SEMPRA ENERGY
Form 10-K
February 23, 2006

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

FORM 10-K

(Mark One)

[X]	ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the fiscal year ended December 31, 2005
[ ]	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the transition period from to

Commission file number 1-14201

SEMPRA ENERGY

(Exact name of registrant as specified in its charter)

California	33-0732627
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

101 Ash Street, San Diego, California 92101

(Address of principal executive offices)
(Zip Code)

(619) 696-2034

(Registrant's telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of each class	Name of each exchange on which registered
Common stock, without par value	New York and Pacific

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes X No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No X

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

X

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	[X]	Accelerated filer	[ ]	Non-accelerated filer	[ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes	[redacted]	No	X [redacted]

Exhibit Index on page 38. Glossary on page 46.

Aggregate market value of the voting stock held by non-affiliates of the registrant as of June 30, 2005 was $10.5 billion.

Registrant's common stock outstanding as of January 31, 2006 was 258,414,771 shares.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the 2005 Annual Report to Shareholders are incorporated by reference into Parts I, II, and IV.

Portions of the Proxy Statement prepared for the May 2006 annual meeting of shareholders are incorporated by reference into Part III.

TABLE OF CONTENTS

INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

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

Forward-looking statements are necessarily based upon various assumptions involving judgments with respect to the future and other risks, including, among others, local, regional, national and international economic, competitive, political, legislative and regulatory conditions and developments; actions by the California Public Utilities Commission, the California State Legislature, the California Department of Water Resources, and the Federal Energy Regulatory Commission and other regulatory bodies in the United States and other countries; capital markets conditions, inflation rates, interest rates and exchange rates; energy and trading markets, including the timing and extent of changes in commodity prices; the availability of natural gas; weather conditions and conservation efforts; war and terrorist attacks; business, regulatory, environmental and legal decisions and requirements; the status of deregulation of retail natural gas and electricity delivery; the timing and success of business development efforts; the resolution of litigation; and other uncertainties, all of which are difficult to predict and many of which are beyond the control of the company. Readers are cautioned not to rely unduly on any forward-looking statements and are urged to review and consider carefully the risks, uncertainties and other factors which affect the company's business described in this report and other reports filed by the company from time to time with the Securities and Exchange Commission.

PART I

ITEM 1. BUSINESS AND RISK FACTORS

Back to Contents

Description of Business

A description of Sempra Energy and its subsidiaries (the company) is given in "Management's Discussion and Analysis of Financial Condition and Results of Operations" of the 2005 Annual Report to Shareholders, which is incorporated by reference. The company has four separately managed reportable segments comprised of Southern California Gas Company (SoCalGas), San Diego Gas & Electric Company (SDG&E), Sempra Commodities and Sempra Generation. SoCalGas and SDG&E are collectively referred to as "the California Utilities."

Company Website

The company's website address is http://www.sempra.com. The company makes available free of charge through its website, its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission. The charters of the audit, compensation and corporate governance committees of the company's board of directors (the board), the board's corporate governance guidelines, and the company's code of business conduct and ethics for directors and officers are posted on the company's website. Printed copies may be obtained by writing to the company's Corporate Secretary at Sempra Energy, 101 Ash Street, San Diego, CA 92101-3017.

Risk Factors

The following risk factors and all other information contained in this report should be considered carefully when evaluating Sempra Energy and its subsidiaries. These risk factors could affect the actual results of Sempra Energy and its subsidiaries and cause such results to differ materially from those expressed in any forward-looking statements of, or made by or on behalf of, Sempra Energy or its subsidiaries. Other risks and uncertainties, in addition to those that are described below, may also impair their business operations. If any of the following risks occurs, Sempra Energy's business, cash flows, results of operations and financial condition could be seriously harmed. In addition, the trading price of its securities could decline due to the occurrence of any of these risks. These risk factors should be read in conjunction with the other detailed information concerning Sempra Energy and its subsidiaries set forth in the notes to Consolidated Financial Statements and in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in the 2005 Annual Report to Shareholders, which is incorporated by reference in this report.

Risks Related to the California Utilities

The California Utilities are subject to extensive regulation by state, federal and local legislation and regulatory authorities, which may adversely affect the operations, performance and growth of their businesses.

The California Public Utilities Commission (CPUC), which consists of five commissioners appointed by the Governor of California for staggered six-year terms, regulates the California Utilities' rates (except electric transmission rates, which are regulated by the Federal Energy Regulatory Commission (FERC)) and conditions of service, sales of securities, rates of return, rates of depreciation, uniform systems of accounts, examination of records and long-term resource procurement. The CPUC conducts various reviews of utility performance (which may include reasonableness and prudency reviews) and affiliate relationships and conducts audits and investigations into various matters which may, from time to time, result in disallowances and penalties adversely affecting earnings and cash flows. Various proceedings involving the CPUC and relating to the California Utilities' rates, costs, incentive mechanisms, performance-based regulation and compliance with affiliate and holding company rules are discussed in the notes to Consolidated Financial Statements and in "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Periodically, the California Utilities' rates are approved by the CPUC based on forecasts of capital and operating costs. If the California Utilities' actual capital and operating costs were to exceed the amount included in its base rates approved by the CPUC, it would adversely affect earnings and cash flows.

To promote efficient operations and improved productivity and to move away from reasonableness reviews and disallowances, the CPUC adopted Performance-Based Regulation (PBR) for the California Utilities. Under PBR, regulators require future income potential to be tied to achieving or exceeding specific performance and operating income goals, rather than relying solely on expanding utility plant to increase earnings. The three areas that are eligible for PBR rewards are: operational incentives based on measurements of safety, reliability and customer satisfaction; energy efficiency rewards based on the effectiveness of the programs; and natural gas procurement rewards. Although the California Utilities have received PBR rewards in the past, there can be no assurance that they will receive rewards in the future, or that they would be of comparable amounts. Additionally, if the California Utilities fail to achieve certain minimum performance levels established under the PBR mechanisms, they may be assessed financial disallowances or penalties which could negatively affect earnings and cash flows.

The FERC regulates electric transmission rates, the transmission and wholesale sales of electricity in interstate commerce, transmission access and other similar matters involving SDG&E.

The California Utilities may be adversely affected by new regulations, decisions, orders or interpretations of the CPUC, FERC or other regulatory bodies. New legislation, regulations, decisions, orders or interpretations could change how the California Utilities operate, could affect their ability to recover various costs through rates or adjustment mechanisms, or could require the California Utilities to incur additional expenses.

SDG&E may incur substantial costs and liabilities as a result of its ownership of nuclear facilities.

SDG&E owns a 20% interest in the San Onofre Nuclear Generating Station (SONGS), a 2,150 megawatt nuclear generating facility near San Clemente, California. The Nuclear Regulatory Commission (NRC) has broad authority under federal law to impose licensing and safety-related requirements for the operation of nuclear generation facilities. SDG&E's ownership interest in SONGS subjects it to the risks of nuclear generation, which include:

- the potential harmful effects on the environment and human health resulting from the operation of nuclear facilities and the storage, handling and disposal of radioactive materials;
- limitations on the amounts and types of insurance commercially available to cover losses that might arise in connection with nuclear operations; and
- uncertainties with respect to the technological and financial aspects of decommissioning nuclear plants at the end of their licensed lives.

The California Utilities' future results of operations and financial condition may be materially adversely affected by the outcome of pending litigation against them.

The California energy crisis of 2000 - 2001 has generated numerous lawsuits, governmental investigations and regulatory proceedings involving many energy companies, including Sempra Energy and the California Utilities. In January 2006, Sempra Energy and the California Utilities reached agreement to settle several of these lawsuits including, subject to court and other approvals, the principal class action antitrust lawsuits in which they are defendants. The companies remain defendants in several additional lawsuits arising out of the energy crisis, including lawsuits commenced in the fourth quarter of 2005 by the California Attorney General. The company is also responding to an ongoing CPUC proceeding related to the increase in natural gas prices at the California-Arizona border in 2000 - 2001. Sempra Energy and the California Utilities have expended and continue to expend substantial amounts defending these lawsuits and in connection with related investigations and regulatory proceedings. Sempra Energy and the California Utilities have established reserves for the agreed and unresolved issues. However, given the uncertainties involved in resolving litigation, Sempra Energy's and the California Utilities' results of operations and financial condition may be materially adversely affected.

These proceedings are discussed in the notes to Consolidated Financial Statements and in "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Risks Related to Sempra Energy's Electric Generation, Commodities Trading, Liquefied Natural Gas (LNG), Pipelines & Storage and Other Businesses

Sempra Energy's businesses are exposed to market risk, and its financial condition, results of operations, cash flows and liquidity may be adversely affected by fluctuations in commodity market prices that are beyond its control.

Sempra Commodities is a full-service trading company that markets and trades physical and financial commodity products. Its trading portfolios consist of physical and financial commodity contracts, including contracts for natural gas, electricity, petroleum products, base metals and other commodities that are settled by the delivery of the commodity or cash. Although Sempra Commodities generally seeks to structure its trading contracts so that a substantial majority of its trading revenues are realizable within 24 months and strives to maintain appropriate hedging mechanisms for its trading book, Sempra Commodities may have substantial unhedged trading positions in the market, resulting from the management of its trading portfolios or from its inability to hedge, in whole or in part, particular risks.

Sempra Generation generates electricity that it sells under long-term contracts and into the spot market or other competitive markets. It purchases fuel for its power plants, consisting of natural gas and coal, and may also purchase electricity in the open market to satisfy its contractual obligations.

Sempra Energy's revenues and results of operations could be adversely affected if the prevailing market prices for electricity, natural gas, coal or other commodities, whether procured for power plants or to satisfy contractual obligations with trading counterparties or customers, in regional markets and other competitive markets in which the company competes, change in a direction or manner that it has not anticipated and for which it has not provided through purchase or sale commitments or other hedging transactions.

Unanticipated changes in market prices for energy-related and other commodities result from multiple factors, including: weather conditions; seasonality; changes in demand; transmission or transportation constraints or inefficiencies; availability of competitively priced alternative energy sources; commodity production levels; actions by the Organization of the Petroleum Exporting Countries with respect to the supply of crude oil; federal, state and foreign energy and environmental regulation and legislation; natural disasters, wars, embargoes and other catastrophic events; and expropriation of assets by foreign countries.

In 2001 the FERC, which has jurisdiction over wholesale power and transmission rates, independent system operators and other entities that control transmission facilities or that administer wholesale power sales in some of the markets in which the company operates, imposed price limitations which resulted in unexpected moves in electricity prices. The FERC may impose additional price limitations, bidding rules and other mechanisms or terminate existing price limitations from time to time in the future. Any such action by the FERC may result in prices for electricity changing in an unanticipated direction or manner, and may have an adverse effect on Sempra Energy's sales and results of operations.

Sempra Energy and its subsidiaries cannot and do not attempt to fully hedge their assets or positions against changes in commodity prices, and their hedging procedures may not work as planned.

To reduce financial exposure related to commodity price fluctuations, Sempra Energy's subsidiaries routinely enter into contracts to hedge a substantial portion of their purchase and sale commitments and inventories of electricity, natural gas, coal, crude oil and refined petroleum products, base metals and other commodities. As part of this strategy, they routinely utilize fixed-price, forward, physical purchase and sales contracts, futures, financial swaps and option contracts traded in the over-the-counter markets or on exchanges. However, the company does not cover the entire exposure of its assets or its positions to market price volatility and the coverage will vary over time. To the extent Sempra Energy's subsidiaries have unhedged positions, or if their hedging strategies do not work as planned, fluctuating commodity prices could have a material adverse effect on Sempra Energy's business, results of operations, cash flows and financial condition.

Risk management procedures may not prevent losses.

Although Sempra Energy and its subsidiaries have in place risk management systems and control systems that use advanced methodologies to quantify and manage risk, these systems may not always prevent material losses. Risk management procedures may not always be followed or may not always work as planned. In addition, daily value-at-risk and loss limits are based on historic price movements. If prices significantly or persistently deviate from historic prices, the limits may not protect the company from significant losses. As a result of these and other factors, there can be no assurances that Sempra Energy's risk management procedures will prevent losses that would negatively affect its business, results of operations, cash flows and financial condition.

A downgrade in Sempra Energy's credit ratings could negatively affect its commodities trading and other non-utility businesses.

If Sempra Energy's credit ratings were to be downgraded, the business prospects of its commodities trading and other non-utility businesses, which generally rely on the credit-worthiness of Sempra Energy, would be adversely affected. Sempra Commodities would be required to comply with various margin or other credit enhancement obligations under its trading and marketing contracts, substantially all of which are guaranteed by Sempra Energy, and it may be unable to continue to trade or able to do so only on less-favorable terms. To meet liquidity requirements, Sempra Energy and its subsidiaries maintain substantial unused committed lines of credit for which borrowings are available without regard to credit ratings. However, a ratings downgrade could require Sempra Energy to divert to Sempra Commodities all or a portion of the liquidity that these lines would otherwise provide for the expansion of Sempra Energy's other non-utility businesses. In addition, if these lines were to become unavailable or to be inadequate to meet margin or other credit enhancement requirements, Sempra Commodities' trading partners could exercise other remedies such as liquidating and netting their exposures to Sempra Commodities, making it more difficult or impossible for Sempra Commodities to manage effectively its remaining trading positions or to continue its trading business, and Sempra Energy and its subsidiaries may not have sufficient liquidity to meet their obligations.

Sempra Energy's businesses depend on counterparties, customers and suppliers performing in accordance with their agreements, and any failure by them to perform could require the company to incur substantial expenses and expose it to commodity price risk and volatility, which could adversely affect Sempra Energy's liquidity, cash flows and results of operations.

Sempra Energy's subsidiaries are exposed to the risk that counterparties, customers and suppliers that owe money or commodities as a result of market transactions or other long-term agreements will not perform their obligations under such agreements. Should they fail to perform, the company may be required to acquire alternative hedging arrangements or to honor the underlying commitment at then-current market prices. In such event, Sempra Energy's subsidiaries may incur additional losses to the extent of amounts already paid to such counterparties or suppliers. In addition, the subsidiaries often extend credit to counterparties and customers. While the company performs significant credit analyses prior to extending credit, Sempra Energy and its subsidiaries are exposed to the risk that they may not be able to collect amounts owed to them.

If the Department of Water Resources (DWR) were to succeed in setting aside, or were to fail to perform its obligations under its long-term power contract with Sempra Generation, Sempra Energy's business, results of operations and cash flows will be materially adversely affected.

In 2001, Sempra Generation entered into a 10-year power sales agreement with the DWR, to supply up to 1,900 megawatts to the state. Sempra Energy expects the contract with the DWR will be a source of significant revenue over the 10-year period. The validity of the power sales agreement with the DWR continues to be the subject of extensive litigation between the parties before the FERC, in California courts and in arbitration proceedings. If the DWR were to succeed in setting aside its obligations under the contract, or if the DWR fails or is unable to meet its contractual obligations on a timely basis, it could have a material adverse effect on Sempra Energy's business, results of operations, cash flows and financial condition. These proceedings are described in the notes to Consolidated Financial Statements and in "Management's Discussion and Analysis of Financial Condition and Results of Operations." As described in Note 15 of the notes to Consolidated Financial Statements, the company unilaterally reduced its price to the DWR by $4.15 per megawatt-hour in connection with the agreement to settle other litigation.

In the future, Sempra Energy's subsidiaries may elect not to or may not be able to enter into long-term supply and sales agreements or long-term firm capacity agreements for their projects, which would subject their sales to increased volatility and its businesses to increased competition.

The electric generation and wholesale power sales industries have become highly competitive. As more plants are built and competitive pressures increase, wholesale electricity prices become more volatile. Without the benefit of long-term power sales agreements, such as the 10-year power sales agreement between Sempra Generation and the DWR, Sempra Energy's sales will be subject to increased price volatility, and it may be unable to sell the power generated by Sempra Generation's facilities or operate those facilities profitably.

Sempra LNG has obtained long-term LNG supply agreements that substantially reduce its exposure to changes in natural gas prices (through corresponding natural gas sales agreements or by tying supply prices to prevailing natural gas prices or long-term firm capacity agreements) for a substantial portion of the processing capacity of the LNG terminals that it currently has under construction and does not intend to commence significant construction of other LNG terminals until it has obtained similar long-term agreements. However, if the counterparties, customers or suppliers to one or more of the key agreements for the LNG facilities were to fail or become unable to meet their contractual obligations on a timely basis, it could have a significant negative impact on Sempra Energy's business, results of operations, cash flows and financial condition.

Business development activities may not be successful and projects under construction may not commence operation as scheduled, which could increase Sempra Energy's costs and impair its ability to recover its investments.

The acquisition, development and construction of LNG receiving terminals, natural gas pipelines and storage facilities, and other energy infrastructure projects involve numerous risks. Sempra Energy and its subsidiaries may be required to expend significant sums for preliminary engineering, permitting, fuel supply, resource exploration, legal and other expenses before it can be established whether a project is feasible, economically attractive or capable of being built. Sempra Energy's success in developing a particular project is contingent upon, among other things, negotiation of satisfactory engineering, procurement and construction agreements, supply and natural gas sales agreements or firm capacity service agreements, receipt of required governmental permits and timely implementation and satisfactory completion of construction, and successful completion of a particular project may be adversely affected by unforeseen engineering problems, construction delays and contractor performance shortfalls, work stoppages, adverse weather conditions, environmental and geological conditions, and other factors. If the company is unable to complete the development of a facility, it typically will not be able to recover its investment in the project.

The operation of existing and future facilities also involves many risks, including the breakdown or failure of generation or regasification and storage facilities or other equipment or processes, labor disputes, fuel interruption and operating performance below expected levels. In addition, weather-related incidents and other natural disasters can disrupt generation, regasification, storage and transmission systems. The occurrence of any of these events could lead to operating facilities below expected capacity levels, which may result in lost revenues or increased expenses, including higher maintenance costs and penalties, and could adversely affect Sempra Energy's business, cash flows and results of operations.

Competition among developers and operators of LNG terminals is rapidly increasing, which may adversely affect the profitability of Sempra LNG's proposed LNG terminals.

Although there are only a limited number of LNG terminal facilities operating in North America today, many companies have announced plans to develop LNG facilities to serve the North American market. Some of these competitors have more operating experience, more development experience, larger staffs and greater financial resources than the company. Industry analysts have predicted that, if all of the proposed LNG facilities in North America that have been announced by developers are actually built, there will likely be substantial excess capacity for such terminals in the near future. Excess capacity would likely lead to decreased prices for such services. Although its LNG facilities in Mexico, Louisiana and Texas are more advanced in the siting, permitting and regulatory approval processes than the proposed projects of many of its competitors, there can be no assurance that Sempra Energy will be able to maintain that advantage.

Sempra Energy's subsidiaries rely on transportation assets that they do not own or control to deliver electricity and natural gas.

Sempra Energy's subsidiaries depend on electric transmission lines, natural gas pipelines and other transportation facilities owned and operated by third parties to deliver the electricity and natural gas they sell to wholesale markets, to supply natural gas and coal to their electric generation facilities, and to provide retail energy services to customers. Sempra LNG also will rely on specialized LNG ships to transport LNG to its LNG facilities and on natural gas pipelines to transport natural gas for customers of the facilities. If transportation is disrupted, or if capacity is inadequate, the ability of Sempra Energy's subsidiaries to sell and deliver their products and services may be hindered. As a result, they may be responsible for damages incurred by their customers, such as the additional cost of acquiring alternative supply at then-current spot market rates.

Sempra Energy's businesses require numerous permits and other governmental approvals from various federal, state, local and foreign governmental agencies, and any failure to obtain or maintain required permits or approvals could cause Sempra Energy's sales to decline and/or its costs to increase.

The acquisition, ownership and operation of LNG receiving terminals, natural gas pipelines and storage facilities, and electric generation facilities require numerous permits, approvals and certificates from federal, state, local and foreign governmental agencies. All of the existing and planned development projects of Sempra Energy's subsidiaries require multiple permits. If there is a delay in obtaining any required regulatory approvals or if the company fails to obtain any required approvals or to comply with any applicable laws or regulations, it may not be able to operate its facilities, or it may be forced to incur additional costs.

Sempra Energy's businesses are subject to complex government regulations and may be adversely affected by changes in these regulations or in their interpretation or implementation.

In recent years, the regulatory environment applicable to the electric power and natural gas industries has undergone significant changes, on both federal and state levels, which have affected the nature of these industries and the manner in which their participants conduct their businesses. These changes are ongoing, and Sempra Energy cannot predict the future course of changes in this regulatory environment or the ultimate effect that this changing regulatory environment will have on its businesses. Moreover, existing regulations may be revised or reinterpreted, and new laws and regulations may be adopted or become applicable to the company and its facilities. Future changes in laws and regulations may have a detrimental effect on Sempra Energy's business, cash flows, financial condition and results of operations.

Sempra Energy's other operations are subject to affiliate rules relating to transactions with the California Utilities. These businesses could be adversely affected by changes in these rules or by additional CPUC or FERC rules' further restricting their ability to sell electricity or natural gas or to trade with the California Utilities. Affiliate transaction rules also could require these businesses to obtain the prior approval of the CPUC before entering into any such transactions with the California Utilities. Any such restrictions or approval requirements could adversely affect the LNG receiving terminals, natural gas pipelines, electric generation plants or trading operations of the company's subsidiaries.

Various proceedings, inquiries and investigations relating to the business activities of Sempra Generation and Sempra Commodities are currently pending before the FERC. A description of such proceedings, inquiries and investigations is provided in the notes to Consolidated Financial Statements and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Sempra Energy's businesses have significant environmental compliance costs, and future environmental compliance costs could adversely affect Sempra Energy's profitability.

Sempra Energy's subsidiaries are subject to extensive federal, state, local and foreign statutes, rules and regulations relating to environmental protection. They are required to obtain numerous governmental permits, licenses and other approvals to construct and operate their businesses. Additionally, to comply with these legal requirements, they must spend significant sums on environmental monitoring, pollution control equipment and emissions fees. The company also is generally responsible for all on-site liabilities associated with the environmental condition of its electric generation facilities and other energy projects which it has acquired or developed, regardless of when the liabilities arose and whether they are known or unknown. If Sempra Energy's subsidiaries fail to comply with applicable environmental laws, they may be subject to penalties, fines and/or curtailments of their operations.

The scope and effect of any new environmental laws and regulations, including their effects on operations, are difficult to predict. However, increasing national and international concerns regarding global warming and proposed regulations regarding carbon dioxide, mercury, nitrogen oxide and sulfur dioxide emissions could result in requirements for additional pollution control equipment or significant emission fees or taxes that could adversely affect Sempra Generation. In addition, existing environmental regulations could be revised or reinterpreted and other new laws and regulations could be adopted or become applicable to the company and its facilities.

Sempra Energy's international businesses are exposed to different local, regulatory and business risks and challenges, which could have a material adverse effect on Sempra Energy's financial condition, cash flows and results of operations.

Sempra Energy subsidiaries currently have interests in electricity generation, natural gas distribution and transmission, and LNG terminal projects in Mexico, and also have trading, marketing and risk management operations in Canada, Europe and Asia. Sempra Pipelines & Storage also has ownership interests in electricity and natural gas distribution businesses in Argentina, Chile and Peru. Developing infrastructure projects, owning energy assets and operating businesses in foreign jurisdictions subject the company to significant political and financial risks which vary by country, including:

- ♦ changes in foreign laws and regulations, including tax and environmental laws and regulations;
- ♦ changes in U.S. laws and regulations, including tax and environmental laws and regulations, related to foreign operations;
- ♦ high rates of inflation;
- ♦ changes in government policies or personnel;
- ♦ trade restrictions;
- ♦ limitations on U.S. company ownership in foreign countries;
- ♦ permitting and regulatory compliance;
- ♦ changes in labor supply and labor relations in operations outside the U.S.;
- ♦ adverse rulings by foreign courts or tribunals and difficulty in enforcing contractual rights in foreign jurisdictions; and
- ♦ general political, economic and business conditions.

Sempra Energy's international businesses also are subject to foreign currency risks. These risks arise from both volatility in foreign currency exchange rates and devaluations of foreign currencies. In such cases, an appreciation of the U.S. dollar against a local currency could reduce the amount of cash and income received from those foreign subsidiaries. For example, the devaluation of the Argentine peso against the U.S. dollar in recent years (as well as the Argentine government's unilateral, retroactive abrogation of utility agreements in early 2002) has had a material adverse effect on Sempra Pipelines & Storage's two unconsolidated subsidiaries in Argentina. In September 2002, Sempra Pipelines & Storage initiated arbitration proceedings under the 1994 Bilateral Investment Treaty between the U.S. and Argentina for recovery of the diminution of the value of its investments that has resulted from Argentine governmental actions. Sempra Pipelines & Storage has claimed damages of at least $211 million (revised from an earlier claim of $258 million) in these proceedings, which are continuing. A description of legal proceedings relating to Sempra Pipelines & Storage's business operations in Argentina is provided in the notes to Consolidated Financial Statements. While Sempra Pipelines & Storage believes that it has contracts and other measures in place to mitigate its most significant foreign currency exchange risks, it has some exposure that is not fully mitigated.

Other Risks Related to the Company

Sempra Energy's cash flows, ability to pay dividends and ability to meet its debt obligations largely depend on the performance of its subsidiaries.

The company's ability to pay dividends and meet its debt obligations is dependent on cash flows from its subsidiaries and, in the short term, its ability to raise capital from external sources. Cash flows from the subsidiaries are dependent, in the long term, on the ability of the subsidiaries to generate operating cash flows in excess of their own capital expenditures. In addition, the subsidiaries are separate and distinct legal entities and could be precluded from making such distributions under certain circumstances, including as a result of legislation or regulation or in times of financial distress.

Natural disasters, catastrophic accidents or acts of terrorism could materially adversely affect Sempra Energy's business, earnings and cash flows.

Like other major industrial facilities, Sempra Energy's generation plants (including SONGS), electric transmission facilities, LNG receiving terminals and storage facilities, chartered oil and LNG tankers and natural gas pipelines and storage facilities may be damaged by natural disasters, catastrophic accidents or acts of terrorism. Any such incidents could result in severe business disruptions, significant decreases in revenues or significant additional costs to the company, which could have a material adverse effect on Sempra Energy's earnings and cash flows. Given the nature and location of these facilities, any such incidents also could cause fires, leaks, explosions, spills or other significant damage to natural resources or property belonging to third parties, or personal injuries, which could lead to significant claims against Sempra Energy and its subsidiaries. Insurance coverage may become unavailable for certain of these risks and the insurance proceeds received for any loss of or damage to any of its facilities, or for any loss of or damage to natural resources or property or personal injuries caused by its operations, may be insufficient to cover the company's losses or liabilities without materially adversely affecting the company's financial condition, earnings and cash flows.

GOVERNMENT REGULATION

The most significant government regulation affecting Sempra Energy is the regulation over its utility subsidiaries.

California Utility Regulation

The CPUC, which consists of five commissioners appointed by the Governor of California for staggered six-year terms, regulates SDG&E's and SoCalGas' rates and conditions of service, sales of securities, rate of return, rates of depreciation, uniform systems of accounts, examination of records, and long-term resource procurement. The CPUC conducts various reviews of utility performance and conducts investigations into various matters, such as deregulation, competition and the environment, to determine its future policies. The CPUC also regulates the relationship of the California Utilities with Sempra Energy and is currently investigating this relationship, as discussed further in Note 14 of the notes to Consolidated Financial Statements.

The California Energy Commission (CEC) has discretion over electric demand forecasts for the state and for specific service territories. Based upon these forecasts, the CEC determines the need for additional energy sources and for conservation programs. The CEC sponsors alternative-energy research and development projects, promotes energy conservation programs and maintains a state-wide plan of action in case of energy shortages. In addition, the CEC certifies power-plant sites and related facilities within California.

The CEC conducts a 20-year forecast of supply availability and prices for every market sector consuming natural gas in California. This forecast includes resource evaluation, pipeline capacity needs, natural gas demand and wellhead prices, and costs of transportation and distribution. This analysis is used to support long-term investment decisions.

United States Utility Regulation

The FERC regulates the interstate sale and transportation of natural gas, the transmission and wholesale sales of electricity in interstate commerce, transmission access, the uniform systems of accounts, rates of depreciation and electric rates involving sales for resale. Both the FERC and the CPUC are currently investigating prices charged to the California investor-owned utilities (IOUs) by various suppliers of natural gas and electricity. Further discussion is provided in Notes 13, 14 and 15 of the notes to Consolidated Financial Statements.

The NRC oversees the licensing, construction and operation of nuclear facilities. NRC regulations require extensive review of the safety, radiological and environmental aspects of these facilities. Periodically, the NRC requires that newly developed data and techniques be used to re-analyze the design of a nuclear power plant and, as a result, requires plant modifications as a condition of continued operation in some cases.

Local Regulation

SoCalGas has natural gas franchises with the 240 legal jurisdictions in its service territory. These franchises allow SoCalGas to locate, operate and maintain facilities for the transmission and distribution of natural gas in streets and other public places. Some franchises have fixed lives, such as that for the city of Los Angeles, which expires in 2012. The range of expiration dates for the franchises with definite lives is 2006 to 2048. Most of the franchises have indeterminate lives with no termination date.

SDG&E has electric franchises with the two counties and the 26 cities in its electric service territory, and natural gas franchises with the one county and the 18 cities in its natural gas service territory. These franchises allow SDG&E to locate, operate and maintain facilities for the transmission and distribution of electricity and/or natural gas in streets and other public places. Most of the franchises have indeterminate lives, except for the electric and natural gas franchises with the cities of Encinitas (2012), San Diego (2020), Coronado (2028) and Chula Vista (2035), and the natural gas franchises with the city of Escondido (2035) and the county of San Diego (2029).

Sempra Pipelines & Storage's Mexican utilities build and operate natural gas distribution systems in Mexicali, Chihuahua and the La Laguna-Durango zone in north-central Mexico. The operations are regulated by labor and environmental agencies of city and state governments, and by Mexico's Comision Reguladora de Energía.

Operations of Sempra Generation, Sempra LNG and Sempra Pipelines & Storage are regulated by various states and local public utilities commissions and other agencies.

Other

Regulation

Sempra Commodities' operations are subject to regulation by the New York Mercantile Exchange, the London Metals Exchange, the Commodity Futures Trading Commission, the FERC and the National Futures Association. It also has trading locations in Canada, Europe and Asia that are subject to regulation as to operations and financial position.

Sempra Generation and Sempra LNG have operations in the United States that are subject to regulation by the FERC and operations in Mexico that are subject to regulation by the Comision Reguladora de Energía.

Sempra Pipelines & Storage's affiliates have international operations in Argentina, Chile, Mexico and Peru that are subject to federal, local and other regulations of the countries and/or political subdivisions in which they are located. These regulatory bodies include but are not limited to Mexico's Comision Reguladora de Energia, Argentina's Ente Nacional Regulador de Gas, Chile's Comision Nacional de Energia and Peru's Consejo Nacional de Energia.

Other subsidiaries are also subject to varying amounts of regulation by various governments, including various states in the United States.

Licenses and Permits

The California Utilities obtain numerous permits, authorizations and licenses in connection with the transmission and distribution of natural gas and electricity. They require periodic renewal, which results in continuing regulation by the granting agency.

The company's other subsidiaries are also required to obtain numerous permits, authorizations and licenses in the normal course of business. Some of these permits, authorizations and licenses require periodic renewal. Sempra Generation and its subsidiaries obtain a number of permits, authorizations and licenses in connection with the construction and operation of power generation facilities. In addition, Sempra Generation obtains permits in connection with wholesale distribution of electricity. Sempra Pipelines & Storage's Mexican subsidiaries obtain construction permits for their natural gas distribution and transmission systems from the local governments where the service is provided. Sempra Pipelines & Storage obtains licenses and permits for natural gas storage facilities and pipelines. Sempra LNG obtains licenses and permits for the construction and operation of LNG facilities.

Other regulatory matters are described in Notes 13 and 14 of the notes to Consolidated Financial Statements.

NATURAL GAS UTILITY OPERATIONS

Resource Planning and Natural Gas Procurement and Transportation

The company is engaged in the purchase, sale, distribution, storage and transportation of natural gas through the California Utilities. The company's resource planning, power procurement, contractual commitments and related regulatory matters are discussed below and in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Notes 14 and 15 of the notes to Consolidated Financial Statements.

Customers

For regulatory purposes, customers are separated into core and noncore customers. Core customers are primarily residential and small commercial and industrial customers, without alternative fuel capability. Noncore customers consist primarily of electric generation, wholesale, large commercial, industrial and enhanced oil recovery customers.

Most core customers purchase natural gas directly from the California Utilities. Core customers are permitted to aggregate their natural gas requirement and purchase directly from brokers or producers. The California Utilities continue to be obligated to purchase reliable supplies of natural gas to serve the requirements of core customers.

Natural Gas Procurement and Transportation

Most of the natural gas purchased and delivered by the California Utilities is produced outside of California, primarily in the southwestern U.S. and Canada. The California Utilities purchase natural gas under short-term and long-term contracts, which are primarily based on monthly spot-market prices.

To ensure the delivery of the natural gas supplies to the distribution system and to meet the seasonal and annual needs of customers, SoCalGas is committed to firm pipeline capacity contracts that require the payment of fixed reservation charges to reserve firm transportation entitlements. SoCalGas sells excess capacity, if any, on a short-term basis. Interstate pipeline companies, primarily El Paso Natural Gas Company, Transwestern Pipeline Company and Kern River Gas Transmission, provide transportation services into SoCalGas' intrastate transmission system for supplies purchased by SoCalGas or its transportation customers from outside of California. During 2005, SoCalGas renegotiated certain expiring capacity contracts with new expiration dates of up to 2011. The rates that interstate pipeline companies may charge for natural gas and transportation services are regulated by the FERC.

SDG&E has long-term natural gas transportation contracts with various interstate pipelines that expire on various dates between 2006 and 2023. SDG&E currently purchases natural gas on a spot basis from Canada, the Rocky

Mountain area and the Southwestern U.S. to fill its long-term pipeline capacity and purchases additional spot-market supplies delivered directly to California for its remaining requirements. SDG&E continues its ongoing assessment of its pipeline capacity portfolio, including the release of a portion of this capacity to third parties. In accordance with regulatory directives, SDG&E has reconfigured its pipeline capacity portfolio as of November 2005 to secure firm transportation rights from a diverse mix of U.S. and Canadian supply sources for its projected core customer natural gas requirements. All of SDG&E's natural gas is delivered through SoCalGas' pipelines under a long-term transportation agreement. In addition, under separate agreements expiring in March 2008, SoCalGas provides SDG&E up to nine billion cubic feet of storage capacity.

According to "Btu's Daily Gas Wire", the annual average spot price of natural gas at the California/Arizona border was $7.62 per million British thermal unit (mmbtu) in 2005 ($11.42 per mmbtu in December 2005), compared with $5.57 per mmbtu in 2004 and $5.13 per mmbtu in 2003. The California Utilities' weighted average cost (including transportation charges) per mmbtu of natural gas was $7.83 in 2005, $5.94 in 2004 and $5.06 in 2003.

Natural Gas Storage

SoCalGas provides natural gas storage services for use by the core, noncore and off-system customers. Core customers are allocated a portion of SoCalGas storage capacity. Remaining customers, including SDG&E, can bid and negotiate the desired amount of storage on a contract basis. The storage service program provides opportunities for customers to store natural gas, usually during the summer, to reduce winter purchases when natural gas costs are generally higher. This allows customers to select the level of service they desire to assist them in managing their fuel procurement and transportation needs.

Demand for Natural Gas

The California Utilities face competition in the residential and commercial customer markets based on the customers' preferences for natural gas compared with other energy products. In the non-core industrial market, some customers are capable of using alternate fuels, which can affect the demand for natural gas. The company's ability to maintain its industrial market share is largely dependent on energy prices. The demand for natural gas by electric generators is influenced by a number of factors. In the short-term, natural gas use by electric generators is impacted by the availability of alternative sources of generation. The availability of hydroelectricity is highly dependent on precipitation in the western United States. In addition, natural gas use is impacted by the performance of other generation sources in the western United States, including nuclear and coal, and other natural gas facilities outside the service area. Natural gas use is also impacted by changes in end-use electricity demand. For example, natural gas use generally increases during summer heat waves. Over the long-term, natural gas used to generate electricity will be influenced by additional factors such as the location of new power plant construction and the development of renewable resources. More generation capacity currently is being constructed outside Southern California than within the California Utilities' service area. This new generation will likely displace the output of older, less efficient local generation, reducing the use of natural gas for local electric generation.

Effective March 31, 1998, electric industry restructuring provided out-of-state producers the option to provide power to California utility customers. As a result, natural gas demand for electric generation within Southern California competes with electric power generated throughout the western United States. Although electric industry restructuring has no direct impact on the company's natural gas operations, future volumes of natural gas transported for electric generating plant customers may be significantly affected to the extent that regulatory changes divert electric generation from the company's service area.

Growth in the natural gas markets is largely dependent upon the health and expansion of the Southern California economy and prices of other energy products. External factors such as weather, the price of electricity, electric deregulation, the use of hydroelectric power, development of renewable resources, development of new natural gas supply sources and general economic conditions can result in significant shifts in demand and market price. The

California Utilities added 86,000 new customer meters in each of 2005 and 2004, representing growth rates of 1.4 percent in both years. The California Utilities expect that their growth rate for 2006 will approximate 2005's.

The natural gas distribution business is seasonal in nature and revenues generally are greater during the winter months. As is prevalent in the industry, the company injects natural gas into storage during the summer months (usually April through October) for withdrawal from storage during the winter months (usually November through March) when customer demand is higher.

ELECTRIC UTILITY OPERATIONS

Customers

At December 31, 2005, SDG&E had 1.3 million meters consisting of 1,188,000 residential, 141,000 commercial, 480 industrial, 1,990 street and highway lighting, and 6,700 direct access. The company's service area covers 4,100 square miles. The company added 20,000 new customer meters in 2005 and 22,000 in 2004, representing growth rates of 1.5% and 1.7%, respectively.

Resource Planning and Power Procurement

SDG&E's resource planning, power procurement and related regulatory matters are discussed below, in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Notes 13, 14 and 15 of the notes to Consolidated Financial Statements.

Electric Resources

Based on CPUC-approved purchased-power contracts currently in place with SDG&E's various suppliers and SDG&E's 20-percent share of a generating plant, as of December 31, 2005, the supply of electric power available to SDG&E is as follows:

Supplier	Source	Expiration date	Megawatts (MW)
PURCHASED POWER CONTRACTS:			
DWR-allocated contracts:			
Williams Energy Marketing & Trading	Natural gas	2007 to 2010	1,906 *
Sunrise Power Co. LLC	Natural gas	2012	574
Other	Natural gas / wind	2006 to 2013	227
Total			2,707
Other contracts with Qualifying Facilities (QFs):			
Applied Energy Inc.	Cogeneration	2019	102
Yuma Cogeneration	Cogeneration	2024	50
Goal Line Limited Partnership	Cogeneration	2025	50
Other (16 contracts)	Cogeneration	2009 and thereafter	61
Total			263

Other contracts with renewable sources:			
Oasis Power Partners	Wind	2019	60
AES Delano	Bio-mass	2007	49
PPM Energy	Wind	2018	25
WTE / FPL	Wind	2019	17
Other (6 contracts)	Bio-gas	2007-2014	24
Total			175
Other long-term contracts:			
Portland General Electric (PGE)	Coal	2013	89
Total contracted			3,234
GENERATION:			
SONGS			430
Miramar			47
Total Generation			477
TOTAL CONTRACTED AND GENERATION			3,711

* Effective January 1, 2007, 1,200 megawatts were reallocated to Southern California Edison (Edison) by the CPUC, as described in Note 13 of the notes to Consolidated Financial Statements.

Under the contract with PGE, SDG&E pays a capacity charge plus a charge based on the amount of energy received and/or PGE's non-fuel costs. Costs under the contracts with QFs are based on SDG&E's avoided cost. Charges under the remaining contracts are for firm and as-available energy and are based on the amount of energy received. The prices under these contracts are at the market value at the time the contracts were negotiated.

SONGS

SDG&E owns 20 percent of SONGS, which is located south of San Clemente, California. SONGS consists of three nuclear generating units. The cities of Riverside and Anaheim own a total of 5 percent of Units 2 and 3. Edison owns the remaining interests and is the operator of SONGS.

Unit 1 was removed from service in November 1992 when the CPUC issued a decision to permanently shut it down. Decommissioning of Unit 1 is now in progress and its spent nuclear fuel is being stored on site.

Units 2 and 3 began commercial operation in August 1983 and April 1984, respectively. SDG&E's share of the capacity is 214 MW of Unit 2 and 216 MW of Unit 3.

SDG&E had fully recovered its SONGS capital investment through December 31, 2003.

Additional information concerning the SONGS units and nuclear decommissioning is provided below, in "Environmental Matters" herein, and in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Notes 6, 13 and 15 of the notes to Consolidated Financial Statements.

Nuclear Fuel Supply

The nuclear fuel supply cycle includes materials and services (uranium oxide, conversion of uranium oxide to uranium hexafluoride, uranium enrichment services, and fabrication of fuel assemblies) performed by others under various contracts which extend through 2008. The availability and the cost of the various components of the nuclear-fuel cycle for SDG&E's nuclear facilities in subsequent years cannot be estimated at this time.

Spent fuel from SONGS is being stored on site in the independent spent fuel storage installation, where storage capacity is expected to be adequate through 2022, the expiration date of the units' NRC operating license. Pursuant to the Nuclear Waste Policy Act of 1982, SDG&E entered into a contract with the U.S. Department of Energy (DOE) for spent-fuel disposal. Under the agreement, the DOE is responsible for the ultimate disposal of spent fuel from SONGS. SDG&E pays the DOE a disposal fee of $1.00 per megawatt-hour of net nuclear generation, or $3 million per year. The DOE projects that it will not begin accepting spent fuel until 2010 at the earliest.

Additional information concerning nuclear-fuel costs and the storage and movement of spent fuel is provided in Notes 13 and 15, respectively, of the notes to Consolidated Financial Statements.

Power Pools

SDG&E is a participant in the Western Systems Power Pool, which includes an electric-power and transmission-rate agreement with utilities and power agencies located throughout the United States and Canada. More than 270 investor-owned and municipal utilities, state and federal power agencies, energy brokers, and power marketers share power and information in order to increase efficiency and competition in the bulk power market. Participants are able to make power transactions on standardized terms that have been pre-approved by the FERC.

Transmission Arrangements

The Pacific Intertie, consisting of AC and DC transmission lines, connects the Northwest with SDG&E, Pacific Gas & Electric (PG&E), Edison and others under an agreement that expires in July 2007. SDG&E's share of the Pacific Intertie is 266 MW.

Power originating from sources utilizing the Pacific Intertie, as well as power from other sources, can be imported into SDG&E's system via the Edison-SDG&E interconnection at the SONGS switchyard. Five 230-kilovolt transmission lines into SDG&E's system from that interconnection comprise the "South of SONGS" path, which is normally rated at 2,200 MW.

SDG&E's 500-kilovolt Southwest Powerlink transmission line, which is shared with Arizona Public Service Company and Imperial Irrigation District, extends from Palo Verde, Arizona to San Diego. SDG&E's share of the line is 970 MW, although it can be less under certain system conditions.

Mexico's Baja California Norte system is connected to SDG&E's system via two 230-kilovolt interconnections with firm capability of 408 MW in the north to south direction and 800 MW in the south to north direction.

SDG&E is in the planning stages for the Sunrise Powerlink, a new 500-kilovolt transmission line between the existing Imperial Valley Substation and a new Central Substation to be located within the SDG&E system. The proposed rating of the Sunrise Powerlink is 1,000 MW or higher. The project is subject to CPUC approval and is estimated to cost at least $1 billion. The planned in-service date is June 2010.

Transmission Access

The National Energy Policy Act governs procedures for others' requests for transmission service. The FERC approved the California IOUs' transfer of operation and control of their transmission facilities to the Independent System Operator (ISO) in 1998. Additional information regarding the FERC, ISO and transmission issues is provided in Note

14 of the notes to Consolidated Financial Statements.

SEMPRA GLOBAL AND SEMPRA FINANCIAL

Sempra Global consists of most of the businesses of Sempra Energy other than the California Utilities, and serves a broad range of customers' energy and other needs. Sempra Global includes Sempra Commodities, Sempra Generation, Sempra LNG and Sempra Pipelines & Storage. Descriptions of these business units and information concerning their operations and the operations of Sempra Financial are provided under "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Notes 2, 3, 15 and 16 of the notes to Consolidated Financial Statements.

RATES AND REGULATION -- CALIFORNIA UTILITIES

Information concerning rates and regulations applicable to the California Utilities is provided in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Notes 1, 13 and 14 of the notes to Consolidated Financial Statements in the 2005 Annual Report to Shareholders, which is incorporated by reference.

ENVIRONMENTAL MATTERS

Discussions about environmental issues affecting the company are included in Note 15 of the notes to Consolidated Financial Statements. The following additional information should be read in conjunction with those discussions.

Hazardous Substances

In 1994, the CPUC approved the Hazardous Waste Collaborative Memorandum account, allowing California's IOUs to recover their hazardous waste cleanup costs, including those related to Superfund sites or similar sites requiring cleanup. Recovery of 90 percent of hazardous waste cleanup costs and related third-party litigation costs, and 70 percent of the related insurance-litigation expenses is permitted. In addition, the company has the opportunity to retain a percentage of any insurance recoveries to offset the 10 percent of costs not recovered in rates.

At December 31, 2005, the company had accrued its estimated remaining investigation and remediation liability related to hazardous waste sites, including numerous locations that had been manufactured-gas plants, of $46 million, of which 90 percent is authorized to be recovered through the Hazardous Waste Collaborative mechanism. This estimated cost excludes remediation costs of $10.3 million associated with SDG&E's former fossil-fuel power plants. The company believes that any costs not ultimately recovered through rates, insurance or other means will not have a material adverse effect on the company's consolidated results of operations or financial position.

Estimated liabilities for environmental remediation are recorded when amounts are probable and estimable. Amounts authorized to be recovered in rates under the Hazardous Waste Collaborative mechanism are recorded as a regulatory asset.

Electric and Magnetic Fields (EMFs)

Although scientists continue to research the possibility that exposure to EMFs causes adverse health effects, science has not demonstrated a cause-and-effect relationship between exposure to the type of EMFs emitted by power lines and other electrical facilities and adverse health effects. Some laboratory studies suggest that such exposure creates biological effects, but those effects have not been shown to be harmful. The studies that have most concerned the public are epidemiological studies, some of which have reported a weak correlation between childhood leukemia and the proximity of homes to certain power lines and equipment. Other epidemiological studies found no correlation between estimated exposure and any disease. Scientists cannot explain why some studies using estimates of past exposure report correlations between estimated EMF levels and disease, while others do not.

To respond to public concerns, the CPUC previously directed California IOUs to adopt a low-cost EMF-reduction policy that requires reasonable design changes to achieve noticeable reduction of EMF levels that are anticipated from new projects. The CPUC has recently reviewed the resultant policy in an Order Instituting Ratemaking and found no new scientific research to support a change to the existing policy, finding existing policy of prudent avoidance to be sufficient and reasonable.

Air and Water Quality

The transmission and distribution of natural gas require the operation of compressor stations, which are subject to increasingly stringent air-quality standards. Costs to comply with these standards are recovered in rates.

In connection with the issuance of operating permits, SDG&E and the other owners of SONGS previously reached agreement with the California Coastal Commission to mitigate the environmental damage to the marine environment attributed to the cooling-water discharge from SONGS Units 2 and 3. SDG&E's share of the cost is estimated to be $34 million, of which $16 million had been incurred at December 31, 2005. Rate recovery of 50% of the remaining costs is uncertain.

OTHER MATTERS

Research, Development and Demonstration (RD&D)

Effective January 2005, a surcharge was established by the CPUC for natural gas public interest RD&D. The natural gas public interest research program is administered by the CEC. For 2005, the funding level is subject to a statewide cap of $12 million. The statewide cap increases to $15 million in 2006. For 2005, SoCalGas and SDG&E funding for the natural gas public purpose RD&D program was $6 million and $1 million, respectively. In addition, SoCalGas operates a separate natural gas RD&D program as discussed below.

The SoCalGas ratepayer-funded RD&D program is focused on utility operations, end use utilization, advanced distributed power generation and transportation. Each of these activities provides benefits to customers and society by providing more cost-effective, efficient natural gas equipment with lower emissions, increased safety and reduced operating costs. For 2005, SoCalGas' RD&D expenditures were $11 million and expenditures averaged $9 million over the past three years.

SDG&E continues to fund the California Public Interest Energy Research (PIER) Program for electric research. For 2005, SDG&E's funding level was $6 million for the PIER program.

Employees of Registrant

As of December 31, 2005, the company had 13,420 employees, compared to 13,381 at December 31, 2004.

Labor Relations

Field, technical and most clerical employees at SoCalGas are represented by the Utility Workers' Union of America (UWUA) or the International Chemical Workers' Union Council (ICWUC). The collective bargaining agreement for field, technical and most clerical employees at SoCalGas covering wages, hours, working conditions, medical and various benefit plans is in effect through September 30, 2008.

Certain employees at SDG&E are represented by the Local 465 International Brotherhood of Electrical Workers. The current contract is in effect through August 31, 2008.

At some of its field job sites, Sempra Generation employs mechanics who are represented by the International Union of Operating Engineers, Local 501. One collective bargaining agreement is in effect through July 7, 2007. At another operating facility, the company is in the process of labor contract negotiations with Operating Engineers, Local 501, on a new collective bargaining agreement.

ITEM 2. PROPERTIES

Back to Contents

Electric Properties - SDG&E

SDG&E's interest in SONGS is described in "Electric Resources" herein. At December 31, 2005, SDG&E's electric transmission and distribution facilities included substations, and overhead and underground lines. The electric facilities are located in San Diego, Imperial and Orange counties of California and in Arizona, and consist of 1,835 miles of transmission lines and 21,601 miles of distribution lines. Periodically, various areas of the service territory require expansion to accommodate customer growth.

In 2005, SDG&E purchased a 45-MW electric generation facility located in San Diego, California. In 2006, SDG&E will purchase the 550-MW Palomar power plant, located in Escondido, California, which is being constructed by Sempra Generation.

Natural Gas Properties - California Utilities

At December 31, 2005, the California Utilities' natural gas facilities included 3,037 miles of transmission and storage pipeline, 56,113 miles of distribution pipeline and 52,569 miles of service piping. They also included 13 transmission compressor stations and 4 underground storage reservoirs, with a combined working capacity of 125 billion cubic feet (bcf).

Energy Properties - Other

At December 31, 2005, Sempra Generation operates power plants in California, Arizona, Texas, Nevada and Mexico with total capacity of 3,805 MW. Additional information is provided in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Notes 2 and 3 of the notes to Consolidated Financial Statements.

At December 31, 2005, Sempra Pipelines & Storage's operations in Mexico included 1,726 miles of distribution pipeline, 165 miles of transmission pipeline and one compressor station.

At December 31, 2005, the company's two small natural gas utilities, Frontier Energy and Bangor Gas, located in North Carolina and Maine, respectively, owned 148 miles of transmission lines and 258 miles of distribution lines.

Other Properties

The 21-story corporate headquarters building at 101 Ash Street, San Diego is occupied pursuant to an operating lease that expires in 2015. The lease has two separate five-year renewal options.

SoCalGas leases approximately half of a 52-story office building in downtown Los Angeles through 2011. The lease has six separate five-year renewal options.

SDG&E occupies an office complex in San Diego pursuant to an operating lease ending in 2007. The lease can be renewed for two five-year periods.

Sempra Global leases office facilities at various locations in the U.S., Mexico and Europe with the leases ending from 2006 to 2027. Sempra LNG owns land in Baja California, Mexico on which it is developing an LNG receiving terminal. Sempra LNG also has a land lease to develop an LNG receiving terminal in Hackberry, Louisiana and another subsidiary of Sempra Energy owns land where the Port Arthur LNG receipt terminal is under development.

The company owns or leases other warehouses, offices, operating and maintenance centers, shops, service facilities and equipment necessary in the conduct of its business.

ITEM 3. LEGAL PROCEEDINGS

Back to Contents

Except for the matters described in Notes 13, 14 and 15 of the notes to Consolidated Financial Statements incorporated by reference in Item 8 or referred to elsewhere in "Management's Discussion and Analysis of Financial Condition and Results of Operations" incorporated by reference in this Annual Report, neither the company nor its subsidiaries are party to, nor is their property the subject of, any material pending legal proceedings.

Sempra Energy and SDG&E are defendants in a lawsuit filed by the County of San Diego seeking civil penalties for alleged violations of environmental standards applicable to the abatement, handling and disposal of asbestos-containing materials during the demolition of a natural gas storage facility in 2001. In a federal criminal indictment, SDG&E and two employees have also been charged with having violated these standards and with conspiracy and making false statements to governmental authorities in connection with these matters. Sempra Energy and SDG&E believe that the maximum fines and penalties that could reasonably be assessed against them with respect to these matters would not exceed $750,000. The company believes that the claims and charges are without merit and is vigorously contesting them.

On February 2, 2006, Mesquite Power and Maricopa County, Arizona, settled the issue regarding emissions from the Mesquite Power Plant for $350,000.

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

None

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Back to Contents

Sempra Energy common stock is traded on the New York and Pacific stock exchanges. At January 31, 2006, there were 54,000 record holders of the company's common stock. The quarterly common stock information required by Item 5 is included in the schedule of Quarterly Financial Data of the 2005 Annual Report to Shareholders, which is incorporated by reference.

The information required by Item 5 concerning dividend declarations is included in the "Statements of Consolidated Changes in Shareholders' Equity" set forth in Item 8 of the 2005 Annual Report to Shareholders.

EQUITY COMPENSATION PLANS

The company's 1998 Long Term Incentive Plan and Employee Stock Incentive Plan permit the granting of a wide variety of equity and equity-based incentive awards to officers and key employees. At December 31, 2005, outstanding awards consisted of stock options and restricted stock held by 325 employees.

The company's Non-employee Directors Stock Plan also provides for annual automatic grants to non-employee directors of options to purchase common stock.

The following table sets forth information regarding these plans at December 31, 2005.

Equity Compensation Plan Information

	Number of shares to be issued upon exercise of outstanding options (A)	Weighted-average exercise price of outstanding options	Number of additional shares remaining available for future issuance
Equity compensation plans approved by shareholders:			
1998 Long Term Incentive Plan	8,906,361	$25.81	6,829,968 (B) (C) (D)
Non-employee Directors Stock Plan	530,000	$26.78	834,626
Equity compensation plans not approved by shareholders:			
Employee Stock Incentive Plan	398,350	$24.	