those instruments at fair value and recognize changes in the fair value of derivatives in earnings in the period of change

unless the derivative qualifies as an effective hedge that offsets certain exposures. The effect of this standard on the company's consolidated financial statements has not yet been determined.

3 ACQUISITIONS AND JOINT VENTURES

SEMPRA ENERGY INTERNATIONAL (SEI) On June 10, 1999, SEI and PSEG Global (PSEG) purchased (on a 50/50 basis) Chilquinta Energía S.A. (Energía) for $840 million. Sempra Energy invested $260 million for the purchase of stock and refinanced $160 million of Energía's long-term debt outstanding. In September 1999, Sempra Energy and PSEG completed their acquisition of 47.5 percent of the outstanding shares of Luz del Sur S.A., a Peruvian electric company. Sempra Energy's share of the transaction was $108 million in cash. This acquisition, combined with the 37 percent already owned through Energía, increased the companies' total joint ownership to 84.5 percent of Luz del Sur S.A.

SEI and Proxima Gas S.A. de C.V., partners in the Mexican companies Distribuidora de Gas Natural (DGN) de Mexicali and Distribuidora de Gas Natural de Chihuahua, are the licensees to build and operate natural gas distribution systems in Mexicali and Chihuahua. DGN-Mexicali will invest up to $25 million during the first five years of the 30-year license period. DGN-Chihuahua will invest up to $50 million over the first five years of operation. DGN-Mexicali and DGN-Chihuahua assumed ownership of natural gas distribution facilities during the third quarter of 1997. SEI owns interests of 60 and 95 percent in the DGN-Mexicali and DGN-Chihuahua projects, respectively.

In May 1999, SEI was awarded a 30-year license to build and operate a natural gas distribution system in the La Laguna-Durango zone in north-central Mexico. SEI will invest over $40 million in the project during the first five years of operation.

In August 1998, SEI was awarded a 10-year agreement by the Mexican Federal Electric Commission to provide a complete energy-supply package for a power plant in Rosarito, Baja California. The contract includes provisions for delivery of up to 300 million cubic feet per day of natural gas, the related transportation services in the U.S., and construction of a 23-mile pipeline from the U.S.-Mexico border to the plant. Construction of the pipeline is anticipated to be completed by mid-2000 at a cost of $35 million. The pipeline will also serve as a link for a natural gas distribution system in Tijuana, Baja California.

In December 1999 Sempra Atlantia Gas (SAG), a subsidiary of SEI, was awarded a 25-year franchise by the provincial government of Nova Scotia to build and operate a natural gas distribution system in Nova Scotia. SAG plans to invest $700 million to $800 million over the next seven years to build the system, which will make natural gas available to 78 percent of the 350,000 households in Nova Scotia. Construction of the system is expected to begin in mid-2000, and delivery of natural gas is expected to begin by the end of 2000.

In March 1998, SEI increased its existing investment in two Argentine natural gas utility holding companies (Sodigas Pampeana S.A. and Sodigas Sur S.A.) from 12.5 percent to 21.5 percent by purchasing an additional interest for $40 million. In June 1999, the company contributed capital to the Argentine companies to retire $32 million of debt. The distribution companies serve 1.2 million customers in central and southern Argentina, respectively, and have a combined throughput of 650 million cubic feet per day.

SEMPRA ENERGY TRADING In December 1997, the company acquired Sempra Energy Trading (SET) for $225 million. SET is a wholesale-energy trading company based in Stamford, Conn. It participates in marketing and trading physical and financial energy products, including natural gas, power, crude oil and associated commodities.

In July 1998, SET purchased CNG Energy Services Corporation, a subsidiary of Pittsburgh-based Consolidated Natural Gas Company, for $36 million. The acquisition expanded SET's business volume by adding large, commodity-trading contracts with local distribution companies, municipalities and major industrial corporations in the eastern United States.

SEMPRA ENERGY RESOURCES In December 1997, Sempra Energy Resources (SER) in partnership with Reliant Energy Power Generation, formed El Dorado Energy. In April 1998, El Dorado Energy began construction on a 480-megawatt power plant near Boulder City, Nevada. As of December 31, 1999, SER has invested $55 million in this project. In October 1998, El Dorado Energy obtained a $158 million senior-secured credit facility, which entails both construction and 15-year term financing for the project. The plant is expected to be operational in the second quarter of 2000.

SEMPRA ENERGY SERVICES CES/Way International, a national leader in energy-service performance contracting, was acquired in January 1998 and renamed Sempra Energy Services in 1999. Headquartered in Houston, Sempra Energy Services provides energy-efficiency services, including energy audits, engineering design, project management, construction, financing and contract maintenance.

4 SHORT-TERM BORROWINGS

PE has a $300 million multiyear credit agreement. SoCalGas has an additional $400 million multiyear credit agreement. These agreements expire in 2001 and bear interest at various rates based on market rates and the companies' credit ratings. SoCalGas' lines of credit are available to support commercial paper. At December 31, 1999, both bank lines of credit were unused. At December 31, 1998, PE had $43 million of bank loans under the credit agreement, which was due and paid in January 1999. SoCalGas' bank line of credit was unused.

SDG&E has $205 million of bank lines available to support commercial paper and variable-rate, long-term debt. The credit agreements expire at varying dates from 2000 through 2002 and bear interest at various rates based on market rates and SDG&E's credit rating. SDG&E's bank lines of credit were unused at both December 31, 1999, and 1998.

In 1999, Sempra Energy Holdings (SEH), the intermediate holding company for many of the company's nonutility subsidiaries, entered into a $500 million credit agreement that expires in 2000. Borrowings under the agreement bear interest at various rates based on market rates and the credit rating of Sempra Energy. SEH's credit agreement is available to support commercial paper. At December 31, 1999, SEH had $182 million of commercial paper outstanding.

5 LONG-TERM DEBT

December 31 (Dollars in millions)	1999	1998
LONG-TERM DEBT		
First-mortgage bonds		
7.625% June 15, 2002	**$ 28**	$ 28
6.875% August 15, 2002	**100**	100
5.75% November 15, 2003	**100**	100
6.8% June 1, 2015	**14**	14
5.9% June 1, 2018	**68**	71
5.9% September 1, 2018	**93**	93
6.1% and 6.4% September 1, 2018 and 2019	**118**	118
9.625% April 15, 2020	**10**	10
Variable rates September 1, 2020	**58**	58
5.85% June 1, 2021	**60**	60
8.75% October 1, 2021	**150**	150
8.5% April 1, 2022	**10**	10
7.375% March 1, 2023	**100**	100
7.5% June 15, 2023	**125**	125
6.875% November 1, 2025	**175**	175
Various rates December 1, 2027	**225**	250
Total	**1,434**	1,462
Rate-reduction bonds	**526**	592
Debt incurred to acquire limited partnerships, secured by real estate, at 6.8% to 9.0%, payable annually through 2009	**284**	305
Various unsecured bonds at 5.67% to 8.75% or at variable rates (3.1% to 3.3% at December 31, 1999) payable from 2000 to 2028	**495**	577
Employee Stock Ownership Plan	**130**	130
Variable rate debt (9.75% at December 31, 1999) payable 2001 and 2004	**160**	–
Capitalized leases	**43**	76
Total	**3,072**	3,142
Less:		
Current portion of long-term debt	**155**	330
Unamortized discount on long-term debt	**15**	17
	170	347
Total	**$2,902**	$2,795

Excluding capital leases, which are described in Note 13, maturities of long-term debt are $152 million in 2000, $320 million in 2001, $234 million in 2002, $277 million in 2003, $175 million in 2004 and $1.9 billion thereafter. SDG&E and SoCalGas have CPUC authorization to issue an additional $738 million in long-term debt. Although holders of variable-rate bonds may elect to redeem them prior to scheduled maturity, for purposes of determining the maturities listed above, it is assumed the bonds will be held to maturity.

FIRST-MORTGAGE BONDS First-mortgage bonds are secured by a lien on substantially all utility plant. SDG&E and SoCalGas may issue additional first-mortgage bonds upon compliance with the provisions of their bond indentures, which permit, among other things, the issuance of an additional $1.4 billion of first-mortgage bonds as of December 31, 1999.

During 1999, the company retired $28 million of first-mortgage bonds prior to scheduled maturity.

CALLABLE BONDS At SDG&E's or SoCalGas' option, certain bonds may be called at a premium. SoCalGas has no variable-rate bonds. SDG&E has $287 million of variable-rate bonds that are callable at various dates within one year. Of the company's remaining callable bonds, $55 million are callable in the year 2000, $150 million in 2001, $204 million in 2002, $621 million in 2003, and $8 million in 2006.

RATE-REDUCTION BONDS In December 1997, $658 million of rate-reduction bonds were issued on behalf of SDG&E at an average interest rate of 6.26 percent. These bonds were issued to facilitate the 10-percent rate reduction mandated by California's electric-restructuring law. See Note 14 for additional information. These bonds are being repaid over 10 years by SDG&E's residential and small commercial customers via a charge on their electricity bills. These bonds are secured by the revenue streams collected from customers and are not secured by, or payable from, utility assets.

The sizes of the rate-reduction bond issuances were set so as to make the utilities neutral as to the 10-percent rate reduction, and were based on a four-year period to recover stranded costs. Because SDG&E recovered its stranded costs in only 18 months (due to the greater-than-anticipated plant-sale proceeds), its bond proceeds were greater than needed. Accordingly, SDG&E will return to its customers over $400 million that it has collected or will collect from its customers. The timing of the return will differ from the timing of the collection, but the specific timing of the repayment and the interest rate thereon are the subject of a CPUC proceeding and are expected to be resolved in early 2000. This refund will not affect SDG&E's net income, except to the extent that the interest associated with the refund (12.63 percent if not reduced as a result of the CPUC proceeding) differs from the return earned by the company on the funds. The bonds and their repayment schedule are not affected by this refund.

UNSECURED DEBT Various long-term obligations totaling $495 million are unsecured. Unsecured bonds totaling $124 million have variable-rate provisions.

DEBT OF EMPLOYEE STOCK OWNERSHIP PLAN (ESOP) AND TRUST (TRUST) The Trust covers substantially all of Southern California Gas Company's employees and is used to fund part of the retirement savings plan. The Trust was assumed by Sempra Energy on October 1, 1999, and participation in the ESOP is being expanded to include employees of SDG&E and other affiliates. In November 1999 the $130 million ESOP debt was refinanced using variable-rate (6.59% at December 31, 1999) notes with a 15-year term. However, because the company is required to make proportionate reductions in the debt balance, the average life of the loan will be less than 10 years. Interest on ESOP debt amounted to $6 million in each of 1999, 1998 and 1997. Dividends used for debt service amounted to $5 million in 1999 and 1998, and $3 million in 1997.

INTEREST-RATE SWAPS SDG&E periodically enters into interest-rate swap and cap agreements to moderate its exposure to interest-rate changes and to lower its overall cost of borrowings. At December 31, 1999, SDG&E had such an agreement, maturing in 2002, with underlying debt of $45 million.

6 FACILITIES UNDER JOINT OWNERSHIP

SONGS and the Southwest Powerlink transmission line are owned jointly with other utilities. The company's interests at December 31, 1999, are:

(Dollars in millions) Project	SONGS	Southwest Powerlink
Percentage ownership	20	89
Utility plant in service	$57	$217
Accumulated depreciation and amortization	$25	$111
Construction work in progress	$ 7	$ 1

The company's share of operating expenses is included in the Statements of Consolidated Income. Each participant in the project must provide its own financing. The amounts specified above for SONGS include nuclear production, transmission and other facilities. Certain substation equipment at SONGS is wholly owned by the company.

SONGS DECOMMISSIONING Objectives, work scope and procedures for the future dismantling and decontamination of the SONGS units must meet the requirements of the Nuclear Regulatory Commission, the Environmental Protection Agency, the CPUC and other regulatory bodies.

The company's share of decommissioning costs for the SONGS units is estimated to be $432 million in today's dollars, based on a cost study completed in 1998. Cost studies are performed and updated periodically by outside consultants. The recovery of decommissioning costs is allowed until the time that the costs are fully recovered.

The amount accrued each year is based on the amount allowed by regulators and is currently being collected in rates. This amount is considered sufficient to cover the company's share of future decommissioning costs.

Payments to the nuclear-decommissioning trusts are expected to continue until SONGS is decommissioned, which is not expected to occur before 2013. Unit 1, although permanently shut down in 1992, was scheduled to be decommissioned concurrently with Units 2 and 3. However, the company and the other owner of Unit 1 received the required regulatory approvals to begin decommissioning Unit 1 in January 2000.

The amounts collected in rates are invested in externally managed trust funds. The securities held by the trust are considered available for sale and shown on the Consolidated Balance Sheets at market value. These values reflect unrealized gains of $164 million and $149 million at December 31, 1999, and 1998, respectively.

The Financial Accounting Standards Board is reviewing the accounting for liabilities related to closure and removal of long-lived assets, such as nuclear power plants, including the recognition, measurement and classification of such costs. The Board could require, among other things, that the company's future balance sheets include a liability for the estimated decommissioning costs, and a related increase in the carrying value of the asset.

Additional information regarding SONGS is included in Notes 13 and 14.

7 INCOME TAXES

The reconciliation of the statutory federal income tax rate to the effective income tax rate is as follows:

For the years ended December 31	**1999**	1998	1997
Statutory federal income tax rate	**35.0%**	35.0%	35.0%
Depreciation	**7.0**	7.5	6.8
State income taxes – net of federal income tax benefit	**6.6**	7.4	6.7
Tax credits	**(14.9)**	(12.9)	(5.7)
Charitable contribution of plant	**(4.4)**	–	–
Other – net	**(1.9)**	(5.1)	(1.7)
Effective income tax rate	**31.2%**	31.9%	41.1%

The components of income tax expense are as follows:

(Dollars in millions)	1999	1998	1997
CURRENT:			
Federal	**$ 72**	$278	$236
State	**21**	89	63
Total	**93**	367	299
DEFERRED:			
Federal	**79**	(165)	1
State	**15**	(58)	7
Total	**94**	(223)	8
DEFERRED INVESTMENT TAX CREDITS–NET	**(8)**	(6)	(6)
Total income tax expense	**$179**	$138	$301

Accumulated deferred income taxes at December 31 result from the following:

(Dollars in millions)	1999	1998
DEFERRED TAX LIABILITIES:		
Differences in financial and tax bases of utility plant	**$ 842**	$924
Regulatory balancing accounts	**166**	23
Regulatory assets	**69**	76
Partnership income	**37**	27
Other	**121**	71
Total deferred tax liabilities	**1,235**	1,121
DEFERRED TAX ASSETS:		
Investment tax credits	**84**	88
General business tax credit carryforward	**46**	–
Comprehensive Settlement (see Note 14)	**42**	95
Postretirement benefits	**69**	76
Other deferred liabilities	**98**	102
Restructuring costs	**51**	42
Other	**160**	177
Total deferred tax assets	**550**	580
Net deferred income tax liability	**$ 685**	$ 541

The net liability is recorded on the consolidated balance sheet as follows:

(Dollars in millions)	1999	1998
Current liability (asset)	**$ 67**	$ (93)
Non-current liability	**618**	634
Total	**$685**	$541

The general business tax credit carryforwards expire in 2019.

The company has not provided for U.S. income taxes on foreign subsidiaries' undistributed earnings ($49 million at December 31, 1999), which are expected to be reinvested indefinitely. It is not possible to predict the amount of U.S. income taxes that might be payable if these earnings are eventually repatriated.

8 EMPLOYEE BENEFIT PLANS

The information presented below describes the plans of the company and its principal subsidiaries. In connection with the PE/Enova business-combination described in Note 1, certain of these plans have been merged with similar plans or modified, and numerous participants have been transferred among plans of related entities. In connection therewith, the company recorded a $66 million special termination benefit in 1998.

PENSION AND OTHER POSTRETIREMENT BENEFITS

The company sponsors several qualified and nonqualified pension plans and other postretirement benefit plans for its employees. Effective March 1, 1999, the Pacific Enterprises Pension Plan merged with the Sempra Energy Cash Balance Plan.

The following tables provide a reconciliation of the changes in the plans' benefit obligations and the fair value of assets over the two years, and a statement of the funded status as of each year end:

(Dollars in millions)	Pension Benefits 1999	Pension Benefits 1998	Other Postretirement Benefits 1999	Other Postretirement Benefits 1998
WEIGHTED-AVERAGE ASSUMPTIONS AS OF DECEMBER 31:				
Discount rate	**7.75%**	6.75%	**7.75%**	6.75%
Expected return on plan assets	**8.00%**	8.50%	**7.85%**	8.50%
Rate of compensation increase	**5.00%**	5.00%	**5.00%**	5.00%
Cost trend of covered health-care charges	–	–	**7.75%**(1)	8.00%(1)
CHANGE IN BENEFIT OBLIGATION:				
Net benefit obligation at January 1	**$ 2,080**	$ 2,117	**$ 563**	$ 531
Service cost	**48**	55	**15**	13
Interest cost	**142**	148	**40**	36
Plan participants' contributions	–	–	**3**	1
Plan amendments	–	18	–	–
Actuarial gains	**(147)**	(44)	**(44)**	–
Special termination benefits	–	63	–	3
Gross benefits paid	**(161)**	(277)	**(22)**	(21)
Net benefit obligation at December 31	**1,962**	2,080	**555**	563
CHANGE IN PLAN ASSETS:				
Fair value of plan assets at January 1	**2,796**	2,653	**443**	363
Actual return on plan assets	**789**	407	**96**	64
Employer contributions	**3**	13	**28**	36
Plan participants' contributions	–	–	**3**	1
Gross benefits paid	**(161)**	(277)	**(22)**	(21)
Fair value of plan assets at December 31	**3,427**	2,796	**548**	443
Funded status at December 31	**1,465**	716	**(7)**	(120)
Unrecognized net actuarial gain	**(1,627)**	(926)	**(185)**	(107)
Unrecognized prior service cost	**66**	73	**(12)**	(13)
Unrecognized net transition obligation	**3**	3	–	–
Net liability at December 31	**$ (93)**	$ (134)	**$(204)**	$(240)

(1) Decreasing to ultimate trend of 6.50% in 2004.

The following table provides the components of net periodic benefit cost (income) for the plans:

For the years ended December 31, (Dollars in millions)	Pension Benefits 1999	Pension Benefits 1998	Pension Benefits 1997	Other Postretirement Benefits 1999	Other Postretirement Benefits 1998	Other Postretirement Benefits 1997
Service cost	**$ 48**	$ 55	$ 53	**$ 15**	$ 13	$ 15
Interest cost	**142**	148	144	**40**	36	35
Expected return on assets	**(206)**	(196)	(178)	**(32)**	(24)	(22)
Amortization of:						
Transition obligation	**1**	1	1	**2**	2	2
Prior service cost	**6**	6	5	**(1)**	(1)	(1)
Actuarial (gain) loss	**(31)**	(23)	(18)	**2**	–	1
Special termination benefit	–	63	13	–	3	2
Settlement credit	–	(30)	–	–	–	–
Regulatory adjustment	**17**	–	–	**24**	9	12
Total net periodic benefit cost (income)	**$ (23)**	$ 24	$ 20	**$ 50**	$ 38	$ 44

The following table provides the amounts recognized on the Sempra Energy balance sheet at December 31.

	Pension Benefits		Other Postretirement Benefits	
(Dollars in millions)	**1999**	1998	**1999**	1998
Prepaid benefit cost	**$ 13**	$ –	**$ –**	$ –
Accrued benefit cost	**(106)**	(125)	**(204)**	(240)
Additional minimum liability	**(18)**	(13)	**–**	–
Intangible asset	**6**	4	**–**	–
Accumulated other comprehensive income, pre-tax	**12**	–	**–**	–
Net liability	**$ (93)**	$(134)	**$(204)**	$(240)

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percent change in assumed health care cost trend rates would have the following effects:

(Dollars in millions)	1% Increase	1% Decrease
Effect on total of service and interest cost components of net periodic postretirement health care benefit cost	$10	$(9)
Effect on the health care component of the accumulated postretirement benefit obligation	$76	$(69)

Except for one nonqualified retirement plan, all pension plans had plan assets in excess of accumulated benefit obligations. For that one plan the projected benefit obligation and accumulated benefit obligation were $67 million and $62 million, respectively, as of December 31, 1999, and $55 million and $45 million, respectively, as of December 31, 1998.

Other postretirement benefits include medical benefits for retirees and their spouses (and Medicare Part B reimbursement for certain retirees) and retiree life insurance.

SAVINGS PLANS The company offers savings plans, administered by plan trustees, to all eligible employees. Eligibility to participate in the various employer plans ranges from one month to one year of completed service. Employees may contribute, subject to plan provisions, from one percent to 15 percent of their regular earnings.

Employer contributions, after one year of completed service, are made in shares of company stock. Employer contribution methods vary by plan, but generally the contribution is equal to 50 percent of the first 6 percent of eligible base salary contributed by employees. The employees' contributions, at the direction of the employees, are primarily invested in company stock, mutual funds or guaranteed investment contracts. Employer contributions for the Sempra and SoCalGas plans are partially funded by the employee stock ownership plan referred to below. Contributions to the savings plans were $14 million in 1999, $14 million in 1998 and $11 million in 1997. The fair value of company stock held by the savings plan was $391 million at December 31, 1999, and $566 million at December 31, 1998.

EMPLOYEE STOCK OWNERSHIP PLAN (ESOP) All contributions to the Employee Stock Ownership Plan and Trust (Trust) are made by the company; there are no contributions made by the participants.

As the company makes contributions to the ESOP, the ESOP debt service is paid and shares are released in proportion to the total expected debt service.Compensation expense is charged and equity is credited for the market value of the shares released. Income-tax deductions are allowed based on the cost of the shares. Dividends on unallocated shares are used to pay debt service and are charged against liabilities. The Trust held 2.9 million and 3.1 million shares of Sempra Energy common stock, with fair values of $51.1 million and $77.9 million, at December 31, 1999, and 1998, respectively.

9 STOCK-BASED COMPENSATION

Sempra Energy has stock-based compensation plans that align employee and shareholder objectives related to the long-term growth of the company. The company's long-term-incentive stock-compensation plan provides for aggregate awards of nonqualified stock options, incentive stock options, restricted stock, stock appreciation rights, performance awards, stock payments or dividend equivalents.

In 1995, Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," was issued. It encourages a fair-value-based method of accounting for stock-based compensation.

As permitted by SFAS No. 123, the company adopted its disclosure-only requirements and continues to account for stock-based compensation in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees."

In 1999 and 1998, 85,400 shares and 102,640 shares, respectively, of restricted company stock were awarded to officers. In 1997, Enova awarded 75,000 shares to key executives. Each award is subject to forfeiture after four years if certain corporate goals are not met. Holders of this stock have voting rights and receive dividends prior to the time the restrictions lapse if, and to the extent, dividends are paid on company stock. Compensation expense for the issuance of these restricted shares was approximately $1 million in 1999, $2 million in 1998 and $1 million in 1997.

In 1999 and 1998, Sempra Energy granted 3,372,400 stock options and 3,425,800 stock options, respectively. The option price is equal to the market price of common stock at the date of grant. The grants, which vest over a four-year period, include options with and without performance-based dividend equivalents. The stock options expire in ten years from the date of grant. All options granted prior to 1997 became immediately exercisable upon approval by PE's shareholders of the business combination with Enova. The options originally were scheduled to vest annually over a service period ranging from three to five years. Compensation expense (or reduction thereof) for the stock option grants was ($13 million), $12 million and $17 million in 1999, 1998 and 1997, respectively.

Had compensation cost for the stock-based compensation plans been determined based on the fair value at the grant dates for awards under those plans, consistent with the method of FASB Statement 123, the company's net income (earnings per share) would have been $378 million ($1.59 per share), $285 million ($1.20 per share) and $439 million ($1.85 per share) for 1999, 1998 and 1997, respectively.

The plans permit the granting of dividend equivalents, which provide grantees the opportunity to receive some or all of the cash dividends that would have been paid on the shares since the grant date, depending on the degree, if any, by which certain corporate goals are met. For grants prior to July 1, 1998, payment of the dividend equivalents is also contingent upon exercise of the options and requires that the market value of the shares purchased exceeds the option price.

The following information is presented after conversion of PE stock into company stock as described in Note 1.

Stock option activity is summarized in the following tables.

OPTIONS WITH DIVIDEND EQUIVALENTS

	Shares Under Option	Average Exercise Price	Options Exercisable at Year End
December 31, 1996	1,876,592	$17.17	282,063
Granted	1,040,103	20.37	
Exercised	(359,288)	16.53	
Cancelled	(71,190)	20.37	
December 31, 1997	2,486,217	18.51	1,513,545
Granted	2,131,803	25.23	
Exercised	(512,059)	17.12	
Cancelled	(509,301)	23.00	
December 31, 1998	3,596,660	22.06	1,387,523
Granted	1,451,100	21.00	
Exercised	(254,886)	17.32	
Cancelled	(99,677)	23.34	
December 31, 1999	4,693,197	$21.96	1,844,079

OPTIONS WITHOUT DIVIDEND EQUIVALENTS

	Shares Under Option	Average Exercise Price	Options Exercisable at Year End
December 31, 1996	1,872,081	$18.12	1,197,687
Exercised	(493,848)	14.94	
Cancelled	(14,737)	35.24	
December 31, 1997	1,363,496	19.08	1,363,496
Granted	1,293,997	26.33	
Exercised	(596,629)	15.72	
Cancelled	(240,632)	29.78	
December 31, 1998	1,820,232	23.92	523,661
Granted	1,921,300	21.00	
Exercised	(12,781)	15.20	
Cancelled	(55,746)	23.25	
December 31, 1999	3,673,005	$22.43	809,056

Additional information on options outstanding at December 31, 1999, is as follows:

OUTSTANDING OPTIONS Range of Exercise Prices	Number of Shares	Average Remaining Life	Average Exercise Price
$12.80–$16.12	502,164	4.44	$15.15
$16.79–$21.00	4,733,585	8.52	$20.45
$24.10–$31.00	3,130,453	8.06	$25.82
	8,366,202	8.10	$22.14

EXERCISABLE OPTIONS Range of Exercise Prices	Number of Shares	Average Exercise Price
$12.80–$16.12	502,164	$15.15
$16.79–$20.36	1,168,825	$18.89
$24.11–$31.00	982,146	$25.84
	2,653,135	$20.75

The fair value of each option grant (including dividend equivalents where applicable) was estimated on the date of grant using the modified Black-Scholes option-pricing model. Weighted average fair values for options granted in 1999, 1998 and 1997 were $4.24, $8.20 and $5.23, respectively.

The assumptions that were used to determine these fair values are as follows:

	1999	1998	1997
Stock price volatility	19%	16%	18%
Risk-free rate of return	5.5%	5.6%	6.4%
Annual dividend yield	0%/6.11%	0%/5.27%	0%
Expected life	6 Years	6 Years	3.8 Years

The second yield percentages apply to the options that do not include dividend equivalents.

10 FINANCIAL INSTRUMENTS

FAIR VALUE The fair values of the company's financial instruments (cash, temporary investments, funds held in trust, notes receivable, investments in limited partnerships, dividends payable, short-term and long-term debt, customer deposits, and preferred stock of subsidiaries) are not materially different from the carrying amounts, except for long-term debt and preferred stock of subsidiaries. The carrying amounts and fair values of long-term debt are $3.1 billion and $3.0 billion, respectively, at December 31, 1999, and $3.1 billion and $3.2 billion, respectively, at December 31, 1998. Included in long-term debt are SDG&E's rate-reduction bonds. The carrying amounts and fair values of the bonds are $526 million and $511 million, respectively, at December 31, 1999, and $592 million and $607 million, respectively, at December 31, 1998. The carrying amounts and fair values of subsidiaries' preferred stock are $204 million and $167 million, respectively, at December 31, 1999, and $204 million and $182 million, respectively, at December 31, 1998. The fair values of the first-mortgage and other bonds and preferred stock are estimated based on quoted market prices for them or for similar issues. The fair values of long-term notes payable are based on the present value of the future cash flows, discounted at rates available for similar notes with comparable maturities.

OFF-BALANCE-SHEET FINANCIAL INSTRUMENTS The company's policy is to use derivative financial instruments to manage its exposure to fluctuations in interest rates, foreign-currency exchange rates and energy prices. Transactions involving these financial instruments expose the company to market and credit risks which may at times be concentrated with certain counterparties, although counterparty nonperformance is not anticipated. Additional information on this topic is discussed in Note 2.

SWAP AGREEMENTS The company periodically enters into interest-rate swap and cap agreements to moderate exposure to interest-rate changes and to lower the overall cost of borrowing. These agreements generally remain off the balance sheet as they involve the exchange of fixed-rate and variable-rate interest payments without the exchange of the underlying principal amounts. The related gains or losses are reflected in the consolidated income statement as part of interest expense.

At December 31, 1999, and 1998, SDG&E had one interest-rate-swap agreement: a floating-to-fixed-rate swap associated with $45 million of variable-rate bonds maturing in 2002. SDG&E expects to hold this financial

instrument to its maturity. This swap agreement has effectively fixed the interest rate on the underlying variable-rate debt at 5.4 percent. SDG&E would be exposed to interest-rate fluctuations on the underlying debt should the counterparty to the agreement not perform. Such nonperformance is not anticipated. This agreement, if terminated, would result in an obligation of $1.3 million at December 31, 1999 ($3 million at December 31, 1998). Additional information on this topic is included in Note 5.

ENERGY DERIVATIVES Information on derivative financial instruments of SET is provided below. The company uses energy derivatives for price-risk management and trading purposes within certain limitations imposed by company policies and regulatory requirements. Energy derivatives are used to mitigate risk and better manage costs. These instruments include forward contracts, swaps, options and other contracts which have maturities ranging from 30 days to 12 months.

SoCalGas is subject to price risk on its natural gas purchases if its cost exceeds a 2 percent tolerance band above the benchmark price. This is discussed further in Note 14. SoCalGas becomes subject to price risk when positions are incurred during the buying, selling and storage of natural gas. As a result of the Gas Cost Incentive Mechanism (GCIM), SoCalGas enters into a certain amount of gas futures contracts in the open market with the intent of reducing gas costs within the GCIM tolerance band. The CPUC has approved the use of gas futures for managing risk associated with the GCIM. For the years ended December 31, 1999, 1998 and 1997, gains and losses from natural gas futures contracts are not material to the company's financial statements.

SEMPRA ENERGY TRADING SET derives a substantial portion of its revenue from market making and trading activities, as a principal, in natural gas, petroleum and electricity. It quotes bid and offer prices to other market makers as well as end users. It also earns trading profits as a dealer by structuring and executing transactions that permit its counterparties to manage their risk profiles. In addition, it takes positions in energy markets based on the expectation of future market conditions. These positions may be offset with similar positions or may be offset in the exchange-traded markets. These positions include options, forwards, futures and swaps. These financial instruments represent contracts with counterparties whereby payments are linked to or derived from energy-market indices or on terms predetermined by the contract, which may or may not be physically or financially settled by SET. For the year ended December 31, 1999, substantially all of SET's derivative transactions were held for trading and marketing purposes.

Market risk arises from the potential for changes in the value of financial instruments resulting from fluctuations in natural gas, petroleum and electricity commodity-exchange prices and basis. Market risk also is affected by changes in volatility and liquidity in markets in which these instruments are traded.

SET adjusts these derivatives to market each month with gains and losses recognized in earnings. These instruments are included in the Consolidated Balance Sheets as energy trading assets or liabilities. Certain instruments such as swaps are entered into and closed out within the same month and, therefore, do not have any balance-sheet impact. Gains and losses are included in revenue or expense, whichever is appropriate, in the Consolidated Income Statements. Sempra Energy guarantees many of SET's transactions.

SET also carries an inventory of financial instruments. As trading strategies depend on both market making and proprietary positions, given the relationships between instruments and markets, those activities are managed in concert in order to maximize trading profits.

SET's credit risk from financial instruments as of December 31, 1999, is represented by the positive fair value of financial instruments after consideration of master netting agreements and collateral. Credit risk disclosures, however, relate to the net accounting losses that would be recognized if all counterparties failed to perform their obligations. Options written do not expose SET to credit risk. Exchange-traded futures and options are not deemed to have significant credit exposure as the exchanges guarantee that every contract will be properly settled on a daily basis.

The following table approximates the counterparty credit quality and exposure of SET expressed in terms of net replacement value (in millions of dollars):

Counterparty credit quality:	Futures, forward and swap contracts	Purchased options	Total
AAA	$ 24	$ 2	$ 26
AA	44	5	49
A	262	49	311
BBB	144	13	157
Below investment grade	84	32	116
Exchanges	37	1	38
	$595	$102	$697

Financial instruments with maturities or repricing characteristics of 180 days or less, including cash and cash equivalents, are considered to be short-term and, therefore, the carrying values of these financial instruments approximate their fair values. SET's commodities owned, trading assets and trading liabilities are carried at fair value. The average fair values during 1999 and 1998, based on quarterly observation, for trading assets and trading liabilities which are considered financial instruments with off-balance-sheet risk, approximate $1,229 million and $1,033 million, respectively. The fair values are net of the amounts offset pursuant to rights of setoff based on qualifying master netting arrangements with counterparties, and do not include the effects of collateral held or pledged.

As of December 31, 1999, and 1998, SET's energy trading assets and trading liabilities approximate the following:

December 31 (Dollars in millions)	1999	1998
ENERGY TRADING ASSETS		
Unrealized gains on swaps and forwards	**$1,244**	$756
Due from commodity clearing organization and clearing brokers	**124**	75
OTC commodity options purchased	**108**	45
Due from trading counterparties	**63**	30
Total	**$1,539**	$906
ENERGY TRADING LIABILITIES		
Unrealized losses on swaps and forwards	**$1,210**	$740
Due to trading counterparties	**82**	35
OTC commodity options written	**73**	30
Total	**$1,365**	$805

Notional amounts do not necessarily represent the amounts exchanged by parties to the financial instruments and do not measure SET's exposure to credit or market risks. The notional or contractual amounts are used to summarize the volume of financial instruments, but do not reflect the extent to which positions may offset one another. Accordingly, SET is exposed to much smaller amounts potentially subject to risk. At December 31, 1999, the notional amounts of SET's financial instruments are:

(Dollars in millions)	Total
Forwards and commodity swaps	$20,044
Futures and exchange options	1,021
Options purchased	1,790
Options written	1,784
Total	$24,639

11 PREFERRED STOCK OF SUBSIDIARIES

PACIFIC ENTERPRISES December 31 (Dollars in millions except call price)	Call Price	1999	1998
Cumulative preferred without par value:			
$4.75 Dividend, 200,000 shares authorized and outstanding	$100.00	**$20**	$20
$4.50 Dividend, 300,000 shares authorized and outstanding	$100.00	**30**	30
$4.40 Dividend, 100,000 shares authorized and outstanding	$101.50	**10**	10
$4.36 Dividend, 200,000 shares authorized and outstanding	$101.00	**20**	20
$4.75 Dividend, 253 shares authorized and outstanding	$101.00	**–**	–
Total		**$80**	$80

All or part of every series is subject to redemption at PE's option at any time upon not less than 30 days' notice, at the applicable redemption price for each series, together with the accrued and accumulated dividends to the date of redemption. All series have one vote per share and cumulative preferences as to dividends. No shares of Class A preferred stock are outstanding.

SOCALGAS December 31 (Dollars in millions)	1999	1998
Not subject to mandatory redemption:		
$25 par value, authorized 1,000,000 shares		
6% Series, 28,134 and 28,664 shares outstanding at December 31, 1999 and 1998	**$ 1**	$ 1
6% Series A, 783,032 shares outstanding	**19**	19
Without par value, authorized 10,000,000 shares 7.75% Series	**–**	–
	$20	$20

None of SoCalGas' series of preferred stock is callable. All series have one vote per share and cumulative preferences as to dividends.

SDG&E December 31 (Dollars in millions except call price)	Call Price	1999	1998
Not subject to mandatory redemption			
$20 par value, authorized 1,375,000 shares:			
5% Series, 375,000 shares outstanding	$24.00	**$8**	$8
4.50% Series, 300,000 shares outstanding	$21.20	**6**	6
4.40% Series, 325,000 shares outstanding	$21.00	**7**	7
4.60% Series, 373,770 shares outstanding	$20.25	**7**	7
Without par value:			
$1.70 Series, 1,400,000 shares outstanding	$25.85	**35**	35
$1.82 Series, 640,000 shares outstanding	$26.00	**16**	16
Total not subject to mandatory redemption		**$79**	$79
Subject to mandatory redemption			
Without par value:			
$1.7625 Series, 1,000,000 shares outstanding	$25.00	**$25**	$25

All series of SDG&E's preferred stock have cumulative preferences as to dividends. The $20 par value preferred stock has two votes per share on matters being voted upon by shareholders of SDG&E and a liquidation value at par, whereas the no-par-value preferred stock is non-voting and has a liquidation value of $25 per share. SDG&E is authorized to issue 10,000,000 shares of no-par-value stock (both subject to and not subject to mandatory redemption). All series are currently callable except for the $1.70 and $1.7625 series (callable in 2003). The $1.7625 series has a sinking fund requirement to redeem 50,000 shares per year from 2003 to 2007; the remaining 750,000 shares must be redeemed in 2008.

12 SHAREHOLDERS' EQUITY AND EARNINGS PER SHARE

The company's outstanding stock options represent the only type of potential common stock at December 31, 1999, 1998 and 1997. The reconciliation between basic and diluted EPS is as follows:

	Income (in millions)	Shares (in thousands)	Earnings Per Share
1999:			
Basic	**$394**	**237,245**	**$1.66**
Effect of dilutive stock options		**308**	
Diluted	**$394**	**237,553**	**$1.66**
1998:			
Basic	$294	236,423	$1.24
Effect of dilutive stock options		701	
Diluted	$294	237,124	$1.24
1997:			
Basic	$432	236,662	$1.83
Effect of dilutive stock options		587	
Diluted	$432	237,249	$1.82

This calculation excludes options covering 3.3 million shares for 1999 and 1998, and 0.2 million shares for 1997 for which the exercise price was greater than the shares' market price.

The company is authorized to issue 750,000,000 shares of no-par-value common stock and 50,000,000 shares of Preferred Stock. Excluding shares held by the ESOP, there were 237,408,051 shares of common stock outstanding at December 31, 1999, compared to 236,956,683 shares at December 31, 1998. No shares of Preferred Stock were issued and outstanding.

13 COMMITMENTS AND CONTINGENCIES

NATURAL GAS CONTRACTS The company buys natural gas under several short-term and long-term contracts. Short-term purchases are primarily from various Southwest U.S. suppliers and are based on monthly spot-market prices. SoCalGas has contracts with pipeline companies. These contracts expire at various dates through the year 2006. In 1998, SoCalGas restructured its long-term commodity purchase contracts with suppliers of California offshore and Canadian gas. These new purchase contracts expire at the end of 2003. SDG&E has long-term capacity contracts with interstate pipelines

which expire on various dates between 2007 and 2023. These agreements provide for payments of an annual reservation charge. SoCalGas and SDG&E recover such fixed charges in rates.

SDG&E had been involved in negotiations and litigation with four Canadian suppliers concerning contract terms and prices related to long-term natural gas supply contracts. In 1999, SDG&E settled with the last of the four suppliers, terminating the contract. SDG&E continues to purchase natural gas from one of the suppliers under terms of the settlement agreement. SDG&E purchases natural gas on a spot basis to fill any additional long-term pipeline capacity. SDG&E intends to continue using the long-term pipeline capacity in other ways as well, including the transport of replacement natural gas and the release of a portion of this capacity to third parties.

In connection with the new natural gas franchise for Nova Scotia, the company plans to build and operate a natural gas system providing service to 78 percent of the 350,000 households in Nova Scotia. Construction of the system is expected to begin in mid-2000. See Note 3 for additional information.

At December 31, 1999, the future minimum payments under natural gas contracts were:

(Dollars in millions)	Storage and Transportation	Natural Gas
2000	$ 191	$425
2001	193	188
2002	195	194
2003	197	172
2004	197	–
Thereafter	511	–
Total minimum payments	$1,484	$979

Total payments under the contracts were $1.3 billion in 1999 and 1998, and $1.4 billion in 1997.

All of SDG&E's gas is delivered through SoCalGas pipelines under a short-term transportation agreement. In addition, SoCalGas provides SDG&E six billion cubic feet of natural gas storage capacity under an agreement expiring March 2001. These agreements are not included in the above table.

PURCHASED-POWER CONTRACTS SDG&E buys electric power under several long-term contracts. The contracts expire on various dates between 2000 and 2025. Under California's electric-industry restructuring law, which is described in Note 14 , the above-market cost of these contracts is recovered from virtually all of SDG&E's customers. In general, the market value of these contracts is recovered by bidding them into the California Power Exchange (PX) and receiving revenue from the PX for bids accepted.

At December 31, 1999, the estimated future minimum payments under the long-term contracts were:

(Dollars in millions)	
2000	$ 198
2001	180
2002	133
2003	133
2004	127
Thereafter	2,046
Total minimum payments	$2,817

The payments represent capacity charges and minimum energy purchases. SDG&E is required to pay additional amounts for actual purchases of energy that exceed the minimum energy commitments. Total payments under the contracts were $251 million in 1999, $293 million in 1998 and $421 million in 1997.

LEASES The company has leases (primarily operating) on real and personal property expiring at various dates from 2000 to 2037. Certain leases on office facilities contain escalation clauses requiring annual increases in rent ranging from 2 percent to 7 percent. The rentals payable under these leases are determined on both fixed and percentage bases, and most leases contain options to extend, which are exercisable by the company. The company also has nuclear fuel and real property that are financed by long-term capital leases. Property, plant and equipment includes $83 million at December 31, 1999, and $214 million at December 31, 1998, related to these leases. The associated accumulated amortization is $39 million and $127 million, respectively.

The minimum rental commitments payable in future years under all noncancellable leases are:

(Dollars in millions)	Operating Leases	Capitalized Leases
2000	$ 66	$ 29
2001	63	6
2002	65	6
2003	57	3
2004	51	2
Thereafter	335	4
Total future rental commitment	$637	50
Imputed interest (5% to 15%)		(7)
Net commitment		$ 43

Rent expense totaled $108 million in 1999, $105 million in 1998 and $137 million in 1997.

In connection with the quasi-reorganization described in Note 2, PE established reserves of $102 million to fair value operating leases related to its headquarters and other leases at December 31, 1992. The remaining amount of these reserves was $70 million at December 31, 1999. These leases are reflected in the above table.

OTHER COMMITMENTS AND CONTINGENCIES At December 31, 1999, commitments for capital expenditures, including the purchase of gas turbines, were approximately $87 million.

ENVIRONMENTAL ISSUES The company's operations are subject to federal, state and local environmental laws and regulations governing hazardous wastes, air and water quality, land use, solid waste disposal and the protection of wildlife. Significant costs are incurred to operate the facilities in compliance with these laws and regulations and these costs generally have been recovered in customer rates.

In 1994, the CPUC approved the Hazardous Waste Collaborative Memorandum account allowing utilities to recover their hazardous waste costs, including those related to Superfund sites or similar sites requiring cleanup. Recovery of 90 percent of cleanup costs and related third-party litigation costs and 70 percent of the related insurance-litigation expenses is permitted. Environmental liabilities that may arise are recorded when remedial efforts are probable and the costs can be estimated.

The company's capital expenditures to comply with environmental laws and regulations were $1.5 million in 1999, $1 million in 1998 and $5 million in 1997, and are not expected to be significant during the next five years due to the sale of SDG&E's fossil fuel power plants. The company has been associated with various sites which may require remediation under federal, state or local environmental laws. The company is unable to determine fully the extent of its responsibility for remediation of these sites until assessments are completed. Furthermore, the number of others that also may be responsible, and their ability to share in the cost of the cleanup, is not known.

As discussed in Note 14, restructuring of the California electric-utility industry has changed the way utility rates are set and costs are recovered. In 1998, the CPUC modified the Hazardous Waste Collaborative mechanism by providing that electric generation-related cleanup costs be eligible for transition-cost recovery. The effect of this decision is that SDG&E's costs of compliance with environmental regulations may not be fully recoverable.

NUCLEAR INSURANCE SDG&E and the co-owners of SONGS have purchased primary insurance of $200 million, the maximum amount available, for public-liability claims. An additional $9.5 billion of coverage is provided by secondary financial protection required by the Nuclear Regulatory Commission and provides for loss sharing among utilities owning nuclear reactors if a costly accident occurs. SDG&E could be assessed retrospective premium adjustments of up to $36 million in the event of a nuclear incident involving any of the licensed, commercial reactors in the United States, if the amount of the loss exceeds $200 million. In the event the public-liability limit stated above is insufficient, the Price-Anderson Act provides for Congress to enact further revenue-raising measures to pay claims, which could include an additional assessment on all licensed reactor operators.

Insurance coverage is provided for up to $2.8 billion of property damage and decontamination liability. Coverage is also provided for the cost of replacement power, which includes indemnity payments for up to three years, after a waiting period of 12 weeks. Coverage is provided primarily through mutual insurance companies owned by utilities with nuclear facilities. If losses at any of the nuclear facilities covered by the risk-sharing arrangements were to exceed the accumulated funds available from these insurance programs, SDG&E could be assessed retrospective premium adjustments of up to $5 million.

DEPARTMENT OF ENERGY DECOMMISSIONING The Energy Policy Act of 1992 established a fund for the decontamination and decommissioning of the Department of Energy nuclear-fuel-enrichment facilities. Utilities which have used DOE enrichment services are being assessed a total of $2.3 billion, subject to adjustment for inflation, over a 15-year period ending in 2006. Each utility's share is based on its share of enrichment services purchased from the DOE through 1992. SDG&E's annual assessment is approximately $1 million. This assessment is recovered through SONGS revenue.

The Nuclear Waste Policy Act of 1982 made the DOE responsible for the disposal of nuclear fuel and other radioactive waste. However, it is uncertain when the DOE will begin accepting nuclear fuel from SONGS. Continued delays by the DOE can lead to increased cost of disposal, which could be significant. If this occurs and the company is unable to recover the increased costs from the federal government or from its customers, the company's profitability from SONGS would be adversely affected.

LITIGATION The company is involved in various legal matters, including those arising out of the ordinary course of business. Management believes that these matters will not have a material adverse effect on the company's results of operations, financial condition or liquidity.

ELECTRIC-DISTRIBUTION SYSTEM CONVERSION Under a CPUC-mandated program and through franchise agreements with various cities, SDG&E is committed, in varying amounts, to converting overhead distribution facilities to underground. As of December 31, 1999, the aggregate unexpended amount of this commitment was approximately $105 million. Capital expenditures for underground conversions were $20 million in 1999, and $17 million in 1998 and 1997.

CONCENTRATION OF CREDIT RISK The company maintains credit policies and systems to minimize overall credit risk. These policies include, when applicable, an evaluation of potential counterparties' financial condition and an assignment of credit limits. These credit limits are established based on risk and return considerations under terms customarily available in the industry. SDG&E and SoCalGas grant credit to utility customers, substantially all of whom are located in their service territories, which together cover most of Southern California and a portion of central California.

SET monitors and controls its credit-risk exposures through various systems which evaluate its credit risk, and through credit approvals and limits. To manage the level of credit risk, SET deals with a majority of counterparties with good credit standing, enters into master netting arrangements whenever possible and, where appropriate, obtains collateral. Master netting agreements incorporate rights of setoff that provide for the net settlement of subject contracts with the same counterparty in the event of default.

14 REGULATORY MATTERS

ELECTRIC-INDUSTRY RESTRUCTURING In September 1996, California enacted a law restructuring its electric-utility industry (AB 1890). The legislation adopts the December 1995 CPUC policy decision restructuring the industry to stimulate competition and reduce rates.

Beginning on March 31, 1998, customers were given the opportunity to choose to continue to purchase their electricity from the local utility under regulated tariffs, to enter into contracts with other energy service providers (direct access) or to buy their power from the PX that serves as an independent wholesale power pool allowing all energy producers to participate competitively. The PX obtains its power from qualifying facilities, from nuclear units and, lastly, from the lowest-bidding suppliers. California's investor-owned utilities (IOUs) are obligated to sell their

power supply, including owned generation and purchased-power contracts, to the PX. The IOUs are also obligated to purchase from the PX the power that they distribute. An Independent System Operator (ISO) schedules power transactions and access to the transmission system. The local utility continues to provide distribution service regardless of which source the consumer chooses. Purchases from the PX/ISO are included in purchased-power expenses and PX/ISO power revenues have been netted therein on the Statements of Consolidated Income. Revenues from the PX/ISO reflect sales to the PX/ISO commencing April 1, 1998, at market prices of energy from SDG&E's power plants and from long-term purchased-power contracts.

Utilities are allowed a reasonable opportunity to recover their stranded costs via a competition transition charge (CTC) to customers through December 31, 2001. Stranded costs include sunk costs, as well as ongoing costs the CPUC finds reasonable and necessary to maintain generation facilities through December 31, 2001. These costs also include other items the utilities had recorded under traditional cost-of-service regulation. Certain stranded costs, such as those related to reasonable employee-related costs directly caused by restructuring, and purchased-power contracts (including those with qualifying facilities) may be recovered beyond December 31, 2001. Outside of those exceptions, any stranded costs not recovered through 2001 would not be collected from customers. Such costs, if any, would be written off as a charge against earnings. Nuclear decommissioning costs are nonbypassable until fully recovered, but are not included as part of transition costs. Additional information is provided in Note 6.

In June 1999, SDG&E completed the recovery of its stranded costs, other than the future above-market portion of qualifying facilities and other purchased-power contracts that were in effect at December 31, 1995, and SONGS costs as described below, both of which will continue to be collected in rates. Recovery of the other stranded costs was affected by, among other things, the sale of SDG&E's fossil power plants and combustion turbines during the quarter ended June 30, 1999. The South Bay Power Plant sale to the San Diego Unified Port District for $110 million was completed on April 23, 1999. Duke South Bay, a subsidiary of Duke Energy Power Services, will manage the plant for the Port District. The sale of the Encina Power Plant and 17 combustion-turbine generators to Dynegy Inc. and NRG Energy Inc. for $356 million was completed on May 21, 1999. SDG&E will operate and maintain both the South Bay and Encina facilities for the new owners until April 2001 and May 2001, respectively.

Stranded costs included the cost of SONGS as of December 31, 1995. SDG&E retains ownership of its 20-percent interest in SONGS. Subsequent SONGS costs are recoverable only from the sales of power produced from SONGS, at rates previously fixed by the CPUC through December 31, 2003, and as determined by the market thereafter. If approved by the CPUC, SDG&E is planning to auction its interest in SONGS. A major issue being addressed is how to handle the decommissioning trust to ensure that adequate funding is available at the time the plant is decommissioned.

AB 1890 required a 10-percent reduction of residential and small-commercial customers' rates, beginning in January 1998, and provided for the issuance of rate-reduction bonds by an agency of the state of California to enable the IOUs to achieve this rate reduction. In December 1997, $658 million of rate-reduction bonds were issued on behalf of SDG&E at an average interest rate of 6.26 percent. These bonds are being repaid over 10 years by SDG&E's residential and small commercial customers via a nonbypassable charge on their electric bills. In 1997, SDG&E formed a subsidiary, SDG&E Funding LLC, to facilitate the issuance of the bonds. In exchange for the bond proceeds, SDG&E sold to SDG&E Funding LLC all of its rights to certain revenue streams collected from such customers. Consequently, the transaction is structured to cause such revenue streams not to be the property of SDG&E nor to be available to satisfy any claims of SDG&E's creditors.

The sizes of the rate-reduction bond issuances were set so as to make the IOUs neutral as to the 10-percent rate reduction, and were based on a four-year period to

recover stranded costs. Because SDG&E recovered its stranded costs in only 18 months (due to the greater-than-anticipated plant-sale proceeds), the bond proceeds were greater than needed. Accordingly, SDG&E will return to its customers over $400 million that it has collected or will collect from its customers. The timing of the return will differ from the timing of the collection, but the specific timing of the repayment and the interest rate thereon are the subject of a CPUC proceeding and are expected to be resolved in early 2000. This refund will not affect SDG&E's net income, except to the extent that the interest associated with the refund (12.63 percent if not reduced as a result of the CPUC proceeding) differs from the return earned by the company on the funds to be refunded. The bonds and their repayment schedule are unaffected by this refund.

AB 1890 also includes a rate freeze for all IOU customers. Beginning in 1998, SDG&E's system-average rates were fixed at 9.43 cents per kwh. The rate freeze would have stayed in place until January 1, 2002. However, in connection with completion of its stranded cost recovery (described above), SDG&E filed with the CPUC for a mechanism to structure electric rates after the end of the rate freeze. SDG&E received approval to reduce base rates (the non-commodity portion of rates) to all electric customers effective July 1, 1999. As a result base electric rates will decrease beyond the original 10-percent rate reduction described above. The portion of the electric rate representing the commodity cost is simply passed through to customers and will fluctuate with the price of electricity from the PX. Except for the interim protection mechanism described below, customers will no longer be insulated from commodity price fluctuations.

In April 1999, SDG&E filed an all-party settlement (including energy service providers, the CPUC's Office of Ratepayer Advocates and the Utility Consumers Action Network) detailing proposed implementation plans for lifting the rate freeze. Included in the settlement is an interim customer-protection mechanism for residential and small-commercial customers that capped rates between July 1999 and September 1999, regardless of how high the PX price had moved during that period. The resulting undercollection (which amounted to less than $1 million) is being recovered through a balancing-account mechanism. A CPUC decision adopting the all-party settlement was issued in May 1999 and became effective July 1, 1999. The interim post-rate-freeze period runs until the CPUC issues its decision on the pending legal and policy issues of ending the rate freeze. This decision is expected during the second quarter of 2000. The decision will address, among other things, a proposal by SDG&E that would limit SDG&E's obligation to purchase from the PX to 80 percent of the electricity required by its utility default customers, and to establish an electric commodity performance-based regulation mechanism, which would measure the company's effectiveness in procuring electricity on behalf of its utility default commodity customers and the administration of its above-market purchased-power contracts.

In October 1997, the FERC approved key elements of the California IOUs' restructuring proposal. This included the transfer by the IOUs of the operational control of their transmission facilities to the ISO, which is under FERC jurisdiction. The FERC also approved the establishment of the California PX to operate as an independent wholesale power pool. The IOUs pay to the PX an upfront restructuring charge (in four annual installments) and an administrative-usage charge for each megawatt hour of volume transacted. SDG&E's share of the restructuring charge is approximately $10 million, which is being recovered in rates. The IOUs have guaranteed $300 million of commercial loans to the ISO and PX for their development and initial start-up. SDG&E's share of the guarantee is $30 million.

Thus far, electric-industry restructuring has been confined to generation. Transmission and distribution have remained subject to traditional cost-of-service regulation and performance-based ratemaking. However, the CPUC is exploring the possibility of opening up electric distribution to competition. During 2000, the CPUC will consider whether any changes should be made in electric distribution regulation. A CPUC staff report will be submitted on this issue to the CPUC in the second quarter of 2000. SDG&E and SoCalGas will actively participate in this effort.

On December 20, 1999, the FERC issued "Order 2000" concerning the formation of Regional Transmission Organizations (RTOs). The rule generally requires all public utilities that own, operate or control interstate transmission to file by October 15, 2000, a proposal for an RTO. Public utilities that are members of an existing, FERC-approved regional entity, which includes SDG&E, must file by January 15, 2001. The rule states that RTOs will be operational by December 15, 2001. The FERC's order permits a number of different types of RTOs, including nonprofit independent system operators, for-profit transmission companies, or other approaches. The FERC also allows flexibility so that an RTO can improve its structure, geographic scope, market support and operations to meet market needs. It notes that the FERC intends for RTOs to alleviate stress on the bulk power system caused by changes in the structure of the industry; improve efficiencies in transmission grid management through better pricing and congestion management; improve grid reliability; remove remaining opportunities for discriminatory transmission practices; improve market performance; increase coordination among state regulatory agencies; cut transaction costs; facilitate the success of state retail access programs; and facilitate reduced regulation. The order also specifies the required characteristics for each RTO, including independence from market participants, and the functional responsibilities required of each RTO. The order also provides guidance on transmission pricing reforms. The identification of RTO regions and formation of the RTOs will be subject to a collaborative process. The impact of Order 2000 on SDG&E depends on the results of this process and other implementation issues.

GAS-INDUSTRY RESTRUCTURING The natural gas industry experienced an initial phase of restructuring during the 1980s by deregulating gas sales to noncore customers. On January 21, 1998, the CPUC released a staff report initiating a project to assess the current market and regulatory framework for California's natural gas industry. The general goals of the plan are to consider reforms to the current regulatory framework emphasizing market-oriented policies benefiting California's natural gas consumers.

In August 1998, California enacted a law prohibiting the CPUC from enacting any natural gas-industry restructuring decision for core (residential and small-commercial) customers prior to January 1, 2000. During the implementation moratorium, the CPUC held hearings throughout the state and intends to give the legislature a draft ruling before adopting a final market-structure policy. SDG&E and SoCalGas have been actively participating in this effort and have argued in support of competition intended to maximize benefits to customers rather than to protect competitors.

In October 1999, the state of California enacted a law (AB 1421) which requires that gas utilities provide "bundled basic gas service" (including transmission, storage, distribution, purchasing, revenue-cycle services and after-meter services) to all core customers, unless the customer chooses to purchase gas from a nonutility provider. The law prohibits the CPUC from further unbundling of distribution-related gas services (including meter reading and billing) and after-meter services (including leak investigation, inspecting customer piping and appliances, pilot relighting and carbon monoxide investigation) for most customers. The objective is to preserve both customer safety and customer choice.

PERFORMANCE-BASED REGULATION (PBR) To promote efficient operations and improved productivity and to move away from reasonableness reviews and disallowances, the CPUC has been directing utilities to use PBR. PBR has replaced the general rate case and certain other regulatory proceedings for both SoCalGas and SDG&E. Under PBR, regulators require future income potential to be tied to achieving or exceeding specific performance and productivity measures, as well as cost reductions, rather than relying solely on expanding utility plant in a market where a utility already has a highly developed infrastructure.

The utilities' PBR mechanisms are in effect through December 31, 2002; however, the CPUC decision allows for the possibility that changes to SoCalGas' mechanism could be adopted in its 1999 Biennial Cost Allocation Proceeding decision, which is anticipated during the sec-

ond quarter of 2000. Each company's PBR mechanism is scheduled to be updated at December 31, 2002, at which time it will be updated for, among other things, changes in costs and volumes. Key elements of the mechanisms include an initial reduction in base rates, an indexing mechanism that limits future rate increases to the inflation rate less a productivity factor, a sharing mechanism with customers if earnings exceed the authorized rate of return on rate base, and rate refunds to customers if service quality deteriorates or awards if service quality exceeds set standards. Specifically, the key elements of the mechanisms include the following:

- Earnings up to 25 basis points in excess of the authorized rate of return on rate base are retained 100 percent by shareholders. Earnings that exceed the authorized rate of return on rate base by greater than 25 basis points are shared between customers and shareholders on a sliding scale that begins with 75 percent of the additional earnings being given back to customers and declining to 0 percent as earned returns approach 300 basis points above authorized amounts. There is no sharing if actual earnings fall below the authorized rate of return. In 1999, SDG&E and SoCalGas were authorized to earn 9.05 percent and 9.49 percent returns, respectively, on their rate base. For 2000, their authorized returns are 8.75 percent for SDG&E and 9.49 percent for SoCalGas.

- Base rates are indexed based on inflation less an estimated productivity factor.

- SDG&E would be authorized to earn or be penalized up to a maximum of $14.5 million annually as a result of its performance related to employee safety, electric reliability, customer satisfaction, and call-center responsiveness. The SoCalGas mechanism authorizes penalties of up to $4 million annually, or more in certain, limited situations.

- The SoCalGas mechanism allows for pricing flexibility for residential and small-commercial customers, with any shortfalls in revenue being borne by shareholders and with any increase in revenue shared between shareholders and customers.

- Annual cost of capital proceedings are replaced by an automatic adjustment mechanism if changes in certain indices exceed established tolerances. The SoCalGas mechanism is triggered if the 12-month trailing average of actual market interest rates increases or decreases by more than 150 basis points and is forecasted to continue to vary by at least 150 basis points for the next year. The SDG&E mechanism is triggered by a 6-month trailing average and a 100-basis-point change in interest rates. If this occurs, there would be an automatic adjustment of rates for the change in the cost of capital according to a formula which applies a percentage of the change to various capital components.

COMPREHENSIVE SETTLEMENT OF NATURAL GAS REGULATORY ISSUES In July 1994, the CPUC approved a comprehensive settlement for SoCalGas (Comprehensive Settlement) of a number of regulatory issues, including rate recovery of a significant portion of the restructuring costs associated with certain long-term contracts with suppliers of California-offshore and Canadian natural gas. In the past, the cost of these supplies had been substantially in excess of SoCalGas' average delivered cost for all natural gas supplies. The restructured contracts substantially reduced the ongoing delivered costs of these supplies. The Comprehensive Settlement permitted SoCalGas to recover in utility rates approximately 80 percent of the contract-restructuring costs of $391 million and accelerated amortization of related pipeline assets of approximately $140 million, together with interest, incurred prior to January 1, 1999. In addition to the supply issues, the Comprehensive Settlement addressed the following other regulatory issues:

- Noncore revenues were governed by the Comprehensive Settlement through July 31, 1999. This treatment is being replaced by the PBR mechanism as adopted in the 1999 Biennial Cost Allocation Proceeding (BCAP). The CPUC's proposed decision on the 1999 BCAP would allow balancing account treatment for 75 percent of noncore revenues.

- The Gas Cost Incentive Mechanism (GCIM) for evaluating SoCalGas' natural gas purchases substantially replaced the previous process of reasonableness reviews. In December 1998 the CPUC extended the GCIM program indefinitely.

GCIM compares SoCalGas' cost of natural gas with a benchmark level, which is the average price of 30-day firm spot supplies in the basins in which SoCalGas purchases natural gas. The mechanism permits full recovery of all costs within a tolerance band above the benchmark price and refunds all savings within a tolerance band below the benchmark price. The costs or savings outside the tolerance band are shared equally between customers and shareholders.

The CPUC approved the use of natural gas futures for managing risk associated with the GCIM. SoCalGas enters into natural gas futures contracts in the open market on a limited basis to mitigate risk and better manage natural gas costs.

In 1998 the CPUC approved GCIM-related shareholder awards to SoCalGas totalling $13 million. In June 1999, SoCalGas filed its annual GCIM application with the CPUC requesting an award of $8 million for the annual period ended March 31, 1999. A CPUC decision is expected during the first quarter of 2000.

PE and SoCalGas recorded the impact of the Comprehensive Settlement in 1993. Upon giving effect to liabilities previously recognized by the companies, the costs of the Comprehensive Settlement, including the restructuring of natural gas supply contracts, did not result in any further charges to PE's earnings.

BIENNIAL COST ALLOCATION PROCEEDING (BCAP) In the second quarter of 1997, the CPUC issued a decision on SoCalGas' 1996 BCAP filing. In this decision, the CPUC considered SoCalGas' relinquishments of interstate pipeline capacity on the El Paso and Transwestern pipelines. This resulted in a reduction in the pipeline demand charges allocated to SoCalGas' customers and surcharges allocated to firm capacity holders through pipeline rate-case settlements adopted at the FERC. However, FERC is reviewing the decision.

On November 4, 1999, the CPUC issued a decision on the 1996 BCAP, shifting $88 million of pipeline surcharges from the pipeline capacity relinquishments to noncore customers. The noncore customer rate impact of the decision is mitigated by overcollections in the regulatory accounts and will be reflected in the rates adopted in the final 1999 BCAP decision.

In October 1998, SoCalGas and SDG&E filed 1999 BCAP applications requesting that new rates become effective August 1, 1999, and remain in effect through December 31, 2002. The proposed beginning date follows the conclusion of SoCalGas' Comprehensive Settlement (discussed above), and the proposed end date aligns with the expiration of the utilities' current PBRs. On January 11, 2000, the CPUC issued a proposed decision adopting overall decreases in natural gas revenues of $208 million for SoCalGas and $38 million for SDG&E. A final CPUC decision is expected in the second quarter of 2000.

COST OF CAPITAL For 2000, SoCalGas is authorized to earn a rate of return on common equity (ROE) of 11.6 percent and a 9.49 percent return on rate base (ROR), the same as in 1999, unless interest-rate changes are large enough to trigger an automatic adjustment as discussed above under "Performance-Based Regulation." For SDG&E, electric-industry restructuring has changed the method of calculating the utility's annual cost of capital. In June 1999, the CPUC adopted a 10.6 percent ROE and an 8.75 percent ROR for SDG&E's electric-distribution and natural gas businesses. The electric-transmission cost of capital is determined under a separate FERC proceeding.

TRANSACTIONS BETWEEN UTILITIES AND AFFILIATED COMPANIES On December 16, 1997, the CPUC adopted rules, effective January 1, 1998, establishing uniform standards of conduct governing the manner in which IOUs conduct business with their energy-related affiliates. The objective of the affiliate-transaction rules is to ensure that these affiliates do not gain an unfair advantage over other competitors in the marketplace and that utility customers do not subsidize affiliate activities. The rules establish standards relating to nondiscrimination, disclosure and information exchange, and separation of activities.

The CPUC excluded utility-to-utility transactions between SDG&E and SoCalGas from the affiliate-transaction rules in its March 1998 decision approving the business combination of Enova and PE, which is described in Note 1.

⑮ SEGMENT INFORMATION

The company, primarily an energy services company, has three separately managed reportable segments comprised of SoCalGas, SDG&E and SET. The two utilities operate in essentially separate service territories under separate regulatory frameworks and rate structures set by the CPUC. SDG&E provides electric and natural gas service to San Diego and southern Orange counties. SoCalGas is a natural gas distribution utility, serving customers throughout most of Southern California and part of central California. SET is based in Stamford, Conn., and is engaged in wholesale trading and marketing of natural gas, power and petroleum in the United States and Europe. The accounting policies of the segments are the same as those described in Note 2, and segment performance is evaluated by management based on reported net income. Intersegment transactions generally are recorded the same as sales or transactions with third parties. Utility transactions are primarily based on rates set by the CPUC and FERC.

For the years ended December 31 (Dollars in millions)	1999	1998	1997
OPERATING REVENUES:			
Southern California Gas	**$2,569**	$2,427	$2,641
San Diego Gas & Electric	**2,207**	2,249	2,167
Sempra Energy Trading	**450**	110	–
Intersegment revenues	**(72)**	(59)	(55)
All other	**206**	254	316
Total	**$5,360**	$4,981	$5,069
INTEREST REVENUE:			
Southern California Gas	**$ 16**	$ 4	$ 1
San Diego Gas & Electric	**40**	31	4
Sempra Energy Trading	**3**	3	–
All other interest	**(26)**	2	29
Total interest	**33**	40	34
Sundry income (loss)	**42**	(6)	12
Total other income	**$ 75**	$ 34	$ 46
DEPRECIATION AND AMORTIZATION:			
Southern California Gas	**$ 260**	$ 254	$ 251
San Diego Gas & Electric (See Note 14)	**561**	603	324
Sempra Energy Trading	**23**	13	–
All other	**35**	59	29
Total	**$ 879**	$ 929	$ 604
INTEREST EXPENSE:			
Southern California Gas	**$ 60**	$ 80	$ 87
San Diego Gas & Electric	**120**	106	74
Sempra Energy Trading	**15**	5	–
All other	**34**	6	33
Total	**$ 229**	$ 197	$ 194
INCOME TAX EXPENSE (BENEFIT):			
Southern California Gas	**$ 182**	$ 128	$ 178
San Diego Gas & Electric	**126**	142	219
Sempra Energy Trading	**(7)**	(9)	–
All other	**(122)**	(123)	(96)
Total	**$ 179**	$ 138	$ 301
NET INCOME:			
Southern California Gas	**$ 200**	$ 158	$ 231
San Diego Gas & Electric	**193**	185	232
Sempra Energy Trading	**19**	(13)	–
All other	**(18)**	(36)	(31)
Total	**$ 394**	$ 294	$ 432

At December 31, or for the years then ended (Dollars in millions)	1999	1998	1997
ASSETS:			
Southern California Gas	**$ 3,532**	$ 3,834	$ 4,205
San Diego Gas & Electric	**4,366**	4,257	4,654
Sempra Energy Trading	**1,829**	1,225	846
All other	**1,543**	1,140	1,051
Total	**$11,270**	$10,456	$10,756
CAPITAL EXPENDITURES:			
Southern California Gas	**$ 146**	$ 128	$ 159
San Diego Gas & Electric	**245**	227	197
Sempra Energy Trading	**26**	–	–
All other	**172**	83	41
Total	**$ 589**	$ 438	$ 397
GEOGRAPHIC INFORMATION:			
Long-lived assets:			
United States	**$ 5,857**	$ 5,849	$ 5,904
Latin America	**701**	140	67
Total	**$ 6,558**	$ 5,989	$ 5,971
Operating Revenues:			
United States	**$ 5,280**	$4,974	$ 5,058
Latin America	**16**	7	11
Europe	**62**	–	–
Canada	**2**	–	–
Total	**$ 5,360**	$ 4,981	$ 5,069

16 SEMPRA ENERGY HOLDINGS

On May 5, 1999, Sempra Energy and its wholly owned subsidiary, Sempra Energy Holdings (SEH), jointly filed a shelf registration for the public offering of common stock, preferred stock and debt securities of Sempra Energy; debt securities of SEH; and certain other securities to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933. Any debt securities issued by SEH would be fully guaranteed by Sempra Energy. At December 31, 1999, no debt securities were outstanding. Summarized financial information of SEH is provided below.

December 31 (Dollars in millions)	1999	1998
Current assets	**$2,271**	$1,470
Noncurrent assets	**1,317**	544
Current liabilities	**2,124**	1,452
Noncurrent liabilities	**502**	140

For the Years ended December 31 (Dollars in millions)	1999	1998	1997
Operating revenues	**$672**	$572	$526
Other income	**63**	14	–
Operating expenses	**682**	667	585
Net income (loss)	**11**	(54)	(17)

17 SUBSEQUENT EVENT

On January 26, 2000, the company announced a tender offer to purchase up to 36 million shares, or approximately 15 percent, of outstanding common shares, and a reduction in its quarterly dividend payable on shares of its common stock to $0.25 per share ($1.00 annualized rate) from its previous level of $0.39 per share ($1.56 annualized rate) commencing with the dividend payable in the second quarter of 2000.

On February 23, 2000, the company completed the sale of $500 million of long-term notes and $200 million of mandatorily redeemable trust preferred securities to finance substantially all of the tender offer.

On February 25, 2000, the tender offer was completed, with all 36 million shares sought being tendered.

Quarterly Financial Data (unaudited)

Quarter ended (Dollars in millions except per-share amounts)	March 31	June 30	September 30	December 31
1999				
Revenues and other income	$1,191	$1,517	$1,254	$1,473
Operating expenses	971	1,380	1,006	1,276
Operating income	$ 220	$ 137	$ 248	$ 197
Net income	$ 99	$ 82	$ 108	$ 105
Average common shares outstanding (diluted)	237.4	237.5	237.8	237.6
Net income per common share (diluted)	$ .42	$ .35	$ .45	$ .44
1998				
Revenues and other income	$1,348	$1,219	$1,143	$1,305
Operating expenses	1,164	1,135	940	1,147
Operating income	$ 184	$ 84	$ 203	$ 158
Net income	$ 87	$ 31	$ 91	$ 85
Average common shares outstanding (diluted)	236.4	236.9	237.4	237.6
Net income per common share (diluted)	$ 0.37	$ 0.13	$ 0.38	$ 0.36

Quarterly Common Stock Data (unaudited)

	1999				1998			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Market price								
High	$26	$24⅞	$23 3/16	$21¾	*	*	$28	$29 5/16
Low	19⅛	18½	20	17⅛	*	*	23¾	24 9/16
Dividends declared(1)	$0.39	$0.39	$0.39	$0.39	$0.32	$0.46	$0.39	$0.39

*Not presented as the formation of Sempra Energy was not completed until June 26, 1998.

(1) Prior to the formation of Sempra Energy on June 26, 1998, dividends declared represents the sum of dividends declared by Pacific Enterprises and Enova Corporation, divided by the sum of the combining companies' shares after the conversion of PE's shares into Sempra Energy shares as described in Note 1 to the notes to Consolidated Financial Statements.

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President and Chief Operating Officer
Sempra Energy

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Corona del Mar, California

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Time Warner Cable
Stamford, Connecticut

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California State University System
Long Beach, California

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YMCA of San Diego County
San Diego, California

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Solana Beach, California

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Chief Executive Officer
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Los Angeles, California

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Executive Education Programs,
Sanford and Betty Sigoloff
Professor of Management
Anderson Graduate School
of Management
University of California, Los Angeles
Los Angeles, California

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Sempra Energy

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Chief Executive Officer

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Vice Chairman, President and
Chief Operating Officer

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Group President,
Unregulated Business Units

WARREN I. MITCHELL
Group President,
Regulated Business Units

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Executive Vice President and
General Counsel

NEAL E. SCHMALE
Executive Vice President and
Chief Financial Officer

DARCEL L. HULSE
Senior Vice President

FREDERICK E. JOHN
Senior Vice President,
External Affairs

MARGOT A. KYD
Senior Vice President,
Chief Administrative and
Environmental Officer

G. JOYCE ROWLAND
Senior Vice President,
Human Resources and
Chief Ethics Officer

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Corporate Planning and
Development

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JERRY W. DEEMS
Vice President and
Chief Information Technology
Officer

CHARLES A. McMONAGLE
Vice President and
Treasurer

MARK D. RANDLE
Vice President,
Energy Risk Management

WILLIAM L. REED
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Chief Regulatory Officer

THOMAS S. SAYLES
Vice President,
Governmental and
Community Affairs

THOMAS C. SANGER
Corporate Secretary

Southern California Gas Company

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President,
Energy Distribution Services

LEE M. STEWART
President,
Energy Transportation
Services

RICHARD M. MORROW
Vice President,
Customer Services and
Marketing
Energy Transportation
Services

ROY M. RAWLINGS
Vice President,
Distribution Operations,
Energy Distribution Services

ANNE S. SMITH
Vice President,
Customer Services
and Marketing
Energy Distribution Services

San Diego Gas & Electric

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President

GARY D. COTTON
Senior Vice President,
Fuels and Power

STEVEN D. DAVIS
Vice President,
Distribution Operations

PAMELA J. FAIR
Vice President, Marketing
and Customer Services

Sempra Energy Trading

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Chairman and
Chief Executive Officer

DAVID A. MESSER
President

RALPH TODARO
Chief Financial Officer

Sempra Energy International

DARCEL L. HULSE
President

DENNIS V. ARRIOLA
Regional President and
General Manager,
South American Operations

GEORGE S. LIPARIDIS
Regional President and
General Manager,
North American Operations

Sempra Energy Solutions

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President,
Sempra Energy Information
Solutions

B.N. TRIPATHI
President,
Sempra Energy Services

WALTER G. HOMAN
Senior Vice President,
Sempra Energy Sales

Sempra Energy Resources

DARCEL L. HULSE
President

Sempra Energy Financial

NANCY N. ROSS
Vice President, Investments

Energy America

DAVID A. MESSER
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Soliance

DALE R. KELLY-COCHRANE
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MICHAEL W. ALLMAN
President

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Shareholder Services

Investors with general questions regarding Sempra Energy, San Diego Gas & Electric, Southern California Gas Co. or Pacific Enterprises stock should contact the company at:
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E-mail: investor@sempra.com
Internet: http://www.sempra.com

NEWS AND INFORMATION To hear corporate news reports and stock updates or to request materials, call 877-773-6397. Sempra Energy's annual report to the Securities and Exchange Commission (Form 10-K) is available to shareholders at no charge by writing to Shareholder Services.

INVESTOR RELATIONS Security analysts, portfolio managers and other members of the financial community should contact:
Clem Teng
Director of Investor Relations
Telephone: 619-696-2901
Fax: 619-696-2374

Stock Exchange Listing

Sempra Energy Common Stock:
Ticker Symbol: SRE
New York Stock Exchange
Pacific Stock Exchange
Pacific Enterprises Preferred Stock:
American Stock Exchange
Pacific Stock Exchange
Southern California Gas Preferred Stock:
Pacific Stock Exchange
San Diego Gas & Electric Preferred Stock:
American Stock Exchange

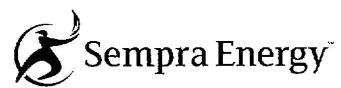
Direct Common Stock Investment Plan

The company offers a Direct Common Stock Investment Plan as a simple, convenient and affordable way to invest in Sempra Energy. Cash dividends from a participant's account can be automatically reinvested in full or in part to purchase additional shares, or participants may choose to receive all or a portion of their cash dividends electronically or by check. Participation in the Plan requires an initial investment of as little as $500. The Plan allows optional cash investments of as little as $25 up to a maximum of $150,000 per calendar year. Nonshareholders pay a $15 fee for the initial cash investment in Sempra Energy. Brokerage commissions incurred in the purchase of shares will be paid by Sempra Energy.

The Plan is offered only by the means of a prospectus, which can be obtained by calling the Plan Administrator, First Chicago Trust Company of New York, at 877-773-6772, or through the Internet at http://www.netstockdirect.com.

Credit Ratings

(As of January 26, 2000)	S&P	Moody's	Duff & Phelps
SEMPRA ENERGY			
Unsecured Debt	A	A2	A
Commercial Paper	A-1	P-1	D-1
SOCALGAS			
Secured Debt	AA–	A1	AA
Unsecured Debt	A+	A2	AA–
Preferred Stock	AA–	a2	A+
Commercial Paper	A1+	P1	D1+
PACIFIC ENTERPRISES			
Preferred Stock	A+	–	A+
SDG&E			
Secured Debt	AA–	Aa3	AA
Unsecured Debt	A+	A1	AA–
Preferred Stock	A+	a1	A+
Commercial Paper	A1+	P1	D1+



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