Sempra Energy
Solutions℠

Sempra Energy Annual Financial Report
and
Supplemental Consolidating Information
(Sempra Energy Solutions and Its Other Subsidiaries)

December 31, 2005

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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, 2005 and 2004, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2005. 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. 64

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the financial statements, the Company adopted Financial Accounting Standards Board Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143*, effective December 31, 2005, Financial Accounting Standards Board Interpretation No. 46, *Consolidation of Variable Interest Entities -- an Interpretation of ARB No. 51*, effective December 31, 2003, and the rescission of EITF Issue No. 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, effective January 1, 2003.

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplemental consolidating information for 2005 on pages 71 through 73 is presented for the purpose of additional analysis of the basic consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, an is not a required part of the basic consolidated financial statements. This supplemental consolidating information is the responsibility of the Company's management. Such information has been subjected to the auditing procedures applied in our audit of the basic 2005 consolidated financial statements and, in our opinion, is fairly presented in all material respects when considered in relation to the basic 2005 consolidated financial statements taken as a whole.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control -- Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway

Commission and our report dated February 21, 2006 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Deloitte & Touche LLP

February 21, 2006
San Diego, California

SEMPRA ENERGY
STATEMENTS OF CONSOLIDATED INCOME

(Dollars in millions, except per share amounts)	Years ended December 31, 2005	2004	2003
OPERATING REVENUES			
California utilities	$ 7,042	$ 6,195	$ 5,791
Sempra Global and parent	4,695	3,239	2,100
Total operating revenues	11,737	9,434	7,891
OPERATING EXPENSES			
California utilities:			
Cost of natural gas	3,232	2,593	2,071
Cost of electric fuel and purchased power	624	576	541
Other cost of sales	2,715	1,741	1,204
Litigation expense	551	150	72
Other operating expenses	2,634	2,243	2,108
Depreciation and amortization	646	621	615
Franchise fees and other taxes	251	236	230
Gains on sale of assets, net	(112)	(15)	(15)
Impairment losses	85	8	122
Total operating expenses	10,626	8,153	6,948
Operating income	1,111	1,281	943
Other income, net (Note 1)	51	33	(40)
Interest income	75	69	104
Interest expense	(311)	(322)	(308)
Preferred dividends of subsidiaries	(10)	(10)	(10)
Trust preferred distributions of subsidiary	—	—	(9)
Income from continuing operations before income taxes and equity in earnings of certain unconsolidated subsidiaries	916	1,051	680
Income tax expense	42	193	47
Equity in income of certain unconsolidated subsidiaries (Note 3)	55	62	62
Income from continuing operations	929	920	695
Discontinued operations, net of tax (Note 4)	(9)	(25)	—
Income before cumulative effect of changes in accounting principles	920	895	695
Cumulative effect of changes in accounting principles, net of tax (Note 1)	—	—	(46)
Net income	$ 920	$ 895	$ 649
Basic earnings per share:			
Income from continuing operations	$ 3.78	$ 4.03	$ 3.29
Discontinued operations, net of tax	(0.04)	(0.11)	—
Cumulative effect of changes in accounting principles, net of tax	—	—	(0.22)
Net income	$ 3.74	$ 3.92	$ 3.07
Weighted-average number of shares outstanding (thousands)	245,906	228,271	211,740
Diluted earnings per share:			
Income from continuing operations	$ 3.69	$ 3.93	$ 3.24
Discontinued operations, net of tax	(0.04)	(0.10)	—
Cumulative effect of changes in accounting principles, net of tax	—	—	(0.21)
Net income	$ 3.65	$ 3.83	$ 3.03
Weighted-average number of shares outstanding (thousands)	252,088	233,852	214,482
Dividends declared per share of common stock	$ 1.16	$ 1.00	$ 1.00

See notes to Consolidated Financial Statements.

SEMPRA ENERGY
CONSOLIDATED BALANCE SHEETS

(Dollars in millions)	December 31, 2005	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 772	$ 419
Short-term investments	12	15
Trade accounts receivable, net	998	950
Other accounts and notes receivable, net	194	82
Due from unconsolidated affiliates	3	4
Deferred income taxes	132	15
Interest receivable	29	80
Trading-related receivables and deposits, net	3,370	2,606
Derivative trading instruments	4,502	2,339
Commodities owned	2,498	1,547
Regulatory assets	255	255
Inventories	212	172
Other	291	222
Current assets of continuing operations	13,268	8,706
Current assets of discontinued operations	50	70
Total current assets	13,318	8,776
Investments and other assets:		
Due from unconsolidated affiliates	21	42
Regulatory assets arising from fixed-price contracts and other derivatives	398	500
Other regulatory assets	713	751
Nuclear decommissioning trusts	638	612
Investments	1,104	1,164
Sundry	920	844
Total investments and other assets	3,794	3,913
Property, plant and equipment:		
Property, plant and equipment	17,564	16,203
Less accumulated depreciation and amortization	(5,463)	(5,117)
Property, plant and equipment, net	12,101	11,086
Total assets	$29,213	$23,775

See notes to Consolidated Financial Statements.

SEMPRA ENERGY
CONSOLIDATED BALANCE SHEETS

(Dollars in millions)	December 31, 2005	December 31, 2004
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Short-term debt	$ 1,062	$ 405
Accounts payable — trade	1,272	1,020
Accounts payable — other	140	106
Income taxes payable	68	187
Trading-related payables	4,127	3,182
Derivative trading instruments	3,246	1,484
Commodities sold with agreement to repurchase	634	513
Dividends and interest payable	140	123
Regulatory balancing accounts, net	192	509
Fixed-price contracts and other derivatives	130	157
Current portion of long-term debt	101	398
Due to unconsolidated affiliates	—	205
Other	1,035	776
Current liabilities of continuing operations	12,147	9,065
Current liabilities of discontinued operations	10	17
Total current liabilities	12,157	9,082
Long-term debt	4,823	4,192
Deferred credits and other liabilities:		
Due to unconsolidated affiliate	162	162
Customer advances for construction	110	97
Postretirement benefits other than pensions	121	129
Deferred income taxes	245	420
Deferred investment tax credits	73	78
Regulatory liabilities arising from removal obligations	2,313	2,692
Asset retirement obligations	958	326
Other regulatory liabilities	200	199
Fixed-price contracts and other derivatives	400	500
Deferred credits and other	1,312	854
Total deferred credits and other liabilities	5,894	5,457
Preferred stock of subsidiaries	179	179
Commitments and contingencies (Note 15)		
SHAREHOLDERS' EQUITY		
Preferred stock (50 million shares authorized; none issued)	—	—
Common stock (750 million shares authorized; 257 million and 234 million shares outstanding at December 31, 2005 and 2004, respectively)	2,958	2,301
Retained earnings	3,588	2,961
Deferred compensation relating to ESOP	(28)	(32)
Accumulated other comprehensive income (loss)	(358)	(365)
Total shareholders' equity	6,160	4,865
Total liabilities and shareholders' equity	$29,213	$23,775

See notes to Consolidated Financial Statements.

SEMPRA ENERGY
STATEMENTS OF CONSOLIDATED CASH FLOWS

(Dollars in millions)	Years ended December 31, 2005	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	**$ 920**	$ 895	$ 649
Adjustments to reconcile net income to net cash provided by operating activities			
Loss from discontinued operations, net of tax	**9**	25	—
Depreciation and amortization	**646**	621	615
Gains on sale of assets, net	**(112)**	(15)	(15)
Impairment losses	**85**	8	122
Deferred income taxes and investment tax credits	**(283)**	13	(118)
Non-cash rate reduction bond expense	**68**	75	68
Equity in income of unconsolidated affiliates	**(66)**	(36)	(5)
Cumulative effect of changes in accounting principles, net of tax	**—**	—	46
Other	**(50)**	(6)	27
Net changes in other working capital components	**(1,169)**	(395)	(158)
Changes in other assets	**27**	(127)	(18)
Changes in other liabilities	**451**	(27)	(28)
Net cash provided by continuing operations	**526**	1,031	1,185
Net cash used in discontinued operations	**(5)**	(30)	—
Net cash provided by operating activities	**521**	1,001	1,185
CASH FLOWS FROM INVESTING ACTIVITIES			
Expenditures for property, plant and equipment	**(1,404)**	(1,083)	(1,049)
Proceeds from sale of assets	**277**	377	29
Proceeds from disposal of discontinued operations	**5**	157	—
Investments in and acquisitions of subsidiaries, net of cash acquired	**(86)**	(74)	(202)
Purchases of nuclear decommissioning and other trust assets	**(299)**	(319)	(330)
Proceeds from sales by nuclear decommissioning and other trusts	**262**	262	283
Dividends received from unconsolidated affiliates	**72**	59	72
Increase in loans to affiliates, net	**—**	—	(99)
Other	**(12)**	10	4
Net cash used in investing activities	**(1,185)**	(611)	(1,292)
CASH FLOWS FROM FINANCING ACTIVITIES			
Common dividends paid	**(268)**	(195)	(182)
Issuances of common stock	**694**	110	505
Repurchases of common stock	**(95)**	(5)	(7)
Issuances of long-term debt	**762**	997	900
Payments on long-term debt	**(532)**	(1,670)	(601)
Redemption of mandatorily redeemable preferred securities	**(200)**	—	—
Increase (decrease) in short-term debt, net	**662**	397	(518)
Other	**(6)**	(14)	(8)
Net cash provided by (used in) financing activities	**1,017**	(380)	89
Increase (decrease) in cash and cash equivalents	**353**	10	(18)
Cash and cash equivalents, January 1	**419**	409	427
Cash and cash equivalents, December 31	**$ 772**	$ 419	$ 409

See notes to Consolidated Financial Statements.

SEMPRA ENERGY
STATEMENTS OF CONSOLIDATED CASH FLOWS

(Dollars in millions)	Years ended December 31, 2005	2004	2003
CHANGES IN OTHER WORKING CAPITAL COMPONENTS			
(Excluding cash and cash equivalents, and debt due within one year)			
Accounts and notes receivable	$ (92)	$(303)	$(191)
Net trading assets	(1,062)	(454)	59
Income taxes, net	(86)	(64)	72
Inventories	(40)	(26)	(12)
Regulatory balancing accounts	(321)	79	(155)
Regulatory assets and liabilities	(4)	(23)	(30)
Other current assets	(38)	(31)	(9)
Accounts payable	283	300	75
Other current liabilities	191	127	33
Net changes in other working capital components	$(1,169)	$(395)	$(158)
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Interest payments, net of amounts capitalized	$ 295	$ 318	$ 296
Income tax payments, net of refunds	$ 429	$ 254	$ 118

See notes to Consolidated Financial Statements.

SEMPRA ENERGY
STATEMENTS OF CONSOLIDATED CHANGES IN SHAREHOLDERS' EQUITY
Years ended December 31, 2005, 2004 and 2003

(Dollars in millions)	Comprehensive Income	Common Stock	Retained Earnings	Deferred Compensation Relating to ESOP	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2002		$1,436	$1,861	$(33)	$(439)	$2,825
Net income	$649		649			649
Comprehensive income adjustments:						
Foreign currency translation gains (Note 1)	57				57	57
Pension	(16)				(16)	(16)
SFAS 133	(3)				(3)	(3)
Comprehensive income	$687					
Common stock dividends declared			(212)			(212)
Equity units adjustment		6				6
Quasi-reorganization adjustment (Note 1)		19				19
Issuance of common stock		553				553
Tax benefit related to employee stock options		13				13
Repurchase of common stock		(6)				(6)
Common stock released from ESOP		7		(2)		5
Balance at December 31, 2003		2,028	2,298	(35)	(401)	3,890
Net income	$895		895			895
Comprehensive income adjustments:						
Foreign currency translation gains (Note 1)	40				40	40
Pension	28				28	28
Available-for-sale securities	4				4	4
SFAS 133	(36)				(36)	(36)
Comprehensive income	$931					
Common stock dividends declared			(232)			(232)
Quasi-reorganization adjustment (Note 1)		86				86
Issuance of common stock		172				172
Tax benefit related to employee stock options		16				16
Repurchase of common stock		(5)				(5)
Common stock released from ESOP		4		3		7
Balance at December 31, 2004		2,301	2,961	(32)	(365)	4,865
Net income	$920		920			920
Comprehensive income adjustments:						
Foreign currency translation gains (Note 1)	30				30	30
Available-for-sale securities	(4)				(4)	(4)
SFAS 133	(19)				(19)	(19)
Comprehensive income	$927					
Common stock dividends declared			(293)			(293)
Issuance of common stock		720				720
Tax benefit related to employee stock options		26				26
Repurchase of common stock		(95)				(95)
Common stock released from ESOP		6		4		10
Balance at December 31, 2005		$2,958	$3,588	$(28)	$(358)	$6,160

See notes to Consolidated Financial Statements.

SEMPRA ENERGY
STATEMENTS OF CONSOLIDATED CHANGES IN SHAREHOLDERS' EQUITY
Years ended December 31, 2005, 2004 and 2003

(Dollars in millions)	Comprehensive Income	Common Stock	Retained Earnings	Deferred Compensation Relating to ESOP	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2002		$1,436	$1,861	$(33)	$(439)	$2,825
Net income	$649		649			649
Comprehensive income adjustments:						
Foreign currency translation gains (Note 1)	57				57	57
Pension	(16)				(16)	(16)
SFAS 133	(3)				(3)	(3)
Comprehensive income	$687					
Common stock dividends declared			(212)			(212)
Equity units adjustment		6				6
Quasi-reorganization adjustment (Note 1)		19				19
Issuance of common stock		553				553
Tax benefit related to employee stock options		13				13
Repurchase of common stock		(6)				(6)
Common stock released from ESOP		7		(2)		5
Balance at December 31, 2003		2,028	2,298	(35)	(401)	3,890
Net income	$895		895			895
Comprehensive income adjustments:						
Foreign currency translation gains (Note 1)	40				40	40
Pension	28				28	28
Available-for-sale securities	4				4	4
SFAS 133	(36)				(36)	(36)
Comprehensive income	$931					
Common stock dividends declared			(232)			(232)
Quasi-reorganization adjustment (Note 1)		86				86
Issuance of common stock		172				172
Tax benefit related to employee stock options		16				16
Repurchase of common stock		(5)				(5)
Common stock released from ESOP		4		3		7
Balance at December 31, 2004		2,301	2,961	(32)	(365)	4,865
Net income	$920		920			920
Comprehensive income adjustments:						
Foreign currency translation gains (Note 1)	30				30	30
Available-for-sale securities	(4)				(4)	(4)
SFAS 133	(19)				(19)	(19)
Comprehensive income	$927					
Common stock dividends declared			(293)			(293)
Issuance of common stock		720				720
Tax benefit related to employee stock options		26				26
Repurchase of common stock		(95)				(95)
Common stock released from ESOP		6		4		10
Balance at December 31, 2005		$2,958	$3,588	$(28)	$(358)	$6,160

See notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES AND OTHER FINANCIAL DATA

Principles of Consolidation

The Consolidated Financial Statements include the accounts of Sempra Energy (the company); its majority-owned subsidiaries and in 2004 the variable-interest entities of which the company was the primary beneficiary. Investments in affiliated companies over which Sempra Energy has the ability to exercise significant influence, but not control, are accounted for using the equity method. Further discussion of investments in unconsolidated subsidiaries is provided in Note 3. All material intercompany accounts and transactions have been eliminated.

In connection with charges related to litigation, the significant instances of which are discussed in Note 15, Sempra Energy management determines the allocation of the charges among its business units based on the extent of their involvement with the subject of the litigation.

Quasi-Reorganization

In 1993, Pacific Enterprises (PE) effected a quasi-reorganization for financial reporting purposes as of December 31, 1992. Certain of the liabilities established in connection with the quasi-reorganization were favorably resolved in 2003 and 2004, resulting in adjustments to common equity in these years. The remaining liabilities will be resolved in future years and management believes the provisions established for these matters are adequate.

Use of Estimates in the Preparation of the Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of revenues and expenses during the reporting period, and the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. Although management believes the estimates and assumptions are reasonable, actual amounts can differ significantly from those estimates.

Basis of Presentation

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

Regulatory Matters

Effects of Regulation

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

The California Utilities prepare their financial statements in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) 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. To the extent that recovery is no longer probable as a result of changes in regulation or the utility's competitive position, the related regulatory assets would be written off. In addition, SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, requires that a loss be recognized whenever a regulator excludes all or part of utility plant or regulatory assets from ratebase. Regulatory liabilities represent reductions in future rates for amounts due to customers. Information concerning regulatory assets and liabilities is provided below in "Revenues," "Regulatory Balancing Accounts" and "Regulatory Assets and Liabilities."

Regulatory Balancing Accounts

The amounts included in regulatory balancing accounts at December 31, 2005, represent net payables (payables net of receivables) of $13 million and $179 million for SoCalGas and SDG&E, respectively. The corresponding amounts at December 31, 2004 were net payables of $178 million and $331 million, respectively.

Except for certain costs subject to balancing account treatment, fluctuations in most operating and maintenance accounts affect utility earnings. Balancing accounts provide a mechanism for charging utility customers the amount actually incurred for certain costs, primarily commodity costs. The CPUC has also approved balancing account treatment for variances between forecast and actual for SoCalGas' and SDG&E's volumes and commodity costs, eliminating the impact on earnings from any throughput and revenue variances from adopted forecast levels. Additional information on regulatory matters is included in Notes 13 and 14.

Regulatory Assets and Liabilities

In accordance with the accounting principles of SFAS 71, the company records regulatory assets and regulatory liabilities as discussed above.

Regulatory assets (liabilities) as of December 31 relate to the following matters:

(Dollars in millions)	2005	2004
SDG&E		
Fixed-price contracts and other derivatives	$ 473	$ 500
Recapture of temporary rate reduction*	116	183
Deferred taxes recoverable in rates	294	278
Unamortized loss on retirement of debt, net	42	46
Employee benefit costs	174	160
Removal obligations**	(1,216)	(1,246)
Other	36	29
Total	(81)	(50)
SoCalGas		
Fixed-price contracts and other derivatives	49	148
Environmental remediation	39	42
Unamortized loss on retirement of debt, net	40	44
Removal obligations**	(1,097)	(1,446)
Deferred taxes refundable in rates	(200)	(199)
Employee benefit costs	97	65
Other	3	7
Total	(1,069)	(1,339)
Total	$(1,150)	$(1,389)

* In connection with electric industry restructuring, which is described in Note 13, SDG&E temporarily reduced rates to its small-usage customers. That reduction is being recovered in rates through 2007.

** This is related to SFAS 143, *Accounting for Asset Retirement Obligations,* which is discussed below in "New Accounting Standards."

Net regulatory assets (liabilities) are recorded on the Consolidated Balance Sheets at December 31 as follows:

(Dollars in millions)	2005	2004
Current regulatory assets	$ 255	$ 255
Noncurrent regulatory assets	1,111	1,251
Current regulatory liabilities*	(3)	(4)
Noncurrent regulatory liabilities	(2,513)	(2,891)
Total	$(1,150)	$(1,389)

* Included in Other Current Liabilities.

All of these assets either earn a return, generally at short-term rates, or the cash has not yet been expended and the assets are offset by liabilities that do not incur a carrying cost.

Cash and Cash Equivalents

Cash equivalents are highly liquid investments with maturities of three months or less at the date of purchase.

Non-cash Investing and Financing Activities

Property, Plant and Equipment increased by $45 million in 2005 as a result of changes in unpaid construction costs. (Comparable changes in 2004 and 2003 were not material.) Also in 2005, the company acquired subsidiary assets of $126 million and assumed related liabilities of $55 million, for a net cash payment of $71 million. In 2003 the company consolidated variable interest entities (as discussed further under "New Accounting Standards" below) with assets of $820 million and liabilities of $881 million.

Restricted cash

Restricted cash was $12 million and $15 million at December 31, 2005 and 2004, respectively. The amounts are included in current assets under the caption Short-term Investments and primarily serve as cash collateral for certain debt agreements.

Collection Allowances

The allowance for doubtful accounts was $12 million, $8 million and $19 million at December 31, 2005, 2004 and 2003, respectively. The company recorded provisions for doubtful accounts of $13 million, $12 million and $5 million in 2005, 2004 and 2003, respectively.

The allowance for realization of trading assets was $64 million, $56 million and $67 million at December 31, 2005, 2004 and 2003, respectively. The company recorded provisions (reduction thereof) for trading assets of $30 million, $3 million and $(4) million in 2005, 2004 and 2003, respectively.

Trading Instruments

Trading assets and trading liabilities (described further in Note 10) include option premiums paid and received, unrealized gains and losses from exchange-traded futures and options, over-the-counter (OTC) swaps, forwards, physical commodities and options. Trading instruments are recorded by Sempra Commodities on a trade-date basis and the majority of such derivative instruments are adjusted daily to current market value. Unrealized gains and losses on OTC transactions reflect amounts which would be received from or paid to a third party upon net 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 an enforceable netting arrangement.

Futures and exchange-traded option transactions are recorded as contractual commitments on a trade-date basis and carried at current market value based on current closing exchange quotations. Derivative commodity swaps and forward transactions are accounted for as contractual commitments on a trade-date basis and carried at fair value derived from current 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. For long-dated forward transactions, current market values are derived using internally developed valuation methodologies based on available market information. When there is an absence of observable market data at inception, the value of the transaction is its cost. 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 significantly from realized values. Changes in market values are reflected in net income. Although trading instruments may have scheduled maturities in excess of one year, the actual settlement of these transactions can occur sooner, resulting in the current classification of trading assets and liabilities on the Consolidated Balance Sheets.

Energy transportation and storage contracts are recorded at cost, and energy commodity inventory is recorded at the lower of cost or market. However, metals inventories continue to be recorded at fair value in accordance with Accounting Research Bulletin (ARB) No. 43, *Restatement and Revision of Accounting Research Bulletins*.

Inventories

At December 31, 2005, inventory shown on the Consolidated Balance Sheets, which does not include Commodities Owned (which is shown as a separate caption on the balance sheets), included natural gas of $140 million, and materials and supplies of $72 million. The corresponding balances at December 31, 2004 were $115 million and $57 million, respectively. Natural gas at the California Utilities ($140 million and $111 million at December 31, 2005 and 2004, respectively) is valued by the last-in first-out (LIFO) method. When the California Utilities' inventory is consumed, differences between the LIFO valuation and replacement cost are reflected in customer rates. Materials and supplies at the California Utilities are generally valued at the lower of average cost or market.

Income Taxes

Income tax expense includes current and deferred income taxes from operations during the year. In accordance with SFAS 109, *Accounting for Income Taxes*, the company records deferred income taxes for temporary differences between the book and tax bases of assets and liabilities. Investment tax credits from prior years are being amortized to income by the California Utilities over the estimated service lives of the properties. Other credits, mainly low-income housing and synthetic-fuel tax credits, are recognized in income as earned. The company follows certain provisions of SFAS 109 that permit regulated enterprises to recognize regulatory assets or liabilities to offset deferred tax liabilities and assets, respectively, if it is probable that such amounts will be recovered from, or returned to, customers. The company follows Accounting Principles Board Opinion (APBO) 23, *Accounting for Income Taxes — Special Areas*, in recording deferred taxes for investments in foreign subsidiaries and the undistributed earnings of foreign subsidiaries.

Property, Plant and Equipment

Property, Plant and Equipment primarily represents the buildings, equipment and other facilities used by the California Utilities to provide natural gas and electric utility services, and by Sempra Generation.

The cost of plant includes labor, materials, contract services, and certain expenditures incurred during a major maintenance outage of a generating plant. Maintenance costs are expensed as incurred. In addition, the cost of utility plant includes an allowance for funds used during construction (AFUDC). The cost of non-utility plant includes capitalized interest. The cost of most retired depreciable utility plant minus salvage value is charged to accumulated depreciation.

Property, plant and equipment balances by major functional categories are as follows:

(Dollars in billions)	Property, Plant and Equipment at December 31, 2005	2004	Depreciation rates for years ended December 31, 2005	2004	2003
California Utilities:					
Natural gas operations	**$ 8.6**	$ 8.1	**3.66%**	3.65%	4.27%
Electric distribution	**3.5**	3.4	**4.13%**	4.11%	4.70%
Electric transmission	**1.1**	1.0	**3.05%**	3.06%	3.09%
Other electric	**0.6**	0.6	**9.75%**	11.33%	9.53%
Construction work in progress	**0.8**	0.5	**NA**	NA	NA
Total	**14.6**	13.6			
Sempra Global and Parent:					
Land and land rights	**0.1**	0.1			
Buildings and leasehold improvements	**0.1**	0.2			
Machinery and equipment					
Generating plant	**1.4**	1.2			
Pipelines	**0.3**	0.3			
Other	**0.5**	0.4			
Construction work in progress	**0.5**	0.3			
Other	**0.1**	0.1			
	3.0	2.6	**various**	various	various
Total	**$17.6**	$16.2			

Accumulated depreciation and decommissioning of natural gas and electric utility plant in service were $3.4 billion and $1.6 billion, respectively, at December 31, 2005, and were $3.3 billion and $1.4 billion, respectively, at December 31, 2004. Depreciation expense is based on the straight-line method over the useful lives of the assets or, for the California Utilities, a shorter period prescribed by the CPUC. Accumulated depreciation for power plants at Sempra Generation was $111 million and $47 million at December 31, 2005 and 2004, respectively. Depreciation expense is computed using the straight-line method over the asset's estimated original composite useful life or the remaining term of the site leases, whichever is lower.

AFUDC, which represents the cost of debt and equity funds used to finance the construction of utility plant, is added to the cost of utility plant. Although it is not a current source of cash, AFUDC increases income and is recorded partly as an offset to interest charges and partly as a component of Other Income, Net in the Statements of Consolidated Income. AFUDC amounted to $19 million, $18 million and $29 million for 2005, 2004 and 2003, respectively. Total capitalized carrying costs, including AFUDC and the impact of Sempra Generation's construction projects, were $48 million, $27 million and $55 million for 2005, 2004 and 2003, respectively.

Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of the net assets of acquired companies. Goodwill is not amortized, but is tested annually for impairment in accordance with SFAS 142, *Goodwill and Other Intangible Assets*.

There were no changes in the carrying amount of goodwill (included in Noncurrent Sundry Assets on the Consolidated Balance Sheets) since January 1, 2004. As of December 31, 2005, goodwill is recorded as follows:

(Dollars in millions)	
Sempra Commodities	$164
Sempra Generation	18
Other	6
	$188

In addition, the unamortized goodwill related to unconsolidated subsidiaries (included in Investments on the Consolidated Balance Sheets), primarily those located in South America, was $291 million and $296 million at December 31, 2005 and 2004, respectively, before foreign-currency translation adjustments. Including foreign-currency translation adjustments, these amounts were $258 million and $238 million, respectively. Other intangible assets were not material at December 31, 2005 or 2004.

Long-Lived Assets

The company periodically evaluates whether events or circumstances have occurred that may affect the recoverability or the estimated useful lives of long-lived assets, the definition of which does not include unconsolidated subsidiaries. Impairment of long-lived assets occurs when the estimated future undiscounted cash flows are less than the carrying amount of the assets. If that comparison indicates that the assets' carrying value may be permanently impaired, the potential impairment is measured based on the difference between the carrying amount and the fair value of the assets based on quoted market prices or, if market prices are not available, on the estimated discounted cash flows. This calculation is performed at the lowest level for which separately identifiable cash flows exist. Further discussion of SFAS 144 is provided in "New Accounting Standards." During 2005 impairments included pre-tax write-downs of $66 million at Sempra Generation and $6 million at Sempra Pipelines & Storage for abandoned projects. Impairments in 2003 included a $77 million before-tax write-down of the carrying value of the assets of Frontier Energy, a small utility subsidiary of Sempra Pipelines & Storage, and a $24 million before-tax write-down of the carrying value of the assets at Atlantic Electric & Gas Limited (AEG). This is discussed further in "New Accounting Standards" below and in Note 4. The carrying value of unconsolidated subsidiaries is evaluated for impairment based on the requirements of APBO 18, *The Equity Method of Accounting for Investments in Common Stock*.

Nuclear Decommissioning Liability

At December 31, 2005 and 2004, SDG&E had asset retirement obligations of $339 million and $328 million, respectively, and related regulatory liabilities of $346 million and $333 million, respectively, related to nuclear decommissioning, in accordance with SFAS 143. Information about San Onofre Nuclear Generating Station (SONGS) decommissioning costs is included below in "New Accounting Standards."

Legal Fees

Legal fees that are associated with a past event for which a contingent liability has been recorded are accrued when it is probable that fees also will be incurred.

Comprehensive Income

Comprehensive income includes 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 foreign-currency translation adjustments, minimum pension liability adjustments and certain hedging activities. The components of other comprehensive income, which consists of all these changes other than net income as shown on the Statements of Consolidated Income, are shown in the Statements of Consolidated Changes in Shareholders' Equity.

The components of Accumulated Other Comprehensive Income (Loss), net of income taxes at December 31, 2005 (in millions of dollars) are as follows:

Foreign-currency translation loss	$(264)
Financial instruments, net of $30 income tax benefit	(58)
Minimum pension liability adjustments, net of $25 income tax benefit	(36)
Balance as of December 31, 2005	$(358)

Stock-Based Compensation

The company has stock-based employee compensation plans, which are described in Note 9. The company accounts for these plans under the recognition and measurement principles of APBO 25, *Accounting for Stock Issued to Employees,* and related Interpretations. Employee compensation cost is reflected in net income in all years for restricted stock awards, and in 2005, for the acceleration in vesting for certain options. The following table provides the pro forma effects of recognizing compensation expense in accordance with SFAS 123, *Accounting for Stock-Based Compensation*:

(Dollars in millions, except per share amounts)	Years ended December 31, 2005	2004	2003
Net income as reported	$ 920	$ 895	$ 649
Stock-based employee compensation expense reported in net income, net of tax	37	24	13
Total stock-based employee compensation under fair-value method for all awards, net of tax	(43)	(30)	(20)
Pro forma net income	$ 914	$ 889	$ 642
Earnings per share:			
Basic — as reported	$3.74	$3.92	$3.07
Basic — pro forma	$3.72	$3.89	$3.03
Diluted — as reported	$3.65	$3.83	$3.03
Diluted — pro forma	$3.63	$3.80	$2.99

Revenues

Revenues of the California Utilities are primarily derived from deliveries of electricity and natural gas to customers and changes in related regulatory balancing accounts. Revenues from electricity and natural gas sales and services are recorded under the accrual method and recognized upon delivery. The portion of SDG&E's electric commodity that was procured for its customers by the California Department of Water Resources (DWR) and delivered by SDG&E is not included in SDG&E's revenues or costs. Commodity costs associated with long-term contracts allocated to SDG&E from the DWR also are not included in the Statements of Consolidated Income, since the DWR retains legal and financial responsibility for these contracts. Note 13 includes a discussion of the electric industry restructuring. Natural gas storage contract revenues are accrued on a monthly basis and reflect reservation, storage and injection charges in accordance with negotiated agreements, which have terms of up to three years. Operating revenue includes amounts for services rendered but unbilled (approximately one-half month's deliveries) at the end of each year. Included in revenues for the California utilities are revenues of $1.8 billion, $1.7 billion and $1.8 billion for electric and $5.3 billion, $4.5 billion and $4.0 billion for natural gas for 2005, 2004 and 2003, respectively.

Additional information concerning utility revenue recognition is discussed above under "Regulatory Matters."

Sempra Commodities generates a substantial portion of its revenues from market making and trading activities, as a principal, in natural gas, electricity, petroleum, metals and other commodities, for which it quotes bid and ask prices to end users and other market makers. Principal transaction revenues are recognized on a trade-date basis, and include realized gains and losses, and the net change in the fair value of unrealized gains and losses. Sempra Commodities also earns trading profits as a dealer by structuring and executing transactions. Sempra Commodities utilizes derivative instruments to reduce its exposure to unfavorable changes in market prices, which are subject to significant and volatile fluctuation. These instruments include futures, forwards, swaps and options.

Options, which are either exchange-traded or directly negotiated between counterparties, provide the holder with the right to buy from or sell to the other party an agreed amount of a commodity at a specified price within a specified period or at a specified time. As a writer of options, Sempra Commodities generally receives an option premium and then manages the risk of an unfavorable change in the value of the underlying commodity by entering into offsetting transactions or by other means.

Forward and future transactions are contracts for delivery of commodities in which the counterparty agrees to make or take delivery at a specified price. Commodity swap transactions may involve the exchange of fixed and floating payment obligations without the exchange of the underlying commodity. Sempra Commodities' financial instruments represent contracts with counterparties whereby payments are linked to or derived from market indices or on terms predetermined by the contract.

Non-derivative contracts are being carried at cost and accounted for on an accrual basis and, therefore, the related profit or loss will be recognized as the contract is performed. Derivative instruments are discussed further in Note 10.

Sempra Generation's revenues are derived primarily from the sale of electric energy to governmental and wholesale power marketing entities and are recognized as the energy is delivered in accordance with the provisions of Emerging Issues Task Force (EITF) 91-6, *Revenue Recognition of Long-term Power Supply Contracts,* and EITF 96-17, *Revenue Recognition Under Long-term Power Sales Contracts that Contain Both Fixed and Variable Terms.* During 2005 and 2004, electric energy sales to the DWR accounted for a significant portion of Sempra Generation's revenues. A small portion of Sempra Generation's revenue is generated from energy-related products and services to commercial, industrial, government and institutional markets.

The consolidated foreign subsidiaries of Sempra Pipelines & Storage, all of which operate in Mexico, recognize revenue as deliveries are made similar to the California Utilities, except that SFAS 71 is not applicable due to the different regulatory environment.

Foreign Currency Translation

The assets and liabilities of the company's foreign operations are 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 do not enter into the calculation of net income or retained earnings (unless the operation is being discontinued), but are reflected in Comprehensive Income and in Accumulated Other Comprehensive Income, a component of shareholders' equity, as described above. To reflect the fluctuation in the value of the Argentine peso, the functional currency of the company's Argentine operations, Sempra Pipelines & Storage adjusted its investment in its two Argentine natural gas utility holding companies downward by $3 million, downward by $1 million and upward by $26 million in 2005, 2004 and 2003, respectively. A similar adjustment has been made to its investment in

Chile to reflect the fluctuation in the value of the Chilean peso, the functional currency of the company's Chilean operations, upward by $32 million in 2005, $22 million in 2004 and $43 million in 2003. These non-cash adjustments did not affect net income, but did affect Comprehensive Income and Accumulated Other Comprehensive Income (Loss). Smaller adjustments have been made to other operations where the U.S. dollar is not the functional currency. Additional information concerning these investments is described in Note 3.

Currency transaction gains and losses in a currency other than the entity's functional currency are included in the calculation of consolidated net income. The company recorded $1 million of currency transaction gains in 2005 and $8 million of currency transaction losses in 2003.

Transactions with Affiliates

Loans to Unconsolidated Affiliates

In December 2001, Sempra Pipelines & Storage issued two U.S. dollar denominated loans totaling $35 million and $22 million to its affiliates Camuzzi Gas Pampeana S.A. and Camuzzi Gas del Sur S.A., respectively. These loans have variable interest rates (11.54% at December 31, 2005) and are due in October 2006 and June 2006, respectively. The balances outstanding under the notes were $21 million and $42 million at December 31, 2005 and 2004, respectively. These amounts are included in non-current assets under Due from Unconsolidated Affiliates, because company management does not expect to request payment in 2006.

Loans from Unconsolidated Affiliates

At both December 31, 2005 and 2004, Sempra Pipelines & Storage had long-term notes payable to affiliates which include $60 million at 6.47% due April 1, 2008 and $100 million at 6.62% due April 1, 2011. The loans are due to Chilquinta Energía Finance Co. LLC and are secured by Sempra Pipelines & Storage's investments in Chilquinta Energía S.A. and Luz del Sur S.A.A. (Luz del Sur), which are discussed in Note 3.

In February 2000, a wholly owned subsidiary trust of the company issued $200 million of preferred stock in the form of 8.90% Cumulative Quarterly Income Preferred Securities, Series A (QUIPS). The company redeemed the $200 million of mandatorily redeemable trust preferred securities in February 2005.

Revenues and Expenses with Unconsolidated Affiliates

During the first seven months of 2005 and in all of 2004, Sempra Generation recorded $38 million and $60 million, respectively, in sales to El Dorado, then an unconsolidated affiliate, and recorded $43 million and $71 million, respectively, of purchases from El Dorado for those same periods. Sempra Energy purchased the remaining 50% interest in El Dorado in July 2005 and consolidated El Dorado in its financial statements. Additionally, during 2005 and 2004, Sempra Commodities recorded $85 million and $28 million, respectively of purchases from Topaz Power Partners (Topaz), an unconsolidated affiliate. Sales to Topaz were $213 million and $74 million in 2005 and 2004, respectively.

Capitalized Interest

The company recorded $33 million, $12 million and $34 million of capitalized interest for 2005, 2004 and 2003, respectively, including the portion of AFUDC related to debt.

Other Income, Net

Other Income, Net consists of the following:

(Dollars in millions)	Years ended December 31, 2005	2004	2003
Equity in income (losses) of unconsolidated subsidiaries (Note 3)	$11	$(26)	$(57)
Regulatory interest, net	(6)	3	(2)
Allowance for equity funds used during construction	14	14	21
Gain on settlement of Cameron liability	—	13	—
Sundry, net	32	29	(2)
Total	$51	$ 33	$(40)

New Accounting Standards

SFAS 123 (revised 2004), "Share-Based Payment" (SFAS 123R): In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS 123R, a revision of SFAS 123, *Accounting for Stock-Based Compensation* (SFAS 123), which establishes the accounting for transactions in which an entity exchanges its equity instruments for goods or services received. This statement requires companies to measure and record the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The company expects to adopt the provisions of SFAS 123R using a modified prospective application. The modified prospective method requires companies to recognize compensation cost for unvested awards that are outstanding on the effective date based on the fair value that the company had originally estimated for purposes of preparing its SFAS 123 pro forma disclosures. For all new awards that are granted or modified after the effective date, a company would use SFAS 123R's measurement model. The effect of adopting SFAS 123R has not been determined; however, the pro forma effects of recognizing compensation expense in accordance with SFAS 123 are discussed above in Stock-Based Compensation. The effective date of this statement is January 1, 2006.

SFAS 143, "Accounting for Asset Retirement Obligations" and FASB Interpretation No. (FIN) 47, "Accounting for Conditional Asset Retirement Obligations, an interpretation of SFAS 143": Beginning in 2003, SFAS 143 requires entities to record the present value of liabilities for future costs expected to be incurred when assets are retired from service, if the retirement process is legally required. It requires recording of the estimated retirement cost over the life of the related asset by depreciating the present value of the obligation (measured at the time of the asset's acquisition) and accreting the discount until the liability is settled. The adoption of SFAS 143 on January 1, 2003 resulted in the recording of an addition to utility plant of $71 million, representing the company's share of SONGS' estimated future decommissioning costs (as discounted to the present value at the dates the units began operation), and accumulated depreciation of $41 million related to the increase to utility plant, for a net increase of $30 million. On January 1, 2003, the company recorded additional asset retirement obligations of $20 million associated with the future retirement of a former power plant and three storage facilities.

In March 2005, the FASB issued FIN 47, *"Accounting for Conditional Asset Retirement Obligations, an interpretation of SFAS 143."* The interpretation clarifies that the term "conditional asset-retirement obligation" as used in SFAS 143, refers to a legal obligation to perform an asset-retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. FIN 47 requires companies to recognize a liability for the fair value of a conditional asset-retirement obligation if the fair value of the obligation can be reasonably estimated.

The adoption of FIN 47 on December 31, 2005 resulted in the recording of an addition to utility plant of $198 million and accumulated depreciation of $74 million related to the increase to utility plant, for a net increase of $124 million. In addition, the company recorded a corresponding retirement obligation liability of $619 million (which includes accretion of that discounted value to December 31, 2005) and a regulatory liability of $1.1 billion to reflect that the California Utilities have collected the funds from customers more quickly than FIN 47 would accrete the retirement liability and depreciate the asset.

The adoption of SFAS 143 required the reclassification of utilities' estimated removal costs collected in rates, which had historically been recorded in accumulated depreciation, to a regulatory liability. At December 31, 2005 and 2004, these costs were $200 million and $1.4 billion, respectively, for SoCalGas, and $724 million and $913 million, respectively, for SDG&E. The change in the balance is due to the implementation of FIN 47, which required the reclassification of disposal costs that previously have been included in the utilities' estimated cost of removal obligations to a regulatory liability and to Asset Retirement Obligations.

In accordance with FIN 47, the company has determined that the amount of asbestos-containing materials could not be determined and, therefore, no liability has been recognized for the related removal obligations. Since most, if not all, of the cost of removing such materials would be found at the California Utilities, where the cost of removal would be expected to be recovered in rates, the effect of not recognizing these liabilities is not material to the company's financial condition or results of operations. A liability for the obligations will be recorded in the period in which sufficient information is available to reasonably estimate the removal cost.

Had FIN 47 been in effect on December 31, 2004, the asset retirement obligation liability would have been $583 million as of that date.

Except for the items noted above, the company has determined that there are no other material retirement obligations associated with tangible long-lived assets.

Implementation of SFAS 143 and FIN 47 had no significant effect on results of operations and is not expected to have a significant effect in the future.

The changes in the asset retirement obligations for the years ended December 31, 2005 and 2004 are as follows (dollars in millions):

	2005	2004
Balance as of January 1	**$348***	$337*
Adoption of FIN 47	**619**	
Accretion expense	**25**	24
Payments	**(16)**	(10)
Revision of estimated cash flows	**1**	(3)
Balance as of December 31	**$977***	$348*

* The current portion of the obligation is included in Other Current Liabilities on the Consolidated Balance Sheets.

SFAS 144, "Accounting for Impairment or Disposal of Long-Lived Assets": In August 2001, the FASB issued SFAS 144, which replaces SFAS 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of.* It applies to all long-lived assets. Among other things, SFAS 144 requires that an impairment loss be recorded if the carrying amount of a long-lived asset is not recoverable from its undiscounted cash flows.

During the third and fourth quarters of 2003, the company recorded impairment charges of $77 million and $24 million to write down the carrying value of the assets of Frontier Energy and AEG, respectively. The Frontier Energy impairment resulted from reductions in actual and anticipated sales of natural gas by the utility. The AEG impairment was due to less-than-anticipated customer growth. In applying the provisions of SFAS 144, management determined the fair value of such assets based on its estimates of discounted future cash flows.

During the fourth quarter of 2005, Sempra Generation recorded a non-cash impairment charge to write down the carrying value of a turbine set (consisting of two gas turbines and one steam turbine) to their estimated fair values. The estimated fair value was based on sales of similar assets. The turbine set was initially purchased in anticipation of constructing one of several electrical generation projects under development by the company. The impairment resulted from management's strategic review process and the decision to indefinitely delay all development projects which might utilize the turbine sets. The charge is included in Impairment Losses in the Statements of Consolidated Income.

SFAS 154, "Accounting Changes and Error Corrections, a replacement of APBO 20 and FASB Statement No. 3": This statement applies to all voluntary changes in accounting principles and to changes required by an accounting pronouncement in instances where the pronouncement does not include specific transition provisions. APBO 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. SFAS 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to do so. This statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

EITF 98-10, "Accounting for Contracts Involved in Energy Trading and Risk Management Activities": EITF 98-10 provided for marking to market commodities and arrangements that are not marked to market by SFAS 133 unless certain hedging standards specified in SFAS 133 are complied with. For the company, this consists of contracts involving transportation and storage and certain inventory. The specified hedging standards have been complied with for a portion of the otherwise-excluded items. A substantial majority of the company's items covered by EITF 98-10 are covered by SFAS 133. On January 1, 2003, the company recorded the initial effect of EITF 98-10's rescission as a cumulative effect of a change in accounting principle, which reduced after-tax earnings by $29 million. Neither the cumulative nor the ongoing effect impacts the company's cash flow or liquidity. Additional information on derivative instruments is provided in Note 10.

FIN 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51": FIN 46, as revised by FIN 46R, requires an enterprise to consolidate a variable interest entity (VIE), as defined in FIN 46, if the company is the primary beneficiary of a VIE's activities.

Sempra Energy adopted FIN 46 on December 31, 2003, resulting in the consolidation of two VIEs for which it is the primary beneficiary. One of the VIEs (Mesquite Trust) was the owner of the Mesquite Power plant for which the company had a synthetic lease agreement. The company recorded an after-tax credit of $9 million in the fourth quarter of 2003 for the cumulative effect of the change in accounting principle. The company bought out the lease in January 2004 and now owns the plant.

The other VIE is AEG. Consolidation of AEG resulted in Sempra Energy's recording of 100 percent of AEG's balance sheet and results of operations, whereas it previously recorded only its share of AEG's net operating results. Due to AEG's consolidation, the company recorded an after-tax charge of $26 million in the fourth quarter of 2003 for the cumulative effect of the change in accounting principle. During the first quarter of 2004, Sempra Energy's board of directors approved management's plan to dispose of AEG. Note 4 provides further discussion concerning this matter and the April 2004 disposal of AEG. Had AEG and the Mesquite Trust been consolidated in 2003, the company's net income for 2003 would have been $662 million.

The $46 million cumulative effect recorded in 2003 on the Statements of Consolidated Income, net of the tax benefit of $26 million, consists of the following items which are described above (dollars in millions):

FIN 46:	
Mesquite Trust	$ 9
AEG	(26)
Net Charge	(17)
EITF 98-10	(29)
Total Charge	$(46)

In addition, contracts under which SDG&E acquires power from generation facilities otherwise unrelated to SDG&E could result in a requirement for SDG&E to consolidate the entity that owns the facility. In accordance with FIN 46, SDG&E is continuing the process of determining whether it has any such situations and, if so, gathering the information that would be needed to perform the consolidation. The effects of this, if any, are not expected to significantly affect the financial position of SDG&E and there would be no effect on results of operations or liquidity.

FASB Staff Position (FSP) 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004": As discussed in the 2004 Annual Report, the company continued to evaluate the repatriation provision throughout 2005. The company has completed its evaluation and will not repatriate any foreign earnings pursuant to the repatriation provision.

NOTE 2. RECENT ACQUISITION AND INVESTMENT ACTIVITY

Sempra Commodities

In 2003, the company acquired rights for the development of Bluewater Gas Storage, a natural gas storage facility in Michigan, and in 2004 the company acquired rights for the development of Pine Prairie Energy Center, a salt-cavern natural gas storage facility in Evangeline Parish, Louisiana. In September 2005, Sempra Commodities sold both investments for $253 million.

Sempra Generation

In July 2005, Sempra Generation purchased Reliant Energy's 50-percent interest in El Dorado Energy for $132 million (including assumed debt), resulting in Sempra Generation's having full ownership of the 480-megawatt (MW) El Dorado power plant located in Boulder City, Nevada.

In July 2004, Sempra Generation began construction of the 550-MW Palomar power plant in Escondido, California. The project is expected to be completed in the first half of 2006, at which time it will be sold to SDG&E.

In December 2005, Sempra Generation announced plans to sell or refinance its Texas-based power plants due to the increased market valuation of coal-fired power plants in Texas. The coal-fired assets involved in the announcement include the company's wholly owned Twin Oaks Power plant (Twin Oaks), with a carrying value of $128 million at December 31, 2005, and the Coleto Creek Power plant, with a carrying value of $47 million at December 31, 2005, that the company co-owns in the Topaz joint venture with Carlyle/Riverstone. The joint venture also owns three operating natural gas and oil-fired plants (in Laredo, San Benito and Corpus Christi, Texas) that were included in the announcement. In January 2006, Sempra Generation announced an agreement for the sale of Twin Oaks for $480 million.

Sempra LNG

In December 2004, Sempra LNG entered into two contracts for the Energía Costa Azul terminal in Baja California, Mexico. One is for the construction of the terminal at Costa Azul for $500 million and one is for the construction of the project's breakwater for $170 million. Through December 31, 2005, Sempra LNG has made expenditures of $334 million related to Energía Costa Azul. Construction on the terminal began in early 2005 and the terminal is expected to begin operations in 2008. It is expected to cost approximately $800 million and will be capable of processing 1 billion cubic feet (bcf) of natural gas per day. Sempra Pipelines & Storage will be expanding its Baja California pipelines to connect Energía Costa Azul to existing natural gas pipelines.

In August 2005, Sempra LNG finalized a contract for the construction of its Cameron LNG regasification terminal in Hackberry, Louisiana. The contract is valued at approximately $500 million. The terminal is currently designed to supply 1.5 bcf of natural gas per day. In January 2006, Sempra LNG received approval from the FERC to begin the mandatory pre-filing process to expand the terminal's production capacity to 2.65 bcf per day. The total cost of the project, including the proposed expansion, is expected to be $950 million. In addition, total rent payments and wharfage fees related to the plant's land lease are expected to be $47 million over 30 years. The initial construction of Cameron is scheduled to be completed in late 2008 and the proposed expansion is scheduled for completion in 2010. Grading for the terminal began in August 2005.

Sempra Pipelines & Storage

Sempra Pipelines & Storage will be expanding its existing pipelines in Baja California, Mexico, and adding a spur line to connect Sempra LNG's Energía Costa Azul terminal to existing natural gas pipelines. The estimated costs related to the connection of Energía Costa Azul to these lines is $200 million. The expansion is expected to be completed in early 2008.

In July 2004, the company acquired the rights to develop Liberty Gas Storage (Liberty), a salt-cavern natural gas storage facility located in Calcasieu Parish, Louisiana. In May 2005, ProLiance Transportation and Storage, LLC acquired a 25-percent ownership in Liberty from the company. In December 2005, the company received authorization from the FERC to construct and operate Liberty. The facility will provide 17 bcf of working natural gas capacity for storage and will be connected to the Cameron and Port Arthur Pipelines. These two new pipelines under development by Sempra Pipelines & Storage will connect area liquefied natural gas (LNG) regasification terminals to the interstate gas transmission system. Liberty is estimated to cost $172 million and is expected to begin operations in September 2006.

NOTE 3. INVESTMENTS IN UNCONSOLIDATED SUBSIDIARIES

Investments are generally accounted for under the equity method when the company has an ownership interest of twenty to fifty percent. In these cases, the company's pro rata shares of the subsidiaries' net assets are included in Investments on the Consolidated Balance Sheets, and are adjusted for the company's share of each investee's earnings or losses, dividends and foreign currency translation effects. Equity in earnings of unconsolidated subsidiaries that is recorded before income tax is reported in Other Income, Net on the Statements of Consolidated Income. Equity earnings recorded net of income tax recorded by the subsidiary are reported in Equity in Earnings of Certain Unconsolidated Subsidiaries on the Statements of Consolidated Income. The company accounts for certain investments in housing partnerships made before May 19, 1995 under the cost method, whereby they have been amortized over ten years based on the expected residual value. The company has no unconsolidated subsidiaries where its ability to influence or control an investee differs from its ownership percentage.

The company's long-term investment balances and earnings are summarized as follows:

(Dollars in millions)	Investment at December 31, 2005	2004
Equity method investments:		
Chilquinta Energía	$ 430	$ 376
Luz del Sur	150	157
Sodigas Pampeana and Sodigas Sur	88	82
Elk Hills Power	218	217
Topaz Power Partners	51	66
El Dorado Energy*	—	55
Housing partnerships	121	146
Sempra Financial synthetic-fuel partnerships	—	12
Total	1,058	1,111
Cost method investments — housing partnerships	24	36
Investments in unconsolidated subsidiaries	1,082	1,147
Other	22	17
Total long-term investments	$1,104	$1,164

(Dollars in millions)	Earnings for the Years ended December 31, 2005	2004	2003
Equity method investments:			
Earnings recorded net of tax:			
Chilquinta Energía	$ 25	$ 16	$ 19
Luz del Sur	21	29	20
Sodigas Pampeana and Sodigas Sur	9	17	23
Total earnings recorded net of tax	$ 55	$ 62	$ 62
Earnings recorded before tax:			
Elk Hills Power	$ 3	$ 3	$ (1)
El Dorado Energy*	(6)	(13)	(5)
Topaz Power Partners	28	13	—
Housing partnerships	(17)	(20)	(27)
Sempra Financial synthetic-fuel partnerships	3	(9)	(19)
AEG	—	—	(5)
Total earnings recorded before tax	$ 11	$(26)	$(57)

* El Dorado Energy has been consolidated since the acquisition of the remaining 50% in July 2005.

For equity method investments, costs in excess of equity in net assets (goodwill) were $258 million and $238 million at December 31, 2005 and 2004, respectively. Amortization thereof ceased in 2002 in accordance with SFAS 142. Costs in excess of the underlying equity in net assets will continue to be reviewed for impairment in accordance with APBO 18. Descriptive information concerning each of these investments follows.

Sempra Pipelines & Storage

Sempra Pipelines & Storage and PSEG Global (PSEG), an unaffiliated company, each own a 50-percent interest in Chilquinta Energía S.A., a Chilean electric utility.

On April 1, 2004, Sempra Pipelines & Storage and PSEG sold a portion of their interests in Luz del Sur, a Peruvian electric utility, for a total of $62 million. Each party had a 44-percent interest in Luz del Sur prior to the sale and a 38-percent interest thereafter. As a result of the sale, Sempra Pipelines & Storage recognized a $5 million after-tax gain in 2004, which is included in Equity in Earnings of Certain Unconsolidated Subsidiaries on the Statements of Consolidated Income.

Sempra Pipelines & Storage also owns 43 percent of two Argentine natural gas utility holding companies, Sodigas Pampeana and Sodigas Sur. As a result of the devaluation of the Argentine peso at the end of 2001 and subsequent changes in the value of the peso, Sempra Pipelines & Storage had reduced the carrying value of its investment downward by a cumulative total of $201 million as of December 31, 2005. These non-cash adjustments continue to occur based on fluctuations in the value of the Argentine peso. They do not affect net income, but increase or decrease Other Comprehensive Income (Loss) and Accumulated Other Comprehensive Income (Loss).

The related Argentine economic decline and government responses (including Argentina's unilateral, retroactive abrogation of utility agreements early in 2002) continue to adversely affect the operations of these Argentine utilities. In 2002, Sempra Pipelines & Storage initiated arbitration proceedings under the 1994 Bilateral Investment Treaty between the United States and Argentina for recovery of the diminution of the value of its investments that has resulted from Argentine governmental actions. In 2003, Sempra Pipelines & Storage filed its legal brief with the International Center for Settlement of Investment Disputes, outlining its claims for $211 million (previously $258 million). The company has also presented additional information that may provide a basis for a larger award. Hearings were held in February 2006 and a decision is expected in late 2006. Sempra Energy also has a $48.5 million political-risk insurance policy under which it has filed a claim to recover a portion of the investments' diminution in value and has commenced the arbitration procedure with the insurance company to determine coverage and the amount of the loss under the policy. Hearings are scheduled for April 2006 and a decision is expected in mid-2006.

Sempra Generation

The 550-MW Elk Hills Power (Elk Hills) project located near Bakersfield, California began commercial operations in July 2003. Elk Hills is 50 percent owned by Sempra Generation.

The 480-MW El Dorado power plant, located near Las Vegas, Nevada, began commercial operations in May 2000. In July 2005, Sempra Generation purchased the remaining 50 percent ownership interest in El Dorado for $132 million (including assumed debt) from Reliant Energy Power Generation, who had been the joint venture partner in the El Dorado power plant.

In July 2004, Topaz acquired ten Texas power plants from American Electric Power (AEP), including the 632-MW coal-fired Coleto Creek Power Station and three natural gas and oil-fired plants in Laredo, San Benito and Corpus Christi, Texas. Topaz acquired these assets for $432 million in cash and the assumption of various environmental and asset retirement liabilities currently estimated at $41 million. $355 million of the purchase price was provided by non-recourse project financing related solely to the acquisition of the Coleto Creek Power Station.

The transaction included the acquisition of six operating power plants with generating capacity of 1,950 MW and four inactive power plants capable of generating 1,863 MW. Concurrently with the acquisition, Topaz sold one of the inactive power plants and no gain or loss was recorded on the transaction. In December 2005, Topaz sold the Eagle Pass hydro facility for a small gain.

Topaz has entered into several power sales agreements for 572 MW of Coleto Creek Power Station's capacity. Contracts comprising 98% of the total capacity under contract expire by 2010. Sempra Generation manages the plants.

In conjunction with the acquisition of the Topaz plants, Sempra Energy provided AEP a guarantee for certain specified liabilities described in the acquisition agreement. This guarantee is limited to $75 million for the first five years after the acquisition date and $25 million for the next five years, but not more than $75 million over the entire 10-year period. Management does not expect any material losses to result from the guarantee because performance is not expected to be required and, therefore, management believes that the fair value of the guarantee is immaterial. The guarantee would not necessarily be terminated in connection with sales of the plants.

In December 2005, Sempra Generation announced plans to sell or refinance certain Topaz plants and the Twin Oaks plant discussed in Note 2.

Sempra Financial

Sempra Financial invests as a limited partner in affordable-housing properties. Sempra Financial's portfolio includes 1,300 properties throughout the United States that are expected to provide income tax benefits (primarily from income tax credits) over 10-year periods.

The cost of Sempra Financial's investment in Section 29 income tax credits has been fully recovered for financial statement purposes as a result of a 2004 sale and additional, contingent payments are being recorded as income as they are received.

Sempra Commodities

Available-for-Sale Securities

Sempra Commodities recorded $6 million and $5 million in purchases of available-for-sale securities in 2005 and 2004, respectively, and sold $4 million of available-for-sale securities in 2005, yielding proceeds of $6 million. The cost basis of the sales was determined by the specific identification method and a gain of $2 million was realized as a result of the sales in 2005. Sempra Commodities had $5 million and $14 million of available-for-sale securities included in Investments at December 31, 2005 and 2004, respectively. There was $4 million in unrealized gains, net of income tax, in Accumulated Other Comprehensive Income (Loss) at December 31, 2004 related to these securities, which was largely transferred to income in 2005. Trading securities at December 31, 2005 included $9 million of securities, including a $5 million unrealized gain, that were reclassified from available-for-sale securities during 2005, due to changes in their status. Sempra Commodities had $12 million of trading securities at December 31, 2005.

NOTE 4. DISCONTINUED OPERATIONS

In the first quarter of 2004, Sempra Energy's board of directors approved management's plan to dispose of its interest in AEG, which marketed power and natural gas commodities to commercial and residential customers in the United Kingdom. This disposal met the criteria established for recognition as discontinued operations under SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. In April 2004, AEG went into administrative receivership and substantially all of the assets were sold. This transaction resulted in an after-tax 2004 loss of $2 million.

The net losses from discontinued operations were $9 million and $25 million in 2005 and 2004, respectively. The 2005 loss was primarily attributed to foreign currency translation adjustments associated with AEG's remaining assets and liabilities, legal costs and reserves against accounts receivable. During 2003, the company accounted for its investment in AEG under the equity method of accounting. As such, in 2003, the company recorded its share of AEG's net losses of $5 million in Other Income, Net on the Statements of Consolidated Income. Additionally, during the fourth quarter of 2003, the company recorded an after-tax charge of $21 million to write down the carrying value of assets at AEG. Effective December 31, 2003, AEG was consolidated as a result of the adoption of FIN 46, as discussed in Note 1.

Included within the net loss from discontinued operations are AEG's operating results, summarized below:

(Dollars in millions)	Years ended December 31, 2005	2004
Operating revenues	$—	$201
Loss from discontinued operations, before income tax benefit of $7 for 2004	$—	$ (30)
Loss on disposal of discontinued operations, before income tax benefit of $4 for 2004	$(9)	$ (6)

AEG's balance sheet data, excluding intercompany balances (which are significant) eliminated in consolidation, are summarized below:

(Dollars in millions)	December 31, 2005	December 31, 2004
Assets:		
Accounts receivable, net	$14	$37
Other current assets	36	33
Total assets	$50	$70
Total liabilities (all current)	$10	$17

NOTE 5. DEBT AND CREDIT FACILITIES

Committed Lines of Credit

At December 31, 2005, the company had available $4.7 billion in unused, committed lines of credit to provide liquidity and support commercial paper. As of December 31, 2005, $22 million of the lines supported variable-rate debt.

Sempra Global has a $2.5 billion five-year syndicated revolving credit facility expiring in 2010 and a $750 million three-year syndicated revolving credit facility expiring in 2008. The five-year and three-year credit facilities also provide for the issuance of up to $400 million and $500 million, respectively, of letters of credit on behalf of Sempra Global. The amount of borrowings otherwise available under each facility would be reduced by the amount of outstanding letters of credit. Obligations under each facility are guaranteed by Sempra Energy and bear interest at rates varying with market rates and Sempra Energy's credit rating. Each facility requires Sempra Energy to maintain, at the end of each quarter, a ratio of total indebtedness to total capitalization (as defined in the facility) of no more than 65 percent. At December 31, 2005, Sempra Global had letters of credit of $166 million under the facility. The facility also provides support for $673 million of commercial paper outstanding at December 31, 2005.

Sempra Commodities has a five-year syndicated revolving credit facility providing up to $1.72 billion of extensions of credit (consisting of borrowings, letters of credit and other credit support accommodations) to Sempra Commodities and certain of its affiliates. The facility expires in 2010. The amount of credit available under the facility is limited to the amount of a borrowing base consisting of receivables, inventories and other assets of Sempra Commodities that secure the credit facility and that are valued for purposes of the borrowing base at varying percentages of current market value. Extensions of credit are guaranteed by Sempra Energy subject to a maximum guarantee liability of 20 percent of the lenders' total commitments under the facility. The facility requires Sempra Commodities to meet certain financial tests at the end of each quarter, including current ratio, leverage ratio, senior debt to tangible net worth ratio, and minimum net worth and tangible net worth tests. It also requires Sempra Energy to maintain, at the end of each quarter, a ratio of total indebtedness to total capitalization (as defined in the facility) of no more than 65 percent. It also imposes certain other limitations on Sempra Commodities, including limitations on other indebtedness, capital expenditures, liens, transfers of assets, investments, loans, advances, dividends, other distributions, modifications of risk-management policies and transactions with affiliates. At December 31, 2005, letters of credit of $838 million were outstanding under the facility.

Sempra LNG has a $1.25 billion five-year syndicated revolving credit facility that expires in 2009. The facility also provides for the issuance of letters of credit not exceeding $200 million outstanding at any one time. Borrowings, letter of credit obligations and other obligations under the facility are guaranteed by Sempra Energy and bear interest at rates varying with market rates and Sempra Energy's credit ratings. The facility requires Sempra Energy to maintain, at the end of each quarter, a ratio of total indebtedness to total capitalization (as defined in the facility) of no more than 65 percent. Sempra LNG had $200 million of outstanding borrowings and $185 million of outstanding letters of credit under this facility at December 31, 2005.

The California Utilities have a combined $600 million five-year syndicated revolving credit facility expiring in 2010, under which each utility individually may borrow up to $500 million, subject to the combined borrowing limit for both utilities of $600 million. Borrowings under the agreement bear interest at rates varying with market rates and the utility's credit rating. The agreement requires each utility to maintain, at the end of each quarter, a ratio of total indebtedness to total capitalization (as defined in the facility) of no more than 65 percent. Borrowings under the agreement are individual obligations of the borrowing utility and a default by one utility would not constitute a default, or preclude borrowings by, the other. At December 31, 2005, the California Utilities had no amounts outstanding under this facility. The facility provides support for $88 million of commercial paper outstanding at December 31, 2005.

Uncommitted Lines of Credit

At December 31, 2005, Sempra Commodities had $457 million in various uncommitted lines of credit that are guaranteed by Sempra Energy and bear interest at rates varying with market rates and Sempra Energy's credit rating. At December 31, 2005, Sempra Commodities had $343 million of letters of credit and no short-term borrowings outstanding against these lines.

Other Short-term Debt

In addition to the lines of credit and commercial paper, Sempra Energy had $101 million and $80 million of other short-term debt outstanding at December 31, 2005 and 2004, respectively. The company's weighted average interest rates on the total short-term debt outstanding were 4.54% and 2.82% at December 31, 2005 and 2004, respectively.

Long-term Debt

(Dollars in millions)	December 31, 2005	2004
First mortgage bonds		
Variable rate (4.04% at December 31, 2005) December 1, 2009	$ 100	$ 100
4.375% January 15, 2011	100	100
Variable rates after fixed-to-floating rate swaps (3.62% at December 31, 2005) January 15, 2011	150	150
4.8% October 1, 2012	250	250
6.8% June 1, 2015	14	14
5.3% November 15, 2015	250	—
5.45% April 15, 2018	250	250
5.9% June 1, 2018	68	68
5.9% September 1, 2018	93	93
5.85% June 1, 2021	60	60
5% to 5.25% December 1, 2027	150	150
2.516% to 2.832%* January and February 2034	176	176
5.35% May 15, 2035	250	—
5.75% November 15, 2035	250	—
2.8275%* May 1, 2039	75	75
	2,236	1,486
Other long-term debt (unsecured unless otherwise noted)		
4.621% Notes May 17, 2007	600	600
6.0% Notes February 1, 2013	400	400
Notes at variable rates after fixed-to-floating swap (7.81% at December 31, 2005) March 1, 2010	300	300
Notes at variable rates (4.46% at December 31, 2005) May 21, 2008	300	300
4.75% Notes May 15, 2009	300	300
7.95% Notes March 1, 2010	200	200
Rate-reduction bonds, 6.31% to 6.37% at December 31, 2005 payable annually through 2007	132	198
5.9% June 1, 2014	130	130
Employee Stock Ownership Plan		
Bonds at 4.213% November 1, 2014	82	82
Bonds at variable rates (4.59% at December 31, 2005) November 1, 2014	22	33
5.5% December 1, 2021	60	60
Debt incurred to acquire limited partnerships, secured by real estate, at 7.13% to 9.35% annually through 2009	48	76
5.3% July 1, 2021	39	39
4.9% March 1, 2023	25	25
6.375% May 14, 2006	8	8
5.67% January 18, 2028	5	5
6.95% Notes December 1, 2005	—	300
Other debt	40	33
Capitalized leases	4	6
Market value adjustments for interest rate swaps, net (expiring 2009 — 2011)	(1)	13
	4,930	4,594
Current portion of long-term debt	(101)	(398)
Unamortized discount on long-term debt	(6)	(4)
Total	$4,823	$4,192

* After floating-to-fixed rate swaps expiring in 2009.

Excluding market value adjustments for interest-rate swaps and capital leases, which are described in Note 15, maturities of long-term debt are:

(Dollars in millions)	
2006	$ 100
2007	684
2008	308
2009	424
2010	512
Thereafter	2,899
Total	$4,927

Callable Bonds

At the company's option, certain bonds are callable at various dates: $802 million in 2006, $82 million in 2007 and $274 million after 2010. In addition, $2.7 billion of bonds are callable subject to make-whole provisions.

First Mortgage Bonds

First mortgage bonds are issued by the California Utilities and secured by a lien on utility plant. The California Utilities may issue additional first mortgage bonds upon compliance with the provisions of their bond indentures, which require, among other things, the satisfaction of pro forma earnings-coverage tests on first mortgage bond interest and the availability of sufficient mortgaged property to support the additional bonds, after giving effect to prior bond redemptions. The most restrictive of these tests (the property test) would permit the issuance, subject to CPUC authorization, of an additional $2.7 billion of first mortgage bonds at December 31, 2005.

In November 2005, SDG&E issued $250 million of first mortgage bonds maturing in 2015. In November 2005, SoCalGas issued $250 million of first mortgage bonds maturing in 2035. In May 2005, SDG&E issued $250 million of first mortgage bonds maturing in 2035.

Equity Units

In 2002, the company issued $600 million of Equity Units. The units included $600 million of the company's 5.60% senior notes due May 17, 2007. In February 2005, the company remarketed the senior notes for their remaining term at a rate of 4.621%. In March and May 2005, 19.7 million shares of common stock were issued in connection with the settlement of the related common stock purchase contract as discussed in Note 12.

Unsecured Long-term Debt

Various long-term obligations totaling $2.5 billion at December 31, 2005 are unsecured.

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%. These bonds were issued to facilitate the 10-percent rate reduction mandated by California's electric-restructuring law, which is described in Note 13. They are being repaid over ten years by SDG&E's residential and small-commercial customers through a specified 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 property.

Debt of Employee Stock Ownership Plan (ESOP) and Trust (Trust)

The Trust covers substantially all of the employees of the parent organization, SoCalGas and most of Sempra Global's subsidiaries. The Trust is used to fund part of the retirement savings plan described in Note 8. The notes, which are payable by the trust and which mature in 2014, are repriced weekly and subject to repurchase by the company at the holder's option. Of these notes, $81.5 million were repriced at an interest rate of 4.213% for a three-year term ending July 1, 2007. ESOP debt was paid down by $23 million during the last three years, when approximately 635,640 shares of company common stock were released from the Trust in order to fund the employer contribution to the company savings plan. Interest on the ESOP debt amounted to $4 million in 2005, $5 million in 2004 and $6 million in 2003. Dividends used for debt service amounted to $2 million in each of 2005, 2004 and 2003.

Interest-Rate Swaps

The company periodically enters into interest-rate swap agreements to moderate its exposure to interest-rate changes and to lower its overall cost of borrowing.

Fair value hedges

During 2004, to balance the mix of fixed and floating-rate debt, Sempra Energy entered into interest-rate swaps that effectively exchanged the fixed rate on $300 million of its $500 million 7.95% notes maturing in 2010 for a floating rate. The swaps expire in 2010. During 2003, SoCalGas entered into an interest-rate swap that effectively exchanged the fixed rate on $150 million of its $250 million 4.375% first mortgage bonds maturing in 2011 for a floating rate. The swap expires in 2011. At December 31, 2005 and 2004, market value adjustments of $14 million and $10 million, respectively, were recorded as a decrease primarily in Sundry Assets and a corresponding decrease in Long-term Debt without affecting net income or other comprehensive income. There has been no hedge ineffectiveness on these swaps.

Cash flow hedges

In the third quarter of 2005, Sempra Energy Mexico entered into derivative transactions to hedge future interest payments associated with forecasted borrowings of $450 million for facilities related to Sempra LNG's Energía Costa Azul project. The swaps expire in 2027. In September 2004, SDG&E entered into interest-rate swaps to exchange the floating rates on its $251 million Chula Vista Series 2004 bonds maturing from 2034 through 2039 for fixed rates. The swaps expire in 2009. At December 31, 2005, pre-tax income arising from the ineffective portion of interest-rate cash flow hedges included $4 million recorded in Other Income, Net on the Statements of Consolidated Income. The effect of interest-rate cash flow hedges on other comprehensive income (loss) for the years ended December 31, 2005 and 2004 was $4 million and an immaterial amount, respectively. The balance in Accumulated Other Comprehensive Income (Loss) at December 31, 2005 related to interest-rate cash flow hedges was $4 million.

NOTE 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, 2005 were as follows:

(Dollars in millions)	SONGS	Southwest Powerlink
Percentage ownership	20%	91%
Utility plant in service	$39	$290
Accumulated depreciation and amortization	$ 2	$156
Construction work in progress	$21	$ 9

The company and the other owners each holds its interest as an undivided interest as tenants in common in the property. Each owner is responsible for financing its share of each project and participates in decisions concerning operations and capital expenditures.

The company's share of operating expenses is included in the Statements of Consolidated Income.

SONGS Decommissioning

Objectives, work scope and procedures for the dismantling and decontamination of the SONGS units must meet the requirements of the Nuclear Regulatory Commission (NRC), the Environmental Protection Agency, the U.S. Department of the Navy (the land owner), the CPUC and other regulatory bodies.

The company's share of decommissioning costs for the SONGS units is estimated to be $339 million in 2005 dollars. That amount includes the cost to decommission Units 2 and 3, and the remaining cost to complete Unit 1's decommissioning, which is currently in progress. Cost studies are updated every three years. The most recent update was submitted to the CPUC for its approval in 2005. Rate recovery of decommissioning costs is allowed until the time that the costs are fully recovered, and is subject to adjustment every three years based on the costs allowed by regulators. Collections are authorized to continue until 2013, at which time sufficient funds are expected to have been collected to fully decommission SONGS, but may be extended by CPUC approval until 2022, when the units' NRC operating licenses terminate and the decommissioning of Units 2 and 3 would be expected to begin.

The amounts collected in rates are invested in externally managed trust funds. Amounts held by the trusts are invested in accordance with CPUC regulations that establish maximum amounts for investments in equity securities (50 percent of a qualified trust and 60 percent of a nonqualified trust), international equity securities (20 percent) and securities of electric utilities having ownership interests in nuclear power plants (10 percent). Not less than 50 percent of the equity portion of the trusts must be invested passively. The securities held by the trust are considered available for sale. These trusts are shown on the Consolidated Balance Sheets at market value with the offsetting credits recorded in Asset Retirement Obligations and Regulatory Liabilities Arising from Removal Obligations.

Unit 1 was permanently shut down in 1992, and physical decommissioning began in January 2000. Several structures, foundations and large components have been dismantled, removed and disposed of. Spent nuclear fuel has been removed from the Unit 1 Spent Fuel Pool and stored on-site in an independent spent fuel storage installation (ISFSI) licensed by the NRC. The remaining major work will include dismantling, removal and disposal of all remaining equipment and facilities (both nuclear and non-nuclear components), and decontamination of the site. These activities are expected to be completed in 2008. The ISFSI will be decommissioned after a permanent storage facility becomes available and the spent fuel is removed from the site by the U.S. Department of Energy. Unit 1's reactor vessel is expected to remain on site until Units 2 and 3 are decommissioned.

Trust investments include:

		December 31,	
(Dollars in millions)	Maturity dates	2005	2004
Municipal bonds	2006 — 2034	$ 54	$ 45
U.S. government issues	2006 — 2038	222	209
Cash and other securities	2006 — 2033	35	55
Equity securities		327	303
Total		$638	$612

Net earnings of the trust were $30 million in 2005, $46 million in 2004 and $82 million in 2003. Proceeds from sales of securities (which are reinvested) were $223 million in 2005, $237 million in 2004 and $266 million in 2003, including net gains of $3 million, $12 million and $4 million in 2005, 2004 and 2003, respectively. The net unrealized holding gains included in Asset Retirement Obligations and Regulatory Liabilities Arising from Removal Obligations on the Consolidated Balance sheets were $193 million, $182 million and $159 million at December 31, 2005, 2004 and 2003, respectively.

Customer contribution amounts are determined by estimates of after-tax investment returns, decommissioning costs and decommissioning cost escalation rates. Lower actual investment returns or higher actual decommissioning costs result in an increase in future customer contributions.

Discussion regarding the impact of SFAS 143 is provided in Note 1. Additional information regarding SONGS is included in Notes 13 and 15.

NOTE 7. INCOME TAXES

Reconciliations of the U.S. statutory federal income tax rate to the effective income tax rate are as follows:

	Years ended December 31,		
	2005	2004	2003
Statutory federal income tax rate	**35%**	35%	35%
Utility depreciation	**5**	4	7
State income taxes, net of federal income tax benefit	**3**	4	8
Tax credits	**(14)**	(14)	(24)
Foreign subsidiary income tax activity	**(3)**	(3)	(1)
Resolution of Internal Revenue Service audits	**(7)**	—	(12)
Reduction of prior period state income tax accruals, net of federal income tax effect	**(6)**	(3)	—
Reduction of interest rate on prior period federal income tax liabilities, net of tax	**—**	(2)	—
Utility repair allowance	**(2)**	—	(1)
Return to provision adjustments	**(3)**	(1)	(5)
Other, net	**(3)**	(2)	—
Effective income tax rate	**5%**	18%	7%

The geographic components of income from continuing operations before income taxes and equity in earnings of certain unconsolidated subsidiaries are as follows:

	Years ended December 31,		
(Dollars in millions)	**2005**	2004	2003
Domestic	**$748**	$ 796	$551
Foreign	**168**	255	129
Total	**$916**	$1,051	$680