December 31, 2006, the balance in Accumulated Other Comprehensive Income (Loss) related to these securities was $18 million net of income tax, comprised of $19 million of unrealized gains and $1 million of unrealized losses.

Sempra Commodities recorded $12 million and $17 million in purchases of available-for-sale securities in 2007 and 2006, respectively. Sempra Commodities sold $20 million and $1 million of available-for-sale securities in 2007 and 2006, respectively, yielding proceeds of $54 million and $2 million in 2007 and 2006, respectively. The cost basis of the sales was determined by the specific identification method and pretax gains of $34 million and $1 million were realized as a result of the sales in 2007 and 2006, respectively. Sempra Commodities recorded a $1 million pretax impairment loss in 2006 due to the permanent decline in market value of a single available-for-sale security in 2006. There was no impairment of available-for-sale securities in 2007.

The fair value of securities in an unrealized loss position at December 31, 2007 was $13 million. The unrealized losses were primarily caused by temporary declines in the market values of the securities. The company does not consider these investments to be other than temporarily impaired as of December 31, 2007.

Trading Securities

Sempra Commodities had securities of $16 million and $13 million classified as trading securities at December 31, 2007 and 2006, respectively.

In 2007, Sempra Commodities recorded $14 million of pretax gains related to trading securities, including a pretax gain of $6 million resulting from sales, an unrealized pretax gain of $8 million from transfers to trading securities from available-for-sale securities due to changes in their status and an unrealized pretax loss of a negligible amount related to securities held at December 31, 2007.

The December 31, 2006 balance in trading securities included $3 million of securities that were reclassified from available-for-sale securities and $3 million that were reclassified from other investments during 2006 due to changes in their status. In 2006, Sempra Commodities recorded $19 million of pretax gains related to trading securities, including a pretax gain of $17 million resulting from sales, an unrealized pretax gain of $1 million from the aforementioned transfers to trading securities and an unrealized pretax gain of $1 million related to securities held at December 31, 2006.

In 2005, Sempra Commodities recognized a $5 million pretax gain in earnings from the reclassification of $9 million of available-for-sale securities to trading securities.

Sempra Financial

Prior to June 2006, Sempra Financial invested as a limited partner in affordable-housing properties. Sempra Financial's portfolio included 1,300 properties throughout the United States that provided income tax benefits (primarily from income tax credits) generally over 10-year periods.

In June 2006, Sempra Financial effectively sold the majority of its interests in affordable-housing projects to an unrelated party for $83 million subject to certain guarantees. Because of the guarantees, the transaction has been recorded as a financing transaction rather than as a sale, and the company consolidates the investments in the housing partnerships. Subsequent to the transaction, the company expects slightly higher income tax rates since the transaction almost completely eliminated the income tax benefits from the company's affordable-housing investments.

NOTE 5. DISCONTINUED OPERATIONS

In the second quarter of 2006, Sempra Generation sold its 305-MW, coal-fired Twin Oaks Power plant (Twin Oaks) in Texas for $479 million in cash. Also in the second quarter, Sempra Generation completed the sales of Energy Services, which provided energy-saving facilities, and Facilities Management, which managed building heating and cooling facilities, for a total of $95 million in cash. In the third quarter of 2006, Sempra Generation sold its exploration and production subsidiary, Sempra Energy Production Company (SEPCO), for $225 million in cash.

In June 2006, pursuant to Sempra Energy's previously announced plan to focus resources on the development of its core businesses, Sempra Energy's management decided to sell Bangor Gas and Frontier Energy, Sempra Pipelines & Storage's natural gas distribution companies located in Maine and North Carolina, respectively. In accordance with SFAS 144, the company recorded an after-tax impairment loss of $40 million in 2006. The sales of Frontier Energy and Bangor Gas were completed on September 30, and November 30, 2007, respectively, for a total of $5 million in cash.

In accordance with SFAS 144, the above operations have been reported as discontinued for all periods presented in the company's Consolidated Financial Statements.

Information concerning discontinued operations is summarized below:

	Years ended December 31,		
(Dollars in millions)	2007	2006	2005
Operating revenues	$ 10	$ 89	$ 225
Income from operations, before income taxes	$ 2	$ 20	$ 25
Impairment loss	--	(68)	--
Income tax expense (benefit)	4	(20)	9
Consolidated state tax adjustment	--	1	--
	(2)	(27)	16
Gain (loss) on disposal, before income taxes	(2)	525	(9)
Income tax expense	23	174	--
Consolidated state tax adjustment	1	(9)	--
	(24)	342	(9)
	$ (26)	$ 315	$ 7

Current assets and liabilities of discontinued operations at December 31, 2006 consist primarily of income tax balances related to Bangor Gas and Frontier Energy.

NOTE 6. DEBT AND CREDIT FACILITIES

Committed Lines of Credit

At December 31, 2007, the company had available $5.2 billion in unused, committed lines of credit to provide liquidity and support commercial paper (the major components of which are detailed below).

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 November 2008. The five-year and three-year credit facilities include provisions 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, 2007, Sempra Global had letters of credit of $43 million outstanding under the five-year facility and no outstanding borrowings under either facility. The facilities provide support for $642 million of commercial paper outstanding at December 31, 2007.

Sempra Commodities has a five-year syndicated revolving credit facility expiring in 2010 that provides for 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 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 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 leverage ratio, senior debt to tangible net worth ratio, and minimum working capital, 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, 2007, Sempra Commodities had $352 million of outstanding borrowings under this facility. At December 31, 2007, letters of credit of $635 million were outstanding under the facility.

Sempra Commodities also has a $500 million, three-year credit facility expiring in 2009 that provides for extensions of credit (consisting of borrowings and the issuance of letters of credit and bank guarantees) to Sempra Commodities. Extensions of credit under the facility are guaranteed by Sempra Energy and bear interest at rates varying with market rates plus a fixed credit spread. 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 Commodities had $70 million of outstanding borrowings and $341 million of outstanding letters of credit under this facility at December 31, 2007.

Sempra LNG has a $1.25 billion, five-year syndicated revolving credit facility expiring in 2009. The facility includes provisions for the issuance of letters of credit on behalf of Sempra LNG up to $200 million outstanding at any one time. Extensions of credit 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 no outstanding borrowings and $85 million of outstanding letters of credit under this facility at December 31, 2007.

The Sempra 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 a combined borrowing limit for both utilities of $600 million. Borrowings under the agreement bear interest at rates varying with market rates and the borrowing 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, 2007, the Sempra Utilities had no amounts outstanding under this facility.

Short-term borrowings in 2007 resulted from the repayment of maturing long-term debt, and to a lesser extent, increased borrowings at Sempra Commodities.

Guarantees

As discussed in Note 3, Sempra Energy, Conoco and KMP currently hold 25 percent, 24 percent and 51 percent ownership interests, respectively, in Rockies Express, which is constructing a natural gas pipeline to link natural gas producing areas in the Rocky Mountain region to the upper Midwest and the eastern United States. Rockies Express has entered into a $2 billion, five-year credit facility expiring in 2011 that provides for revolving extensions of credit that are guaranteed severally by Sempra Energy, Conoco and KMP in proportion to their respective ownership percentages. Borrowings under the facility bear interest at rates varying with market rates plus a margin that varies with the credit ratings of the lowest-rated guarantor. The facility requires each guarantor to comply with various financial and other covenants comparable to those contained in its senior unsecured credit facilities, consisting in the case of Sempra Energy, primarily of a requirement that it maintain a ratio of total indebtedness to total capitalization (as defined in the facility) of no more than 65 percent at the end of each quarter. Rockies Express had no outstanding borrowings under this facility at December 31, 2007. This facility supports the Rockies Express commercial paper program, which had $1.63 billion outstanding at December 31, 2007. In September 2007, Rockies Express issued $600 million of floating rate notes maturing in August 2009 that are guaranteed severally by Sempra Energy, Conoco and KMP in proportion to their respective ownership percentages. The fair value to the company of these guarantees is negligible.

Uncommitted Lines of Credit

Under uncommitted facilities, lenders provide credit on a discretionary basis. Terms are generally consistent with existing committed credit facilities. At December 31, 2007, Sempra Commodities had $918 million in various uncommitted lines of credit, which are secured by certain assets at Sempra Commodities and guaranteed by Sempra Energy up to 20 percent of the amount of borrowings or credit lines utilized, subject to additional amounts based on the recoverability of Sempra Commodities' collateral. At December 31, 2007, Sempra Commodities had $316 million of letters of credit and no short-term borrowings outstanding against these lines.

Other Short-Term Debt

In addition to its lines of credit and commercial paper, Sempra Commodities had $25 million of other short-term debt outstanding at December 31, 2006.

Weighted Average Interest Rates

The company's weighted average interest rates on the total short-term debt outstanding were 5.59 percent and 5.76 percent at December 31, 2007 and 2006, respectively.

Long-Term Debt

(Dollars in millions)	December 31, 2007	2006
First mortgage bonds:		
Variable rate (5.29% at December 31, 2007) December 1, 2009	$ 100	$ 100
4.375% January 15, 2011	100	100
Variable rates after fixed-to-floating rate swaps (3.88% at December 31, 2007) 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	250
5.45% April 15, 2018	250	250
Variable rate (3.80% at December 31, 2007) July 2018	161	161
5.85% June 1, 2021	60	60
6.0% June 1, 2026	250	250
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	250
5.75% November 15, 2035	250	250
6.125% September 15, 2037	250	--
2.8275%* May 1, 2039	75	75
	2,736	2,486
Other long-term debt (unsecured unless otherwise noted):		
6.0% Notes February 1, 2013	400	400
Notes at variable rates after fixed-to-floating swap (7.42% at December 31, 2007) March 1, 2010	300	300
4.75% Notes May 15, 2009	300	300
7.95% Notes March 1, 2010	200	200
5.9% June 1, 2014	130	130
6.3% December 31, 2021	128	128
5.5% December 1, 2021	60	60
Employee Stock Ownership Plan		
Bonds at 5.781% (fixed through July 1, 2010) November 1, 2014	50	82
Bonds at variable rates (4.99% at December 31, 2007) November 1, 2014	33	10
5.3% July 1, 2021	39	39
Notes at 3.92% to 5.05% payable 2010 through 2012	41	32
4.9% March 1, 2023	25	25
Debt incurred to acquire limited partnerships, secured by real estate, at 7.52% to 9.35% annually through 2009	9	24
4.75% May 14, 2016	8	8
5.67% January 18, 2028	5	5
4.621% Notes May 17, 2007	--	600
Notes at variable rates May 21, 2008	--	300
6.37% Rate-reduction bonds, payable through 2007	--	66
OMEC LLC project financing at 5.2925% April 2019**	63	--
Other debt	28	21
Market value adjustments for interest-rate swaps, net (expiring 2010-2011)	11	(4)
	4,566	5,212
Current portion of long-term debt	(7)	(681)
Unamortized discount on long-term debt	(6)	(6)
Total	$ 4,553	$ 4,525

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

** After floating-to-fixed rate swaps expiring in 2019.

Excluding market value adjustments for interest-rate swaps, maturities of long-term debt are:

(Dollars in millions)	
2008	$ 7
2009	423
2010	513
2011	270
2012	258
Thereafter	3,084
Total	$ 4,555

Callable Long-Term Debt

At the company's option, certain debt is callable subject to premiums at various dates: $674 million in 2008, $50 million in 2010 and $282 million after 2012. In addition, $3.2 billion of bonds are callable subject to make-whole provisions.

In addition, the OMEC LLC project financing loan, discussed in Note 1, with $63 million of borrowings at December 31, 2007, may be prepaid at the borrower's option.

First Mortgage Bonds

First mortgage bonds are issued by the Sempra Utilities and secured by a lien on utility plant. The Sempra 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 $3.1 billion of first mortgage bonds at December 31, 2007.

In September 2007, SDG&E sold $250 million of 6.125-percent first mortgage bonds, maturing in 2037.

Equity Units

In 2002, the company issued $600 million of Equity Units. The units included $600 million of the company's 5.60-percent 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 percent. In May 2007, the company redeemed the $600 million of notes then currently due.

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 13.

Unsecured Long-Term Debt

Various long-term obligations totaling $1.7 billion at December 31, 2007 are unsecured.

In August 2007, the company redeemed $300 million of variable-rate notes due in May 2008.

In 2006, Sempra Pipelines & Storage, in order to reduce its property tax, incurred $128 million of long-term debt related to the development of its Liberty Gas Storage (Liberty) facility in Calcasieu Parish, Louisiana. The debt is payable to the Calcasieu Parish Industrial Development Board. Related to the debt, the company recorded bonds receivable from the Industrial Development Board for the same amount. Both the financing obligation and the bonds receivable have interest rates of 6.3 percent and are due on December 31, 2021.

Rate-Reduction Bonds

In 2007, SDG&E redeemed the $66 million remaining outstanding balance of its rate-reduction bonds, including $17 million in September 2007 in advance of the scheduled maturity of December 26, 2007.

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

The Trust covers substantially all of the employees of the parent organization, SDG&E, SoCalGas and most of Sempra Global's subsidiaries. The Trust is used to fund part of the retirement savings plan described in Note 9. The notes are payable by the Trust and mature in 2014. In July 2007, $50 million of these notes was repriced at an interest rate of 5.781 percent for a three-year term ending July 1, 2010. The remaining $33 million of the notes is repriced weekly and subject to repurchase by the company at the issuer's option. ESOP debt was paid down by $32 million during 2007, 2006 and 2005 when 656,777 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 each of 2007, 2006 and 2005. Dividends used for debt service amounted to $2 million in each of 2007, 2006 and 2005.

Interest-Rate Swaps

The company's fair value interest-rate swaps and interest-rate swaps to hedge cash flows are discussed in Note 11.

NOTE 7. FACILITIES UNDER JOINT OWNERSHIP

San Onofre Nuclear Generating Station (SONGS) and the Southwest Powerlink transmission line are owned jointly with other utilities. The company's interests at December 31, 2007 were as follows:

(Dollars in millions)	SONGS	Southwest Powerlink
Percentage ownership	20%	91%
Utility plant in service	$ 75	$ 311
Accumulated depreciation and amortization	$ 14	$ 169
Construction work in progress	$ 75	$ 2

The company, and each of the other owners, 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 asset retirement obligation related to decommissioning costs for the SONGS units was $411 million at December 31, 2007. 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. Decommissioning cost studies are updated every three years, with the most recent update approved by the CPUC in January 2007. 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 2022.

Unit 1 was permanently shut down in 1992, and physical decommissioning began in January 2000. Most 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 (DOE). The Unit 1 reactor vessel is expected to remain on site until Units 2 and 3 are decommissioned.

The amounts collected in rates are invested in externally managed trust funds. Amounts held by the trusts are invested in accordance with CPUC regulations. These trusts are shown on the Consolidated Balance Sheets at fair value with the offsetting credits recorded in Asset Retirement Obligations and Regulatory Liabilities Arising from Removal Obligations.

The following tables show the fair values and gross unrealized gains and losses for the securities held in the trust funds.

	As of December 31, 2007			
(Dollars in millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities				
U.S. government issues*	$ 168	$ 15	$ --	$ 183
Municipal bonds**	77	1	(2)	76
Total debt securities	245	16	(2)	259
Equity securities	204	234	(4)	434
Cash and other securities***	44	2	--	46
Total available-for-sale securities	$ 493	$ 252	$ (6)	$ 739

*Maturity dates are 2009-2038.

**Maturity dates are 2008-2057.

***Maturity dates are 2008-2049.

(Dollars in millions)	As of December 31, 2006 Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities				
U.S. government issues	$ 215	$ 10	$ (1)	$ 224
Municipal bonds	55	1	--	56
Total debt securities	270	11	(1)	280
Equity securities	142	217	(1)	358
Cash and other securities	61	3	--	64
Total available-for-sale securities	$ 473	$ 231	$ (2)	$ 702

The following table shows the proceeds from sales of securities in the trust and gross realized gains and losses on those sales.

(Dollars in millions)	Years ended December 31, 2007	2006	2005
Proceeds from sales	$ 578	$ 474	$ 223
Gross realized gains	$ 18	$ 22	$ 17
Gross realized losses	$ (12)	$ (13)	$ (11)

Net unrealized gains are included in Asset Retirement Obligations and Regulatory Liabilities Arising from Removal Obligations on the Consolidated Balance Sheets. The company determines the cost of securities in the trust on the basis of specific identification.

The fair value of securities in an unrealized loss position as of December 31, 2007 was $79 million. The unrealized losses were primarily caused by interest-rate movements and fluctuations in the market. The company does not consider these investments to be other than temporarily impaired as of December 31, 2007.

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 provided in Notes 14 and 16.

NOTE 8. 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,		
	2007	2006	2005
Statutory federal income tax rate	35%	35%	35%
Utility depreciation	2	2	5
State income taxes, net of federal income tax benefit	4	4	3
Tax credits	(3)	(4)	(14)
Foreign income taxes	(1)	(1)	(3)
Resolution of Internal Revenue Service audits	--	(1)	(8)
Reduction of prior period state income tax accruals,			
Reduction of prior period state income tax accruals, net of federal income tax effect	1	(1)	(6)
Utility repair allowance	(1)	(1)	(3)
Adjustment to prior year estimated tax accruals	--	(1)	(2)
Other, net	(3)	1	(3)
Effective income tax rate	34%	33%	4%

The geographic components of Income from Continuing Operations Before Income Taxes and Equity in Earnings (Losses) of Certain Unconsolidated Subsidiaries are as follows:

	Years ended December 31,		
(Dollars in millions)	2007	2006	2005
Domestic	$ 1,282	$ 1,682	$ 724
Foreign	268	232	168
Total	$ 1,550	$ 1,914	$ 892

The components of income tax expense are as follows:

	Years ended December 31,		
(Dollars in millions)	2007	2006	2005
Current:			
Federal	$ 247	$ 416	$ 312
State	77	96	11
Foreign	51	52	9
Total	375	564	332
Deferred:			
Federal	124	90	(208)
State	(5)	(36)	(78)
Foreign	36	28	(6)
Total	155	82	(292)
Deferred investment tax credits	(6)	(5)	(6)
Total income tax expense	$ 524	$ 641	$ 34

Accumulated deferred income taxes at December 31 relate to the following:

(Dollars in millions)	2007	2006
Deferred tax liabilities:		
Differences in financial and tax bases of depreciable and amortizable assets	$ 864	$ 831
Regulatory balancing accounts	152	269
Unrealized revenue	63	63
Loss on reacquired debt	24	26
Property taxes	29	27
Other	32	17
Total deferred tax liabilities	1,164	1,233
Deferred tax assets:		
Credits from alternative minimum tax	--	101
Investment tax credits	42	46
Equity losses	34	48
Net operating losses of separate state and foreign entities	125	95
Compensation-related items	169	165
Postretirement benefits	148	198
Other deferred liabilities	34	63
State income taxes	34	54
Bad debt allowance	13	18
Litigation and other accruals not yet deductible	322	327
Total deferred tax assets	921	1,115
Net deferred income tax liability before valuation allowance	243	118
Valuation allowance	41	24
Net deferred income tax liability	$ 284	$ 142

The net deferred income tax liability is recorded on the Consolidated Balance Sheets at December 31 as follows:

(Dollars in millions)	2007	2006
Current asset	$ (247)	$ (270)
Noncurrent liability	531	412
Total	$ 284	$ 142

At December 31, 2007, foreign subsidiaries had $251 million in unused net operating losses available to reduce future income taxes, primarily in Mexico and Canada. Significant amounts of these losses become unavailable to reduce future incomes taxes beginning in 2009. Financial statement benefits were recorded on all but $58 million of these losses, primarily by offsetting them against deferred tax liabilities with the same expiration pattern and country of jurisdiction. No benefits were recorded on the $58 million because they were incurred in jurisdictions where utilization is sufficiently in doubt.

At December 31, 2007, the company had not provided for U.S. income taxes on $803 million of foreign subsidiaries' undistributed earnings, since they are expected to be reinvested indefinitely outside the United States. It is not possible to predict the amount of U.S. income taxes that might be payable if these earnings were eventually repatriated.

Sempra Commodities continued its operations related to synthetic fuels tax credits through 2007, the last year of the program. Credits of $32 million were recorded in 2007.

The impact of the company's adoption of FIN 48 is discussed in Note 2.

NOTE 9. EMPLOYEE BENEFIT PLANS

The company accounts for its employee benefit plans in accordance with SFAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106 and 132(R)* (SFAS 158), which requires an employer to recognize in its statement of financial position an asset for a plan's overfunded status or a liability for a plan's underfunded status, measure a plan's assets and its obligations that determine its funded status as of the end of the company's fiscal year (with limited exceptions), and recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Generally, those changes are reported in the company's comprehensive income and as a separate component of shareholders' equity.

The information presented below covers the employee benefit plans of the company and its principal subsidiaries.

The company has funded and unfunded noncontributory defined benefit plans that together cover substantially all of its employees. The plans provide defined benefits based on years of service and either final average or career salary.

The company also has other postretirement benefit plans covering substantially all of its employees. The life insurance plans are both contributory and noncontributory, and the health care plans are contributory, with participants' contributions adjusted annually. Other postretirement benefits include medical benefits for retirees' spouses.

Pension and other postretirement benefits costs and obligations are dependent on assumptions used in calculating such amounts. These assumptions include discount rates, expected return on plan assets, rates of compensation increase, health-care cost trend rates, mortality rates and other factors. These assumptions are reviewed on an annual basis prior to the beginning of each year and updated when appropriate. The company considers current market conditions, including interest rates, in making these assumptions. The company uses a December 31 measurement date for all of its plans.

In support of its Supplemental Executive Retirement and Deferred Compensation Plans, the company maintains dedicated assets, including investments in life insurance contracts, which totaled $440 million and $379 million at December 31, 2007 and 2006, respectively.

Effective July 1, 2008, SDG&E's other postretirement benefit plan will be amended to increase the health benefits for certain represented participants. This amendment resulted in a $3 million increase in the benefit obligation and unrecognized prior service costs as of December 31, 2007.

Effective January 1, 2008, the pension plans were amended to increase the death benefit for beneficiaries of vested non-represented participants that die prior to retirement. This amendment resulted in a $2 million increase in the benefit obligation and unrecognized prior service costs as of December 31, 2007.

Effective January 1, 2008, the company's and SoCalGas' other postretirement benefit plan was amended to provide a health benefit for both represented and non-represented participants that are surviving spouses over the age of 65. This amendment resulted in an $18 million increase in the benefit obligation and unrecognized prior service costs as of December 31, 2007.

Effective March 1, 2007, the pension plans for all employees, except the represented employees of SoCalGas, were amended to change the calculation of the benefit for certain participants. The affected participants are those who had an accrued benefit under the SoCalGas or SDG&E pension plans at the date the plans transitioned from a traditional defined benefit plan to a cash balance plan. The transition date was July 1, 1998 for SoCalGas and SDG&E non-represented participants, and November 1, 1998 for SDG&E represented participants. Before the amendment date, these participants received the greater of their accrued benefit in the cash balance plan or the present value of their benefit under the prior plan as of June 30, 2003. After the amendment date, they receive the greater of the accrued benefit under the cash balance plan, or the present value of their accrued benefit under the prior plan at June 30, 2003 plus the cash balance benefit accrued after that date. This amendment resulted in a $56 million increase in the company's benefit obligation and in the unrecognized prior service cost at the end of 2006.

In the third quarter of 2006, the Pension Protection Act of 2006 was enacted. This act increases the funding requirements for qualified pension plans beginning in 2008. It also changes certain costs of providing pension benefits, including the interest rate for benefits paid as lump sums and the level of benefits that may be provided through qualified pension plans. The $73 million decrease in the company's pension obligation due to the plan changes required by this legislation were recognized in the benefit obligation and in the unrecognized prior service cost at the end of 2006.

Effective January 1, 2006, the pension plans for all employees, except the represented employees of SoCalGas, were amended to include deferred compensation, beginning January 1, 2006, in pension-eligible earnings. Also effective January 1, 2006, SoCalGas' pension plan for non-represented employees was amended to change the early retirement requirements. The service requirement necessary to qualify for early retirement was changed from 15 years to 10 years for participants currently in or grandfathered back to SoCalGas' prior pension plan as of June 30, 2003. These two changes resulted in a net $1 million increase in the company's benefit obligation and in the unrecognized prior service cost at the end of 2006.

Effective January 1, 2006, the other postretirement benefit plans for represented and non-represented employees at SDG&E and non-represented employees at SoCalGas were amended to integrate the benefits plan design across the Sempra Utilities, resulting in a net $6 million decrease in the benefit obligation as of December 31, 2005.

SoCalGas' pension plan was amended effective January 1, 2005, to increase the pension formula for service credit in excess of 30 years resulting in an increase in the pension benefit obligation of $3 million.

The following table provides a reconciliation of the changes in the plans' projected benefit obligations and the fair value of assets during the latest two years, and a statement of the funded status as of the latest two year ends:

(Dollars in millions)	Pension Benefits 2007	Pension Benefits 2006	Other Postretirement Benefits 2007	Other Postretirement Benefits 2006
CHANGE IN PROJECTED BENEFIT OBLIGATION:				
Net obligation at January 1	$ 2,885	$ 2,843	$ 952	$ 869
Service cost	76	73	26	24
Interest cost	164	158	54	45
Plan amendments	2	(16)	21	--
Actuarial loss (gain)	(90)	25	(139)	59
Curtailments	1	(1)	--	(4)
Special termination benefits	2	--	--	--
Benefit payments	(249)	(197)	(46)	(43)
Federal subsidy (Medicare Part D)	--	--	3	2
Net obligation at December 31	2,791	2,885	871	952
CHANGE IN PLAN ASSETS:				
Fair value of plan assets at January 1	2,535	2,364	694	623
Actual return on plan assets	207	333	47	82
Employer contributions	35	35	45	32
Benefit payments	(249)	(197)	(46)	(43)
Other	--	--	3	--
Fair value of plan assets at December 31	2,528	2,535	743	694
Funded status at December 31	$ (263)	$ (350)	$ (128)	$ (258)
Net recorded liability at December 31	$ (263)	$ (350)	$ (128)	$ (258)

The assets and liabilities of the pension and other postretirement benefit plans are affected by changing market conditions as well as when actual plan experience is different than assumed. Such events result in gains and losses. Investment gains and losses are deferred and recognized in pension and postretirement benefit costs over a period of years. The company uses the asset "smoothing" method for nearly 80 percent of the assets held for its pension and other postretirement plans and recognizes realized and unrealized investment gains and losses over a three-year period. This adjusted asset value, known as the market-related value of assets, is used to determine the expected return-on-assets component of net periodic cost. If, as of the beginning of a year, unrecognized net gain or loss exceeds 10 percent of the greater of the projected benefit obligation or the market-related value of plan assets, the excess is amortized over the average remaining service period of active participants. The asset smoothing and 10-percent corridor accounting methods help mitigate volatility of net periodic costs from year to year.

The net liability is included in the following captions on the Consolidated Balance Sheets at December 31 as follows:

(Dollars in millions)	Pension Benefits 2007	Pension Benefits 2006	Other Postretirement Benefits 2007	Other Postretirement Benefits 2006
Noncurrent assets	$ 75	$ 19	$ --	$ --
Current liabilities	(32)	(18)	--	--
Noncurrent liabilities	(306)	(351)	(128)	(258)
Net recorded liability	$ (263)	$ (350)	$ (128)	$ (258)

Amounts recorded in Accumulated Other Comprehensive Income (Loss) as of December 31, 2007 and 2006, net of tax effects and amounts recorded as regulatory assets, are as follows:

(Dollars in millions)	Pension Benefits 2007	Pension Benefits 2006	Other Postretirement Benefits 2007	Other Postretirement Benefits 2006
Net actuarial loss	$ 70	$ 82	$ 2	$ 3
Prior service credit	(3)	(1)	(2)	(2)
Total	$ 67	$ 81	$ --	$ 1

The accumulated benefit obligations for defined benefit pension plans were $2.6 billion and $2.7 billion at December 31, 2007 and 2006, respectively. The following table provides information concerning the one pension plan with benefit obligations in excess of plan assets as of December 31:

(Dollars in millions)	2007	2006
Projected benefit obligation	$ 774	$ 812
Accumulated benefit obligation	$ 771	$ 809
Fair value of plan assets	$ 684	$ 679

The following table provides the components of net periodic benefit cost and amounts recognized in other comprehensive income for the years ended December 31:

(Dollars in millions)	Pension Benefits 2007	Pension Benefits 2006	Pension Benefits 2005	Other Postretirement Benefits 2007	Other Postretirement Benefits 2006	Other Postretirement Benefits 2005
Net Periodic Benefit Cost						
Service cost	$ 76	$ 73	$ 62	$ 26	$ 24	$ 24
Interest cost	164	158	153	54	45	48
Expected return on assets	(158)	(149)	(153)	(44)	(40)	(39)
Amortization of:						
Prior service cost (credit)	5	10	10	(3)	(3)	(2)
Actuarial loss	8	18	17	6	3	7
Regulatory adjustment	(34)	(38)	(36)	7	4	9
Transfer of retirees	--	--	30	--	--	(10)
Special termination benefit charge	1	--	--	--	--	--
Curtailment charge	6	--	--	--	--	--
Total net periodic benefit cost	68	72	83	46	33	37
Other Changes in Plan Assets and Benefit Obligations Recognized in other Comprehensive Income						
Net gain	(12)	--	--	(2)	--	--
Prior service credit	(4)	--	--	--	--	--
Amortization of prior service credit	--	--	--	1	--	--
Amortization of actuarial loss	(8)	--	--	--	--	--
Total recognized in other comprehensive Income	(24)	--	--	(1)	--	--
Total recognized in net periodic benefit cost and other comprehensive income	$ 44	$ 72	$ 83	$ 45	$ 33	$ 37

The estimated net loss and prior service credit for the pension plans that will be amortized from Accumulated Other Comprehensive Income (Loss) into net periodic benefit cost in 2008 are $6 million and $1 million, respectively. The estimated prior service credit for the other postretirement benefit plans that will be amortized from Accumulated Other Comprehensive Income (Loss) into net periodic benefit cost in 2008 is $1 million.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 establishes a prescription drug benefit under Medicare (Medicare Part D) and a tax-exempt federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that actuarially is at least equivalent to Medicare Part D. The company determined that benefits provided to certain participants actuarially will be at least equivalent to Medicare Part D, and, accordingly, the company is entitled to a tax-exempt subsidy that reduced the company's accumulated postretirement benefit obligation under the plan at January 1, 2007 by $105 million and reduced the net periodic cost for 2007 by $13 million.

The significant assumptions related to the company's pension and other postretirement benefit plans are as follows:

	Pension Benefits		Other Postretirement Benefits	
	2007	2006	2007	2006
WEIGHTED-AVERAGE ASSUMPTIONS USED TO DETERMINE BENEFIT OBLIGATION AS OF DECEMBER 31				
Discount rate	6.10%	5.75%	6.20%	5.85%
Rate of compensation increase	4.50%	4.50%	4.00%	4.50%
WEIGHTED-AVERAGE ASSUMPTIONS USED TO DETERMINE NET PERIODIC BENEFIT COSTS FOR YEARS ENDED DECEMBER 31				
Discount rate	5.75%	5.50%	5.85%	5.60%
Expected return on plan assets	7.00%	7.00%	6.86%	6.85%
Rate of compensation increase	*	*	**	**

* 4.50% for non-qualified pension plans and 4.00% for the qualified pension plan for SoCalGas' unions. All other qualified plan participants use an age-based table.

** 4.00% in 2007 and 4.50% in 2006 for the life insurance benefits for SoCalGas' unions. There are no compensation-based benefits for all other postretirement benefits.

The company develops the discount rate assumptions based on the results of a third party modeling tool that matches each plan's expected future benefit payments to a bond yield curve to determine their present value. It then calculates a single equivalent discount rate that produces the same present value. The modeling tool uses an actual portfolio of 500 to 600 non-callable bonds with a Moody's Aa rating with an outstanding value of at least $50 million to develop the bond yield curve. This reflects over $300 billion in outstanding bonds with approximately 50 issues having maturities in excess of 20 years.

The expected long-term rate of return on plan assets is derived from historical returns for broad asset classes consistent with expectations from a variety of sources.

	2007	2006
ASSUMED HEALTH CARE COST TREND RATES AT DECEMBER 31		
Health-care cost trend rate *	9.48%	9.52%
Rate to which the cost trend rate is assumed to decline (the ultimate trend)	5.50%	5.50%
Year that the rate reaches the ultimate trend	2014 and 2016 **	2009

* This is the weighted average of the increases for the company's health plans. The rate for these plans ranged from 8.50% to 10.00% in 2006 and 2007.

** The ultimate trend rate is reached in 2014 for HMOs and 2016 for Anthem Blue Cross Plans.

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

(Dollars in millions)	1% Increase	1% Decrease
Effect on total of service and interest cost components of net periodic postretirement health-care benefit cost	$ 11	$ (9)
Effect on the health-care component of the accumulated other postretirement benefit obligation	$ 93	$ (77)

Pension Trust Investment Strategy

The asset allocation for the company's pension trust (which includes other postretirement benefit plans, except for those of the Sempra Utilities separately described below) at December 31, 2007 and 2006 and the target allocation for 2008 by asset categories are as follows:

	Target Allocation	Percentage of Plan Assets at December 31,	
Asset Category	2008	2007	2006
U.S. Equity	45%	45%	46%
Foreign Equity	25	25	24
Fixed Income	30	30	30
Total	100%	100%	100%

The company's investment strategy is to stay fully invested at all times and maintain its strategic asset allocation. The equity portfolio is balanced to maintain risk characteristics similar to the Morgan Stanley Capital International (MSCI) 2500 index with respect to industry, sector and market capitalization exposures. The foreign equity portfolios are managed to track the MSCI Europe, Pacific Rim and Emerging Markets indices. Bond portfolios are managed with respect to the Lehman Aggregate Bond Index and Lehman Long Government Credit Bond Index. Other than index weight, the plan does not invest in securities of the company.

Investment Strategy for SoCalGas' Other Postretirement Benefit Plans

The asset allocation for SoCalGas' other postretirement benefit plans at December 31, 2007 and 2006 and the target allocation for 2008 by asset categories are as follows:

	Target Allocation	Percentage of Plan Assets at December 31,	
Asset Category	2008	2007	2006
U.S. Equity	70%	75%	74%
Fixed Income	30	25	26
Total	100%	100%	100%

SoCalGas' other postretirement benefit plans are funded by cash contributions from SoCalGas and the retirees. The asset allocation is designed to match the long-term growth of the plans' liability. These plans are managed using index funds.

Investment Strategy for SDG&E's Postretirement Health Plans

The asset allocation for SDG&E's postretirement health plans at December 31, 2007 and 2006 and the target allocation for 2008 by asset categories are as follows:

	Target Allocation	Percentage of Plan Assets at December 31,	
Asset Category	2008	2007	2006
U.S. Equity	25%	25%	25%
Foreign Equity	5	5	7
Fixed Income	70	70	68
Total	100%	100%	100%

SDG&E's postretirement health plans that are not included in the pension trust (shown above) pay premiums to health maintenance organization and point-of-service plans from company and participant contributions. SDG&E's investment strategy is to maintain a diversified portfolio of equities and tax-exempt California municipal bonds.

Future Payments

The company expects to contribute $73 million to its pension plans and $36 million to its other postretirement benefit plans in 2008.

The following table reflects the total benefits expected to be paid for the next 10 years to current employees and retirees from the plans or from the company's assets.

(Dollars in millions)	Pension Benefits	Other Postretirement Benefits
2008	$ 280	$ 41
2009	$ 255	$ 45
2010	$ 257	$ 48
2011	$ 265	$ 52
2012	$ 267	$ 55
2013-2017	$ 1,374	$ 328

The expected future Medicare Part D subsidy payments are as follows:

(Dollars in millions)	
2008	$ 3
2009	$ 3
2010	$ 3
2011	$ 4
2012	$ 4
2013-2017	$ 26

Savings Plans

The company offers trusteed savings plans to all employees. Participation in the plans is immediate for salary deferrals for all employees except for the represented employees at SoCalGas, who are eligible upon completion of one year of service. Subject to plan provisions, employees may contribute from one percent to 25 percent of their regular earnings, beginning with the start of employment. After one year of each employee's completed service, the company begins to make matching contributions. Employer contribution amounts and methodology vary by plan, but generally the contributions are equal to 50 percent of the first 6 percent of eligible base salary contributed by employees and, if certain company goals are met, an additional amount related to incentive compensation payments.

Employer contributions are initially invested in company common stock but may be transferred by the employee into other investments. Employee contributions are invested in company stock, mutual funds, institutional trusts or guaranteed investment contracts (the same investments to which employees may direct the employer contributions) as elected by the employee. Employer contributions for the Sempra Energy and SoCalGas plans are partially funded by the ESOP referred to below. Company contributions to the savings plans were $31 million in 2007, $31 million in 2006 and $29 million in 2005. The market value of company stock held by the savings plans was $997 million and $976 million at December 31, 2007 and 2006, respectively.

Sempra Commodities also operates defined contribution plans outside of the United States. The contributions made by the company to such plans were $4 million in each of 2007, 2006 and 2005.

Employee Stock Ownership Plan

All contributions to the ESOP Trust (described in Note 6) are made by the company; there are no contributions made by the participants. As the company makes contributions, the ESOP debt service is paid and shares are released in proportion to the total expected debt service. Compensation expense is charged and equity is credited for the market value of the shares released. Dividends on unallocated shares are used to pay debt service and are applied against the liability. The shares held by the Trust are unallocated and consist of 1.5 million shares and 1.7 million shares, respectively, of Sempra Energy common stock, with fair values of $92 million and $94 million, at December 31, 2007 and 2006, respectively.

NOTE 10. SHARE-BASED COMPENSATION

The company has share-based compensation plans intended to align employee and shareholder objectives related to the long-term growth of the company. The plans permit a wide variety of share-based awards, including non-qualified stock options, incentive stock options, restricted stock, restricted stock units, stock appreciation rights, performance awards, stock payments and dividend equivalents.

At December 31, 2007, the company had the following types of equity awards outstanding:

- Non-Qualified Stock Options: Options have an exercise price equal to the market price of the common stock at the date of grant; are service-based; become exercisable over a four-year period (subject to accelerated vesting and/or exercisability upon a change in control, in accordance with severance pay agreements or upon retirement eligibility); and expire 10 years from the date of grant. Options are subject to forfeiture or earlier expiration upon termination of employment.

- Restricted Stock: Substantially all restricted stock vests at the end of a four-year period based on Sempra Energy's total return to shareholders relative to that of market indices (subject to earlier forfeiture upon termination of employment and accelerated vesting upon a change in control, in accordance with severance pay agreements or upon retirement eligibility). Holders of restricted stock have full voting rights. They also have full dividend rights, except for company officers, whose dividends are reinvested to purchase additional shares that become subject to the same vesting conditions as the restricted stock to which the dividends relate.

The company accounts for share-based awards in accordance with SFAS 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)), which requires the measurement and recognition of compensation expense for all share-based payment awards made to the company's employees and directors based on estimated fair values. The company adopted the provisions of SFAS 123(R) on January 1, 2006, using the modified prospective transition method. In accordance with this transition method, the company's consolidated financial statements for prior periods have not been restated to reflect the impact of SFAS 123(R). Under the modified prospective transition method, share-based compensation expense for 2006 includes compensation expense for all share-based compensation awards granted prior to, but for which the requisite service had not yet been performed as of January 1, 2006, based on the fair value estimated in accordance with the original provisions of SFAS 123, *Accounting for Stock-Based Compensation* (SFAS 123). Share-based compensation expense for all share-based compensation awards granted after January 1, 2006 is based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). The company recognizes compensation costs net of an assumed forfeiture rate and recognizes the compensation costs for non-qualified stock options and restricted shares on a straight-line basis over the requisite service period of the award, which is generally four years. However, in the year that an employee becomes eligible for retirement, the remaining expense related to the employee's awards is recognized immediately. The company estimates the forfeiture rate based on its historical experience. The company accounts for these awards as equity awards in accordance with SFAS 123(R).

Total share-based compensation expense for all of the company's share-based awards was comprised as follows:

(Dollars in millions, except per share amounts)		2007		2006
Share-based compensation expense, before income taxes	$	45	$	42
Income tax benefits		(17)		(16)
Share-based compensation expense, net of income taxes	$	28	$	26
Net share-based compensation expense, per common share				
Basic	$	0.11	$	0.10
Diluted	$	0.11	$	0.10

Capitalized compensation cost was $3 million in each of 2007 and 2006.

Prior to the adoption of SFAS 123(R), the company presented the tax benefit of stock option exercises as operating cash flows. Upon the adoption of SFAS 123(R), the tax benefits resulting from tax deductions in excess of the tax benefit related to compensation cost recognized for those share-based awards are classified as financing cash flows.

As of December 31, 2007, 20,515,872 shares were authorized and available for future grants of share-based awards. In addition, on January 1 of each year, additional shares equal to 1.5 percent of the outstanding shares of Sempra Energy common stock become available for grant. Company practice is to satisfy share-based awards by issuing new shares rather than by open-market purchases.

The company uses a Black-Scholes option-pricing model (Black-Scholes model) to estimate the fair value of each non-qualified stock option grant. The use of a valuation model requires the company to make certain assumptions with respect to selected model inputs. Expected volatility is calculated based on the historical volatility of the company's stock price. In accordance with Staff Accounting Bulletin 107 (SAB 107), for all share-based compensation awards granted after December 31, 2007, the average expected life will be based on the contractual term of the option and expected employee exercise and post-vesting employment termination behavior. Currently, it is based on the simplified approach provided by SAB 107. The risk-free interest rate is based on U.S. Treasury zero-coupon issues with a remaining term equal to the expected life assumed at the date of the grant. The weighted-average fair values for options granted during 2007 and 2006 were $13.82 and $10.75 per share, respectively, using the Black-Scholes model with the following weighted-average assumptions:

	2007	2006
Stock price volatility	21%	23%
Risk-free rate of return	4.7%	4.3%
Annual dividend yield	2.1%	2.5%
Expected life	6.2 Years	6.2 Years

A summary of the non-qualified stock options as of December 31, 2007 and activity for the year then ended follows:

	Shares under Option	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Outstanding at December 31, 2006	7,303,435	$ 28.87		
Granted	760,700	$ 57.27		
Exercised	(1,245,696)	$ 25.58		$ 43
Forfeited/canceled	(30,225)	$ 37.83		
Outstanding at December 31, 2007	6,788,214	$ 32.61	5.5	$ 199
Vested or expected to vest, at December 31, 2007	6,705,034	$ 32.47	5.4	$ 197
Exercisable at December 31, 2007	4,851,389	$ 27.06	4.5	$ 169

The aggregate intrinsic value at December 31, 2007 is the total of the difference between the company's closing stock price and the exercise price for all in-the-money options. The total fair value of shares vested in 2007 and 2006 were $7 million and $12 million, respectively.

The $7 million of total compensation cost related to nonvested stock options not yet recognized as of December 31, 2007 is expected to be recognized over a weighted-average period of 2.5 years.

Cash received from option exercises during 2007 was $32 million. The tax benefits realized for the share-based payment award deductions, in addition to the $17 million benefit shown above, totaled $24 million for 2007.

The company uses a Monte-Carlo simulation model to estimate the fair value of the restricted stock awards. The company's determination of fair value is affected by the stock price volatility and dividend yields for the company and its peer group companies. The valuation is also affected by the risk-free rates of return, and a number of other variables. Below are key assumptions for the company:

	2007	2006
Risk-free rate of return	4.6%	4.3%
Annual dividend yield	2.2%	2.6%
Stock price volatility	19%	24%

A summary of the company's restricted stock awards as of December 31, 2007 and the activity during the year is presented below.

	Shares		Weighted-Average Grant-Date Fair Value
Nonvested at December 31, 2006	2,872,003	$	37.41
Granted	803,706	$	36.62
Vested	(867,012)	$	42.65
Forfeited	(49,900)	$	36.59
Nonvested at December 31, 2007	2,758,797	$	35.79

The $31 million of total compensation cost related to nonvested restricted stock awards not yet recognized as of December 31, 2007, is expected to be recognized over a weighted-average period of 2.1 years. The total fair value of shares vested in 2007 and 2006 was $37 million and $68 million, respectively.

Prior to the adoption of SFAS 123(R), the company recognized share-based compensation expense in accordance with APBO 25, *Accounting for Stock Issued to Employees*, whereby it would have recorded compensation expense only if it had granted options at a discount, which it did not do, and for certain pre-1999 stock option grants that included dividend equivalents. The company provided pro forma disclosure amounts in accordance with SFAS 148, *Accounting for Stock-Based Compensation—Transition and Disclosure*, as if the fair value method defined by SFAS 123 had been applied to its share-based compensation. The pro forma table below reflects net earnings and basic and diluted net earnings per share for 2005, had the company applied the fair value recognition provisions of SFAS 123:

(Dollars in millions, except per share amounts)		2005
Net income as reported	$	920
Stock-based employee compensation expense reported in net income, net of tax		37
Total stock-based employee compensation under fair-value method for all awards, net of tax		(43)
Pro forma net income	$	914
Earnings per share:		
Basic - as reported	$	3.74
Basic - pro forma	$	3.72
Diluted - as reported	$	3.65
Diluted - pro forma	$	3.63

The pro forma effects of estimated share-based compensation expense for stock options on net income and earnings per common share for 2005 were estimated at the date of grant using the Black-Scholes model based on the following assumptions:

	2005
Stock price volatility	25%
Risk-free rate of return	3.9%
Annual dividend yield	2.8%
Expected life	6 Years

The Black-Scholes model weighted-average estimated fair value of stock options granted in 2005 was $8.28 per share. The total intrinsic value of options exercised in 2005 was $74 million. The total fair value of option shares vested in 2005 was $13 million. The weighted-average grant-date fair value for restricted stock granted in 2005 was $36.49 per share. The total fair value of restricted stock vested in 2005 was $10 million.

NOTE 11. FINANCIAL INSTRUMENTS

The company periodically uses commodity derivative instruments and interest-rate swap agreements to moderate its exposure to commodity price changes and interest-rate changes and to lower its overall cost of borrowing.

Fair Value Hedges

Commodity fair value hedges are associated with Sempra Commodities. These hedges are recorded as trading instruments and may involve significant notional quantities of commodities traded within that business.

As of both December 31, 2007 and 2006, the company had fair value interest-rate swap hedges for a notional amount of debt totaling $450 million. The maturities of these swaps range from 2010 to 2011. These fair value hedge balances were an asset of $11 million and a liability of $4 million at December 31, 2007 and 2006, respectively.

Market value adjustments since inception of the interest-rate swap hedges were recorded as an increase in Fixed-price Contracts and Other Derivatives (in noncurrent assets as Sundry or in noncurrent liabilities) and a corresponding increase or decrease in Long-Term Debt without affecting net income or other comprehensive income.

Cash Flow Hedges

Commodity cash flow hedges are primarily associated with Sempra Commodities. These hedges are recorded primarily as trading instruments and may involve significant notional quantities of commodities traded within that business.

As of December 31, 2007 and 2006, the company had established cash flow interest-rate swap hedges for notional debt balances totaling $434 million and $701 million, respectively. The maturities on the swaps at December 31, 2007 range from 2009 to 2038. In addition, OMEC LLC has entered into cash flow interest-rate swap hedges for a notional amount of debt ranging from $73 million to $377 million. The swaps expire in 2019.

In the third quarter of 2005, the company 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. During the second quarter of 2007, the company revised its borrowing plans in anticipation of net cash proceeds to be received in connection with the transaction related to Sempra Commodities discussed in Note 3. Accordingly, as of June 30, 2007, the company reclassified the cash flow hedge gain of $30 million pretax from Accumulated Other Comprehensive Income (Loss) to Other Income, Net in the Statements of Consolidated Income. In August 2007, the company entered into interest-rate swaps with a collective notional value of $450 million to economically offset the original swap instruments.

The balances in Accumulated Other Comprehensive Income (Loss) at December 31, 2007 and 2006 related to all cash flow hedges were losses of $24 million and $50 million, respectively, net of income tax. The company expects that losses of $26 million, which are net of income tax benefit, that are currently recorded in Accumulated Other Comprehensive Income (Loss) related to these cash flow hedges will be reclassified into earnings during the next twelve months as the hedged items affect earnings. However, in connection with the expected consummation of the transaction related to Sempra Commodities discussed in Note 3, a portion of the remaining cash flow hedge balance may be recognized at that time.

Hedge Ineffectiveness

Following is a summary of the hedge ineffectiveness gains (losses) for 2007, 2006 and 2005:

(Dollars in millions)	2007	2006	2005
Commodity hedges:*			
Cash flow hedges	$ 3	$ 24	$ 1
Fair value hedges	29	86	5
Time value exclusions from hedge assessment	192	179	98
Total unrealized gains	224	289	104
Interest-rate hedges:**			
Cash flow hedges***	(19)	(1)	4
Fair value hedges	--	--	--
Total unrealized gains (losses)	(19)	(1)	4
Total ineffectiveness gains	$ 205	$ 288	$ 108

* For commodity derivative instruments, the company records ineffectiveness gains (losses) in Operating Revenues from Sempra Global and Parent on the Statements of Consolidated Income.

** For interest-rate swap instruments, the company records ineffectiveness gains (losses) in Other Income, Net on the Statements of Consolidated Income.

*** The 2007 loss includes $(17) million associated with the consolidation of OMEC LLC as discussed in Note 1.

For commodity derivative instruments designated as fair value hedges, the ineffectiveness gains relate to hedges of commodity inventory and include gains that represent time value of money, which is excluded for hedge assessment purposes. For commodity derivative instruments designated as cash flow hedges, the ineffectiveness amounts for 2007, 2006 and 2005 relate to hedges of natural gas purchases and sales related to transportation and storage capacity arrangements. For 2006 and 2005, the ineffectiveness also relates to the phase-out of synthetic fuels income tax credits. In 2007 and 2006, the company also reclassified $2 million and $39 million, respectively, of losses from Accumulated Other Comprehensive Income (Loss) due to the expectation that these losses will not be recovered. The gains and losses are included in Operating Revenues from Sempra Global and Parent on the Statements of Consolidated Income.

Sempra Commodities

The carrying values of trading assets and trading liabilities, primarily at Sempra Commodities, are as follows:

(Dollars in millions)	December 31, 2007	2006
TRADING ASSETS		
Trading-related receivables and deposits, net:		
Due from trading counterparties	$ 2,657	$ 2,610
Due from commodity clearing organizations and clearing brokers	230	437
	2,887	3,047
Derivative trading instruments:		
Unrealized gains on swaps and forwards	2,264	2,389
OTC commodity options purchased	1,103	1,679
	3,367	4,068
Commodities owned	2,231	1,845
Total trading assets	$ 8,485	$ 8,960
TRADING LIABILITIES		
Trading-related payables	$ 3,328	$ 3,211
Derivative trading instruments sold, not yet purchased:		
Unrealized losses on swaps and forwards	1,252	1,670
OTC commodity options written	722	634
	1,974	2,304
Commodities sold with agreement to repurchase	500	537
Total trading liabilities	$ 5,802	$ 6,052

Based on quarterly measurements, the average fair values during 2007 for trading assets and liabilities were approximately $7.8 billion and $5.5 billion, respectively. For 2006, the amounts were $8.9 billion and $6.4 billion, respectively.

Sempra Commodities' credit risk from physical and financial instruments as of December 31, 2007 is represented by their positive fair value after consideration of collateral. Options written do not expose Sempra Commodities to credit risk. Exchange-traded futures and options are not deemed to have significant credit exposure since the exchanges guarantee that every contract will be properly settled on a daily basis. Credit risk is also associated with its retail customers.

The following table summarizes the counterparty credit quality and exposure for Sempra Commodities, expressed in terms of net replacement value. These exposures are net of collateral in the form of customer margin and/or letters of credit of $1.6 billion and $1.9 billion at December 31, 2007 and 2006, respectively.

(Dollars in millions)	December 31, 2007	2006
Counterparty credit quality*		
Commodity exchanges	$ 230	$ 437
AAA	13	19
AA	478	262
A	419	654
BBB	504	1,032
Below investment grade or not rated	959	1,011
Total	$ 2,603	$ 3,415

* As determined by rating agencies or by internal models intended to approximate rating agency determinations.

Sempra Utilities

At the Sempra Utilities, the use of derivative instruments is subject to certain limitations imposed by company policy and regulatory requirements. These instruments enable the company to estimate with greater certainty the effective prices to be received by the company and the prices to be charged to its customers. The Sempra Utilities record realized gains or losses on derivative instruments associated with transactions for electric energy and natural gas contracts in Cost of Electric Fuel and Purchased Power and Cost of Natural Gas, respectively, on the Statements of Consolidated Income. On the Consolidated Balance Sheets, the Sempra Utilities record corresponding regulatory assets and liabilities related to unrealized gains and losses from these derivative instruments to the extent derivative gains and losses associated with these derivative instruments will be payable or recoverable in future rates.

Fair Value of Financial Instruments

The fair values of certain of the company's financial instruments (cash, temporary investments, notes receivable, dividends payable, short-term debt and customer deposits) approximate their carrying amounts. The following table provides the carrying amounts and fair values of the remaining financial instruments at December 31:

	2007		2006	
(Dollars in millions)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Investments in limited partnerships*	$ 61	$ 84	$ 96	$ 134
Total long-term debt**	$ 4,566	$ 4,620	$ 5,212	$ 5,244
Due to unconsolidated affiliates	$ 162	$ 170	$ 162	$ 169
Preferred stock of subsidiaries***	$ 193	$ 173	$ 196	$ 186

* See Note 4.

** Before reductions for unamortized discount of $6 million at both December 31, 2007 and 2006.

*** At December 31, 2007 and 2006, $14 million and $3 million, respectively, of mandatorily redeemable preferred stock of subsidiaries were included in Other Current Liabilities, and at December 31, 2006, $14 million was included in Deferred Credits and Other Liabilities on the Consolidated Balance Sheets.

The fair values of investments in limited partnerships were based on the present value of estimated future cash flows, discounted at rates available for similar investments. The fair values of debt incurred to acquire limited partnerships were estimated based on the present value of the future cash flows, discounted at rates available for similar notes with comparable maturities. The fair values of the other long-term debt and preferred stock were based on their quoted market prices or quoted market prices for similar securities.

Adoption of SFAS 157

Effective January 1, 2007, the company early-adopted SFAS 157 as discussed in Note 2, which, among other things, requires enhanced disclosures about assets and liabilities carried at fair value.

As defined in SFAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). However, as permitted under SFAS 157, the company utilizes a mid-market pricing convention (the mid-point price between bid and ask prices) as a practical expedient for valuing the majority of its assets and liabilities measured and reported at fair value. The company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The company primarily applies the market approach for recurring fair value measurements and endeavors to utilize the best available information. Accordingly, the company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The company is able to classify fair value balances based on the observability of those inputs. SFAS 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurement) and the lowest priority to unobservable inputs (level 3 measurement). The three levels of the fair value hierarchy defined by SFAS 157 are as follows:

> Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 primarily consists of financial instruments such as exchange-traded derivatives, listed equities and U.S. government treasury securities.
>
> Level 2 – Pricing inputs are other than quoted prices in active markets included in level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Instruments in this category include non-exchange-traded derivatives such as OTC forwards, options and repurchase agreements.
>
> Level 3 – Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value. Level 3 instruments include those that may be more structured or otherwise tailored to customers' needs. At each balance sheet date, the company performs an analysis of all instruments subject to SFAS 157 and includes in level 3 all of those whose fair value is based on significant unobservable inputs.

The following table sets forth by level within the fair value hierarchy the company's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2007. As required by SFAS 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

Recurring Fair Value Measures (Dollars in millions)	At fair value as of December 31, 2007 Level 1	Level 2	Level 3	Total
Assets:				
Trading derivatives	$ 201	$ 2,943	$ 446	$ 3,590
Commodity trading inventories	--	2,177	--	2,177
Other derivatives	25	45	7	77
Nuclear decommissioning trusts	551	175	--	726
Other	86	6	7	99
Total	$ 863	$ 5,346	$ 460	$ 6,669
Liabilities:				
Trading derivatives	$ 200	$ 2,116	$ 59	$ 2,375
Other derivatives	9	32	--	41
Total	$ 209	$ 2,148	$ 59	$ 2,416

Trading derivatives in the Recurring Fair Value Measures table above include OTC unrealized values related to swaps, forwards and options, as well as open, listed exchange transactions. However, exchange transactions, which are cash settled during the life of the transaction, are classified as part of Trading-related Receivables and Deposits, Net on the Consolidated Balance Sheets. The following table provides a reconciliation of these balances as of December 31, 2007.

(Dollars in millions)	As of December 31, 2007 Assets	Liabilities
Derivative trading instruments:		
Per Consolidated Balance Sheet	$ 3,367	$ 1,974
Unrealized revenues for exchange contracts	223	401
Per Recurring Fair Value Measures Table	$ 3,590	$ 2,375

The Recurring Fair Value Measures table above does not include certain commodity trading inventories that are carried on a lower-of-cost-or-market basis. The table does include a portion of commodity trading inventories for which fair value hedge accounting is applied.

(Dollars in millions)	As of December 31, 2007
Commodities owned:	
Per Consolidated Balance Sheet	$ 2,231
Less: Commodities owned, recorded at lower-of-cost-or-market	(54)
Per Recurring Fair Value Measures Table	$ 2,177

The determination of the fair values above incorporates various factors required under SFAS 157. These factors include not only the credit standing of the counterparties involved and the impact of credit enhancements (such as cash deposits, letters of credit and priority interests), but also the impact of the company's nonperformance risk on its liabilities.

Trading derivatives and commodity trading inventories reflect positions held by Sempra Commodities. Trading derivatives include exchange-traded derivative contracts and OTC derivative contracts. Exchange-traded derivative contracts, which include futures and exchange-traded options, are generally based on unadjusted quoted prices in active markets and are classified within level 1. In addition, certain OTC-cleared options and swap contracts are included in level 1, as the fair values of these items are based on unadjusted quoted prices in active markets. Some exchange-traded derivatives are valued using broker