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SAN DIEGO GAS & ELECTRIC COMPANY

EXCERPTS FROM FORM 10-K (Annual Report)

Filed 02/26/10 for the Period Ending 12/31/09

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

January 14, 2011



SAN DIEGO GAS & ELECTRIC CO

FORM 10-K (Annual Report)

Filed 02/26/10 for the Period Ending 12/31/09

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Fiscal Year	12/31

SEMPRA ENERGY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES AND OTHER FINANCIAL DATA

PRINCIPLES OF CONSOLIDATION

Sempra Energy

Sempra Energy's Consolidated Financial Statements include the accounts of Sempra Energy, a California-based Fortune 500 holding company, its consolidated subsidiaries, and variable interest entities. Sempra Energy's principal subsidiaries are

- San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas), which we collectively refer to as the Sempra Utilities; and
- Sempra Global, which is the holding company for Sempra Commodities, Sempra Generation, Sempra Pipelines & Storage, Sempra LNG and other, smaller businesses.

Sempra Energy uses the equity method to account for investments in affiliated companies over which we have the ability to exercise significant influence, but not control. We discuss our investments in unconsolidated subsidiaries in Notes 3 and 4.

SDG&E

SDG&E's Consolidated Financial Statements include its accounts, the accounts of its sole subsidiary, SDG&E Funding LLC, and the accounts of Otay Mesa Energy Center LLC (Otay Mesa VIE) and Orange Grove Energy L.P. (Orange Grove VIE), which are variable interest entities of which SDG&E is the primary beneficiary, as discussed below under "Variable Interest Entities." SDG&E's common stock is wholly owned by Enova Corporation, which is a wholly owned subsidiary of Sempra Energy. The activities of SDG&E Funding LLC were substantially complete in 2007, and the entity was dissolved in 2008.

Pacific Enterprises and SoCalGas

The Consolidated Financial Statements of Pacific Enterprises include the accounts of Pacific Enterprises (PE) and its subsidiary, SoCalGas. Sempra Energy owns all of PE's common stock and PE owns all of SoCalGas' common stock. SoCalGas' Consolidated Financial Statements include its subsidiaries, which comprise less than one percent of its consolidated financial position and results of operations.

PE's operations consist solely of those of SoCalGas and additional items (e.g., cash, intercompany accounts and equity) attributable to serving as a holding company for SoCalGas.

BASIS OF PRESENTATION

This is a combined report of Sempra Energy, SDG&E, PE and SoCalGas. We provide separate information for SDG&E, PE and SoCalGas as required. When only information for SoCalGas is provided, it is the same for PE. References in this report to "we," "our" and "Sempra Energy Consolidated" are to Sempra Energy and its consolidated entities, unless otherwise indicated by the context. We have eliminated intercompany accounts and transactions within each set of consolidated financial statements.

We evaluated events and transactions that occurred after December 31, 2009 through the date the financial statements were issued, and in the opinion of management, the accompanying statements reflect all adjustments necessary for a fair presentation.

QUASI-REORGANIZATION

In 1993, PE effected a quasi-reorganization for financial reporting purposes as of December 31, 1992. A quasi-reorganization permits a company, for accounting purposes, to adjust its financial statements and proceed on much the same basis as if it had been legally reorganized. In 2007, an adjustment to liabilities related to the quasi-reorganization resulted in a decrease to equity. We expect to resolve the remaining liabilities of \$4 million in 2010. We believe the provisions established for these matters are adequate.

USE OF ESTIMATES IN THE PREPARATION OF THE FINANCIAL STATEMENTS

We prepare our financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP). This requires us to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes, including the disclosure of contingent assets and liabilities at the date of the financial statements. Although we believe the estimates and assumptions are reasonable, actual amounts ultimately may differ significantly from those estimates.

REGULATORY MATTERS

Effects of Regulation

The accounting policies of our principal regulated utility subsidiaries, SDG&E and SoCalGas, 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 Sempra Utilities prepare their financial statements in accordance with GAAP provisions governing regulated operations. Under these provisions, 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

Intangible assets included in Goodwill and Other Intangible Assets on the Sempra Energy Consolidated Balance Sheets are recorded as follows:

OTHER INTANGIBLE ASSETS

(Dollars in millions)

	Amortization period (years)	December 31, 2009	December 31, 2008
Storage rights	46	\$ 138	\$ 138
Development rights	50	322	322
Other	15 years to indefinite	9	9
Total		469	469
Less accumulated amortization		(13)	(3)
Total		\$ 456	\$ 466

Amortization expense related to the above intangible assets was \$10 million in 2009, \$3 million in 2008 and a negligible amount in 2007. We estimate the aggregate amortization expense for the next five years to be \$10 million per year.

LONG-LIVED ASSETS

We periodically evaluate whether events or circumstances have occurred that may affect the recoverability or the estimated useful lives of long-lived assets, the definition of which includes intangible assets subject to amortization, but 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 not be recoverable, the impairment is measured based on the difference between the carrying amount and the fair value of the assets. This evaluation is performed at the lowest level for which separately identifiable cash flows exist.

In the second quarter of 2009, we recorded a \$132 million pretax write-off related to certain assets at one of Sempra Pipelines & Storage's Liberty Gas Storage natural gas storage projects. This amount is recorded as Write-off of Long-lived Assets on our Consolidated Statement of Operations for the year ended December 31, 2009. Sempra Pipelines & Storage owns 75 percent of the partnership that is developing the project. Our partner's 25-percent share of the pretax charge is \$33 million, which is included in (Earnings) Losses Attributable to Noncontrolling Interests on our Consolidated Statement of Operations for the year ended December 31, 2009. The impact to our net income and to our earnings is \$97 million and \$64 million, respectively, for the year ended December 31, 2009. In September 2009, the members of the partnership unanimously voted to proceed with the abandonment of the assets that were written off.

VARIABLE INTEREST ENTITIES

We consolidate a variable interest entity (VIE) if we are the primary beneficiary of the VIE's activities. Our determination of whether we are the primary beneficiary is based upon qualitative and quantitative analyses, which assess

- the purpose and design of the VIE;
- the nature of the VIE's risks and the risks we absorb; and
- whether the variable interest holders will absorb a majority of the VIE's expected losses or receive a majority of its expected residual returns (or both).

Otay Mesa VIE

SDG&E has a 10-year agreement to purchase power to be generated at the Otay Mesa Energy Center (OMEC), a 573-megawatt (MW) generating facility that began commercial operations in October 2009. SDG&E supplies all of the natural gas to fuel the power plant and purchases its electric generation output (i.e., tolling). The agreement provides SDG&E with the option to purchase the power plant at the end of the contract term in 2019, or upon earlier termination of the purchased-power agreement, at a predetermined price subject to adjustments based on performance of the facility. If SDG&E does not exercise its option, under certain circumstances, it may be required to purchase the power plant at a predetermined price.

The facility owner, Otay Mesa Energy Center LLC (OMEC LLC), is a VIE (Otay Mesa VIE), of which SDG&E is the primary beneficiary. SDG&E has no OMEC LLC voting rights and does not operate OMEC.

Based upon our analysis, SDG&E absorbs the majority of risk from Otay Mesa VIE under the combination of the tolling agreement and the put option. Accordingly, Sempra Energy and SDG&E have consolidated Otay Mesa VIE since the second quarter of 2007. The CPUC has approved an additional financial return to SDG&E to compensate it for the effect on its financial ratios from the requirement to consolidate Otay Mesa VIE. Otay Mesa VIE's equity of \$146 million and \$128 million is included on the Consolidated Balance Sheets in Other Noncontrolling Interests for Sempra Energy and in Noncontrolling Interests for SDG&E at December 31, 2009 and 2008, respectively.

OMEC LLC has a loan outstanding of \$375 million at December 31, 2009, the proceeds of which were used for the construction of OMEC. The loan is with third party lenders and is secured by property, plant and equipment. SDG&E is not a party to the loan agreement and does not have any additional implicit or explicit financial responsibility to Otay Mesa VIE. The loan matures in April 2019 and bears interest at rates varying with market rates. In addition, OMEC LLC has entered into interest-rate swap agreements to moderate its exposure to interest-rate changes. We provide additional information concerning the interest-rate swaps in Note 11.

Orange Grove VIE

SDG&E has a 25-year agreement to purchase power to be generated by Orange Grove Energy L.P. (Orange Grove), at its 94-MW generating facility located in San Diego County, California. The facility is currently under construction, and we expect it to be

available for commercial operation during the second quarter of 2010. Orange Grove is a VIE (Orange Grove VIE) of which SDG&E is the primary beneficiary. During the third quarter of 2009, all of the conditions precedent in the purchased-power agreement were satisfied, therefore, effective on September 30, 2009, Sempra Energy and SDG&E have consolidated Orange Grove VIE.

Orange Grove has credit facilities that provide for a total of \$100 million for construction of the generating facility. These credit agreements are with a third party lender and are secured by Orange Grove's assets. SDG&E is not a party to the credit agreements and does not have any additional implicit or explicit financial responsibility to Orange Grove. When Orange Grove completes construction of the generating facility, or on June 30, 2010 if construction is not completed by that date, the credit facilities will convert to a term loan that matures in June 2035. Borrowings under the credit facilities bear interest at rates varying with market rates. At December 31, 2009, Orange Grove had \$87 million of outstanding borrowings under the credit facilities and \$3 million of letters of credit supported by the facilities. In addition, Orange Grove has a short-term loan outstanding of \$33 million.

The Consolidated Financial Statements of Sempra Energy and SDG&E include the following amounts associated with Otay Mesa VIE and Orange Grove VIE, which are net of eliminations of transactions between SDG&E and the VIEs:

AMOUNTS ASSOCIATED WITH VARIABLE INTEREST ENTITIES

(Dollars in millions)

	December 31,	
	2009	2008(1)
Cash and cash equivalents	\$ 7	\$ 11
Restricted cash	8	-
Accounts receivable - other	1	23
Inventories	2	-
Total current assets	18	34
Sundry	10	8
Property, plant and equipment	644	464
Total assets	\$ 672	\$ 506
Short-term debt	\$ 33	\$ -
Accounts payable	-	35
Current portion of long-term debt	40	2
Fixed-price contracts and other derivatives	17	13
Other	(13)	-
Total current liabilities	77	50
Long-term debt	422	254
Fixed-price contracts and other derivatives	26	73
Deferred credits and other	1	1
Other noncontrolling interests	146	128
Total liabilities and equity	\$ 672	\$ 506

	Years ended December 31,		
	2009	2008(1)	2007(1)
Operating revenues - electric	\$ (1)	\$ -	\$ -
Operating expenses			
Cost of electric fuel and purchased power	(13)	-	-
Operation and maintenance	7	-	-
Depreciation and amortization	7	-	-
Total operating expenses	1	-	-
Operating income	(2)	-	-
Other income (expense), net	26	(54)	(17)
Net income/Income before income taxes	24	(54)	(17)
(Earnings) losses attributable to noncontrolling interests	(24)	54	17
Earnings	\$ -	\$ -	\$ -

(1) As adjusted for the retrospective adoption of ASC 810 (SFAS 160) discussed in Note 2.

Other contracts under which SDG&E acquires power from generation facilities otherwise unrelated to SDG&E could also result in a requirement for SDG&E to consolidate the entity that owns the facility. In accordance with the current GAAP provisions governing variable interest entities, SDG&E continues the process of determining if it has any such situations and, if so, gathering the information that would be needed to perform the consolidation. However, such information has not been made available to us and an evaluation of variable interests has not been completed for these entities that are grandfathered pursuant to current GAAP guidance. The effects of any required consolidation are not expected to significantly affect the financial position, results of operations or liquidity of SDG&E.

ASSET RETIREMENT OBLIGATIONS

For tangible long-lived assets, we record asset retirement obligations for the present value of liabilities of future costs expected to be incurred when assets are retired from service, if the retirement process is legally required and if a reasonable estimate of fair value can be made. We record 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. Rate-regulated entities record regulatory assets or liabilities as a result of the timing difference between the recognition of costs in accordance with GAAP and costs recovered through the rate-making process. We have recorded a regulatory liability to show that the Sempra Utilities have collected funds from customers more quickly and for larger amounts than we would accrete the retirement liability and depreciate the asset in accordance with GAAP.

We have recorded asset retirement obligations related to various assets including:

SDG&E and SoCalGas