

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549  
FORM 10-K

(Mark One)

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 1997

OR

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	Exact Name of Registrant as specified in its charter	State of Incorporation	IRS Employer Identification Number
1-3779	SAN DIEGO GAS & ELECTRIC COMPANY	California	95-1184800
1-11439	ENOVA CORPORATION	California	33-0643023

101 ASH STREET, SAN DIEGO, CALIFORNIA  
-----  
(Address of principal executive offices) (Zip Code) 92101

Registrant's telephone number, including area code (619)696-2000  
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SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of each class	Name of each exchange on which registered
San Diego Gas & Electric Company Preference Stock (Cumulative) Without Par Value (except \$1.70 and \$1.7625 Series)	American
Cumulative Preferred Stock, \$20 Par Value (except 4.60% Series)	American

Enova Corporation  
Common Stock, Without Par Value New York and Pacific

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

San Diego Gas & Electric Company None  
Enova Corporation None

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 and (2) has been subject to such filing requirements for the past 90 days.  
Yes  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.

Exhibit Index on page 90. Glossary on page 98.

Aggregate market value of the voting stock held by non-affiliates of the registrant as of January 31, 1998:

Enova Corporation Common Stock \$2.9 Billion  
San Diego Gas & Electric Company Preferred Stock \$22 Million

Common Stock outstanding without par value as of January 31, 1998:

Enova Corporation 113,606,162  
San Diego Gas & Electric Company Wholly owned by Enova Corporation

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the March 1998 Proxy Statement prepared for the April 1998 annual meeting of shareholders are incorporated by reference into Part III.

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PART I - Enova Corporation/San Diego Gas & Electric

ITEM 1. BUSINESS

Description of Business

A description of Enova Corporation and its subsidiaries, including a discussion on the proposed business combination with Pacific Enterprises, is given in "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein. Additional information on the business combination is described in Note 1 of the "Notes to Consolidated Financial Statements" herein.

GOVERNMENT REGULATION

Enova Corporation

Enova Corporation and its subsidiaries are exempt from all provisions, except Section 9(a)(2), of the Public Utility Holding Company Act of 1935 ("Holding Company Act") on the basis that Enova Corporation and San Diego Gas & Electric are incorporated in the same state and their business is predominately intrastate in character and carried on substantially in the state of incorporation. It is necessary for Enova Corporation to file an annual exemption statement with the Securities and Exchange Commission (SEC), and the exemption may be revoked by the SEC upon a finding that the exemption may be detrimental to the public interest or the interest of investors or consumers. Enova Corporation has no intention of becoming a registered holding company under the Holding Company Act.

Enova Corporation is not a public utility under the laws of the State of California and is not subject to regulation as such by the California Public Utilities Commission (CPUC). See "State Regulation" below for a description of the regulation of SDG&E by the CPUC. However, the CPUC decision authorizing SDG&E to reorganize into a holding company structure contains certain conditions, which, among other things, provide the CPUC access to the portion of books and records of Enova Corporation and its affiliates that relate to transactions with SDG&E; require Enova Corporation and its subsidiaries to employ accounting and other procedures and controls to facilitate full review by the CPUC and to protect against subsidization by SDG&E's customers of non-utility activities; require that all transfers of market, technological or similar data from SDG&E to Enova Corporation or its affiliates are made at the higher of the fully-loaded cost or market value; preclude SDG&E from guaranteeing any obligations of Enova Corporation without prior written consent from the CPUC; provide for royalty payments to be paid by Enova Corporation or its other subsidiaries in connection with the transfer of product rights, patents, copyrights or similar legal rights from SDG&E; and prevent Enova Corporation and its other subsidiaries from providing certain facilities and equipment to SDG&E except through competitive bidding. In addition, the decision provides that SDG&E shall maintain a balanced capital structure in accordance with prior CPUC decisions, that SDG&E's dividend policy shall continue to be established by SDG&E's board of directors as though SDG&E were a comparable stand-alone utility company, and that the capital requirements of SDG&E, as determined to be necessary to meet SDG&E's service obligations, shall be given first priority by the boards of directors of Enova Corporation and SDG&E.

In December 1997 the CPUC issued a decision on the rules governing transactions between all of California's regulated utilities and their affiliates that are not regulated by the CPUC. A discussion of these

rules is included in "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein.

## San Diego Gas & Electric

### Local Regulation

San Diego Gas & Electric has separate electric and gas franchises with the two counties and the 25 cities in its service territory. These franchises allow SDG&E to locate facilities for the transmission and distribution of electricity and gas in the streets and other public places. The franchises do not have fixed terms, except for the electric and gas franchises with the cities of Chula Vista (expiring in 1998), Encinitas (2012), San Diego (2021) and Coronado (2028); and the gas franchises with the city of Escondido (2036) and the county of San Diego (2030). Negotiations for a new agreement with Chula Vista are currently in progress.

### State Regulation

The CPUC consists of five members appointed by the governor and confirmed by the senate for six-year terms. The CPUC regulates SDG&E's 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 also 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 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.

### Federal Regulation

The Federal Energy Regulatory Commission (FERC) regulates transmission access, the uniform systems of accounts, rates of depreciation and electric rates involving sales for resale. The FERC also regulates the interstate sale and transportation of natural gas.

The Nuclear Regulatory Commission (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.

### Licenses and Permits

SDG&E obtains a number of permits, authorizations and licenses in connection with the construction and operation of its generating plants. Discharge permits, San Diego Air Pollution Control District permits and NRC licenses are the most significant examples. The licenses and permits may be revoked or modified by the granting agency if facts develop or events occur that differ significantly from the facts and projections assumed in granting the approval. Furthermore, discharge permits and other approvals are granted for a term less than the expected life of the facility. They require periodic renewal, which results in continuing regulation by the granting agency.

Other regulatory matters are described throughout this report.

#### SOURCES OF REVENUE

(In Millions of Dollars)	1997	1996	1995
-----			
SDG&E revenue by type of customer:			
Electric-			
Residential	\$ 674	\$ 642	\$ 610
Commercial	670	621	589
Industrial	264	259	250
Other	162	69	55
	-----	-----	-----
Total Electric	1,770	1,591	1,504
	-----	-----	-----
Gas-			
Residential	241	210	189
Commercial	82	69	60
Industrial	38	32	25
Other	37	37	36
	-----	-----	-----
Total Gas	398	348	310
	-----	-----	-----
Total SDG&E	2,168	1,939	1,814
	-----	-----	-----
Other	49	54	57
	-----	-----	-----
Total	\$2,217	\$1,993	\$1,871
	=====	=====	=====

Industry segment information is contained in "Statements of Consolidated Financial Information by Segments of Business" herein.

#### CONSTRUCTION EXPENDITURES

Construction expenditures are described in "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein.

#### ELECTRIC OPERATIONS

##### Introduction

In September 1996 the state of California enacted a law restructuring California's electric utility industry (AB 1890). The legislation adopts the December 1995 CPUC policy decision restructuring the industry to stimulate competition and reduce rates. This is discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Note 10 of the "Notes to Consolidated Financial Statements" herein.

##### Resource Planning

SDG&E's ability to provide energy at the lowest possible cost has been based on a combination of production from its own plants and purchases from other producers. The purchases have been a combination of short-term and long-term contracts and spot-market purchases. Most resource acquisitions are obtained through a competitive bidding process. In December 1994 the CPUC issued its Biennial Resource Plan Update (BRPU) decision ordering SDG&E, Pacific Gas & Electric (PG&E), and Southern California Edison (Edison) to allow qualified non-utility power

producers that cogenerate or use renewable energy technologies to bid for a portion of the utilities' future capacity needs. As a result of the decision, SDG&E would be required to enter into contracts (ranging in term from 17 to 30 years) to purchase an additional 500 megawatts (mw) of power at an estimated cost of \$2.3 billion beginning in 1997. Prices under these contracts could significantly exceed the future market price. In February 1995 the FERC issued an order declaring the BRPU auction procedures unlawful under federal law. In July 1995 the CPUC issued a ruling encouraging SDG&E, PG&E and Edison to reach settlements with the auction winners. In October 1997 SDG&E filed an application with the CPUC seeking approval of the settlements it reached with three of its five auction winners. Settlement discussions with the other two are ongoing. To date, no purchases under the BRPU contracts have been made.

Additional information concerning resource planning is provided in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Notes 9 and 10 of the "Notes to Consolidated Financial Statements" herein.

#### Electric Resources

Based on generating plants in service and purchased-power contracts in place, the net mw of electric power available to SDG&E at February 28, 1998 are as follows:

Source	Net mw
-----	-----
Gas/oil generating plants	1,641
Combustion turbines	332
Nuclear generating plants	430
Long-term contracts with other utilities	325
Contracts with others (94)	593
	-----
Total	3,321
	=====

SDG&E's system peak demand reached an all-time record of 3,668 mw on September 4, 1997, when the net system capability, including power purchases, was 4,102 mw. The previous record was 3,335 mw which was reached on August 17, 1992.

Gas/Oil Generating Plants: SDG&E's South Bay (Chula Vista, California) and Encina (Carlsbad, California) power plants are equipped to burn either natural gas or fuel oil. The four South Bay units went into operation between 1960 and 1971 and can generate 690 mw. The five Encina units began operation between 1954 and 1978 and can generate 951 mw. SDG&E sold and leased back Encina Unit 5 (330 mw) in 1978. The lease term is through 2004, with renewal options for up to 15 additional years.

SDG&E has 19 combustion turbines that were placed in service from 1966 to 1979. They are located at various sites and are used only in times of peak demand.

San Onofre Nuclear Generating Station (SONGS): SDG&E owns 20 percent of the three nuclear units at SONGS (south of San Clemente, California). The cities of Riverside and Anaheim own a total of 5 percent of SONGS 2 and 3. Edison owns the remaining interests and operates the units.

SONGS 1 was removed from service in November 1992 when the CPUC issued a decision to permanently shut down the unit. At that time SDG&E began the

recovery of its remaining capital investment, with full recovery completed in April 1996. SDG&E and Edison filed a decommissioning plan in November 1994, although final decommissioning is not scheduled to occur until 2013 when SONGS 2 and 3 are also decommissioned. The unit's spent nuclear fuel has been removed from the reactor and stored on-site. In March 1993 the NRC issued a Possession-Only License for SONGS 1, and the unit was placed in a long-term storage condition in May 1994.

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

During 1997 SDG&E spent \$7 million on capital modifications and additions and expects to spend \$14 million in 1998. SDG&E deposits funds in an external trust to provide for the future dismantling and decontamination of the units. The shutdown of SONGS 1 does not affect contributions to the trust.

Additional Information: Additional information concerning SDG&E's power plants, the SONGS units, nuclear decommissioning and the CPUC's industry restructuring proposal (including SDG&E's plan to auction its electric generation assets) is provided immediately below and in "Environmental Matters," "Electric Properties," "Legal Proceedings," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Notes 5, 9 and 10 of the "Notes to Consolidated Financial Statements" herein.

Purchased Power: The following table lists contracts with the various suppliers:

Supplier	Period	Megawatt Commitment	Source
-----			
Long-Term Contracts with Other Utilities:			
Portland General Electric (PGE)	Through December 1998	50	Hydro storage
	Through December 2013	75	Coal
Public Service Company of New Mexico (PNM)	Through April 2001	100	System supply
PacifiCorp	Through December 2001	100	System Supply
		-----	
	Total	325	
		=====	
Contracts with Others:			
LG&E Power Marketing	Through December 2001	150	System Supply
Goal Line Limited Partnership	Through December 2025	50	Cogeneration
Illinova Power Marketing	Through December 1999	200	System Supply
Applied Energy	Through December 2019	102	Cogeneration
Yuma Cogeneration	Through June 2024	50	Cogeneration
Other (89)	Various	41	Cogeneration
		-----	
	Total	593	
		=====	

On the contracts with PGE (sourced from coal) and PNM, SDG&E pays a capacity charge plus a charge based on the amount of energy received. SDG&E also has a contract with PGE for available hydro storage service. Charges under these contracts are based on the selling utility's costs, including a return on and depreciation of the utility's rate base (or lease payments in cases where the utility does not own the property), fuel expenses, operating and maintenance expenses, transmission expenses, administrative and general expenses, and state and local taxes. Charges under contracts from PacifiCorp, LG&E and Illinova are for firm energy only and are based on the amount of energy received. The prices under these contracts are at market value at the time the contracts were negotiated. Costs under the remaining contracts (all with Qualifying Facilities) are based on SDG&E's avoided cost.

Additional information concerning SDG&E's purchased-power contracts is described immediately below, and in "Legal Proceedings," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Notes 9 and 10 of the "Notes to Consolidated Financial Statements" herein.

#### Electric Generation Divestiture

In November 1997 SDG&E's board of directors approved a plan to auction the company's power plants and other electric generating assets, enabling SDG&E to continue to concentrate its business on the transmission and distribution of electricity and natural gas as California opens its electric utility industry to competition in 1998. The plan includes the divestiture of SDG&E's fossil power plants (Encina and South Bay) and its combustion turbines, as well as its 20-percent interest in SONGS and its portfolio of long-term power contracts, including those with qualifying facilities. Additional information describing SDG&E's plan to divest of its electric generating assets is

described in Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Notes 9 and 10 of the "Notes to Consolidated Financial Statements" herein.

#### Power Pools

In 1964 SDG&E, PG&E, and Edison entered into the California Power Pool Agreement. It provided for the transfer of electrical capacity and energy by purchase, sale or exchange during emergencies and at other mutually determined times. Due to electric industry restructuring (discussed below) the California Power Pool was terminated by the FERC in May 1997. However, SDG&E, Edison, PG&E and the Los Angeles Department of Water and Power will continue to abide by the provisions of the existing California Statewide Emergency Plan for sharing capacity and energy in the event of a severe resource emergency until the PX and ISO are fully operational.

SDG&E is a participant in the Western Systems Power Pool (WSPP), which includes an electric power and transmission rate agreement with utilities and power agencies located throughout the United States and Canada. More than 150 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 target and coordinate delivery of cost-effective sources of power from outside their service territories through a centralized exchange of information. Although the extent has not yet been determined, the status of the WSPP is likely to change due to industry restructuring and the initiation of the PX and ISO.

#### Transmission Arrangements

In addition to interconnections with other California utilities, SDG&E has firm transmission capabilities for purchased power from the Northwest, the Southwest and Mexico.

**Pacific Intertie:** The Pacific Intertie, consisting of AC and DC transmission lines, enables SDG&E to purchase and receive surplus coal and hydroelectric power from the Northwest. SDG&E, PG&E, Edison and others share transmission capacity on the Pacific Intertie under an agreement that expires in July 2007. SDG&E's share of the intertie was 266 MW. Due to electric industry restructuring (discussed below), the operating rights of SDG&E, Edison and PG&E on the Pacific Intertie have been transferred to the ISO.

**Southwest Powerlink:** 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 and enables SDG&E to import power from the Southwest. SDG&E's share of the line is 931 mw, although it can be less, depending on specific system conditions.

**Mexico Interconnection:** Mexico's Baja California Norte system is connected to SDG&E's system via two 230-kilovolt interconnections with firm capability of 408 mw. SDG&E uses these interconnections for transactions with Comision Federal de Electricidad (CFE), Mexico's government-owned electric utility.

#### Transmission Access

As a result of the enactment of the National Energy Policy Act of 1992, the FERC has established rules to implement the Act's transmission-access provisions. These rules specify FERC-required procedures for others' requests for transmission service. In October 1997 the FERC

approved the transfer of control by the California investor-owned utilities (IOUs) of their transmission facilities to the ISO. Beginning on March 31, 1998 the ISO will be responsible for the operation and control of the transmission lines. Additional information regarding the ISO and transmission access is discussed below and in "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein.

**Power Exchange and Independent System Operator**

Under the CPUC's electric restructuring decision, beginning on March 31, 1998 customers will have the option to buy their electricity through an independent exchange that will obtain power from qualifying facilities, nuclear units and, lastly, from the lowest-bidding suppliers. The PX will serve as a wholesale power pool allowing all energy producers to participate competitively. The ISO will schedule power transactions and access to the transmission system. As discussed above, California's IOUs will transfer the operational control of their transmission facilities to the ISO, which is under FERC jurisdiction. Additional information regarding the PX and ISO is discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein.

**Fuel and Purchased-Power Costs**

The following table shows the percentage of each electric fuel source used by SDG&E and compares the costs of the fuels with each other and with the total cost of purchased power:

	Percent of Kwhr			Cents per Kwhr		
	1997	1996	1995	1997	1996	1995
Natural gas	19.8%	22.8%	21.7%	3.3	2.8	2.3
Nuclear fuel	11.8	19.6	16.5	0.6	0.5	0.5
Fuel oil	0.1	1.1	0.1	2.4	2.2	2.1
Total generation	31.7	43.5	38.3			
Purchased power - net	68.3	56.5	61.7	2.8	3.1	3.3
Total	100.0%	100.0%	100.0%			

The cost of purchased power includes capacity costs as well as the costs of fuel. The cost of natural gas includes transportation costs. The costs of natural gas, nuclear fuel and fuel oil do not include SDG&E's capacity costs. While fuel costs are significantly less for nuclear units than for other units, capacity costs are higher.

**Electric Fuel Supply**

**Natural Gas:** Information concerning natural gas is provided in "Natural Gas Operations" herein.

**Nuclear Fuel:** The nuclear-fuel cycle includes services performed by others. These services and the dates through which they are under contract are as follows:

Mining and milling of uranium concentrate	2003
Conversion of uranium concentrate to uranium hexafluoride	2003
Enrichment of uranium hexafluoride(1)	2003
Fabrication of fuel assemblies	2003
Storage and disposal of spent fuel(2)	--

(1) SDG&E has a contract with Urenco, a British consortium, for enrichment services through 2003.

(2) Spent fuel is being stored at SONGS, where storage capacity will be adequate at least through 2006. If necessary, modifications in fuel-storage technology can be implemented to provide on-site storage capacity for operation through 2013, the expiration date of the NRC operating license. The plan of the U.S. Department of Energy (DOE) is to provide a permanent storage site for the spent nuclear fuel by 2010.

Pursuant to the Nuclear Waste Policy Act of 1982, SDG&E entered into a contract with the DOE for spent-fuel disposal. Under the agreement, the DOE is responsible for the ultimate disposal of spent fuel. SDG&E is paying a disposal fee of \$0.91 per megawatt-hour of net nuclear generation. Disposal fees average \$3 million per year.

To the extent not currently provided by contract, the availability and the cost of the various components of the nuclear-fuel cycle for SDG&E's nuclear facilities cannot be estimated at this time.

Additional information concerning nuclear-fuel costs is discussed in Note 9 of the "Notes to Consolidated Financial Statements" herein.

Fuel Oil: SDG&E has no long-term commitments to purchase fuel oil. The use of fuel oil is dependent upon price differences between it and natural gas, and air-emission limitations associated with the San Diego Air Pollution Control District's Rule 69. Additional information concerning air-emission restrictions, including Rule 69, is provided in "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein. During 1997 SDG&E burned 49,000 barrels of fuel oil.

#### NATURAL-GAS OPERATIONS

SDG&E purchases natural gas for resale to its customers and for fuel in its generating plants. All natural gas is delivered to SDG&E under a transportation and storage agreement with Southern California Gas Company (SoCalGas) through two transmission pipelines with a combined capacity of 454 million cubic feet per day. On December 12, 1997 SDG&E's natural-gas usage, which included consumption by both customers and SDG&E's power plants, reached a new one-day peak of 555 million cubic feet (mcf). The previous record of 500 mcf had been set on November 28, 1994.

During 1997 SDG&E purchased approximately 98 billion cubic feet of natural gas. The majority of SDG&E's natural-gas requirements are met through contracts of less than one year. SDG&E purchases natural gas primarily from various spot-market suppliers and from suppliers under short-term contracts. These supplies originate in New Mexico, Oklahoma and Texas, and are transported to the SoCalGas pipeline at the California border by El Paso Natural Gas Company and by Transwestern Pipeline Company. SDG&E also has long-term contracts for natural gas with four Canadian suppliers. Three of these suppliers have ceased deliveries due to legal disputes. Natural gas from Canada is transported to SDG&E's system over Alberta Natural Gas, Pacific Gas Transmission, and PG&E pipelines. The natural-gas transportation contracts have varying terms through 2023.

Additional information concerning SDG&E's gas operations is provided under "Legal Proceedings," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Note 9 of the "Notes to Consolidated Financial Statements" herein.

## RATE REGULATION

### Industry Restructuring

In September 1996 the state of California enacted a law restructuring California's electric utility industry. The legislation adopts the December 1995 CPUC decision that restructures the industry to stimulate competition and reduce rates. Electric industry restructuring is discussed in detail in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Note 10 of the "Notes to Consolidated Financial Statements" herein.

### Cost of Capital

A description of SDG&E's cost of capital mechanism, the Market-Indexed Capital Adjustment Mechanism (MICAM), is provided in "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein. MICAM eliminates the need to file an annual cost of capital application.

### Electric Fuel Costs and Sales Volumes

Rates to recover electric-fuel and purchased-power costs had previously been determined in the Energy Cost Adjustment Clause (ECAC) proceeding. The Electric Revenue Adjustment Mechanism (ERAM) compensated for variations in sales volume compared to the estimates used for setting the non-fuel component of rates. However, both ECAC and ERAM have been eliminated as part of electric industry restructuring. The elimination of ECAC and ERAM causes the revenues associated with electric fuel costs and sales volumes to be market driven. Although no effect occurred for the full year, quarterly earnings significantly fluctuated in 1997. Additional information on balancing accounts is discussed below in "Balancing Accounts" and in "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein.

### Natural-Gas Costs and Sales Volumes

Natural-gas commodity rates are set monthly based on market prices. Under traditional ratemaking, natural-gas rates were adjusted annually based on a forecast of natural-gas prices. This resulted in rate stability, but also contributed to significant accumulations in the Purchased Gas Account (PGA). Rates to recover the cost of transporting natural gas to SDG&E are determined in the Biennial Cost Allocation Proceeding (BCAP). The BCAP proceeding normally occurs every two years and is updated in the interim year for purposes of amortizing any accumulation in the balancing accounts. The natural-gas balancing accounts include the PGA for natural-gas costs and the Gas Fixed Cost Account (GFCA) for sales volumes. Balancing account coverage includes both core customers (primarily residential and commercial customers) and noncore customers (primarily large, industrial customers). However, SDG&E does not receive balancing account treatment on 25 percent of noncore GFCA overcollections and undercollections.

### Balancing Accounts

Until 1997, the CPUC required electric balancing accounts for fuel and purchased energy costs and for sales volumes, setting balancing account rates based on estimated costs and sales volumes. Revenues were adjusted upward or downward to reflect the differences between authorized and actual volumes and costs. These differences were accumulated in the balancing accounts and represented amounts to be either recovered from customers or returned to them. As of December 31, 1997 net ECAC and ERAM overcollections of \$130 million have been transferred to the interim transition cost balancing account to be applied to transition cost recovery. Additional information on balancing accounts is discussed in "Management's Discussion and Analysis of Financial Condition and Results

of Operations" and in Note 2 of the "Notes to Consolidated Financial Statements" herein.

#### Performance-Based Ratemaking

CPUC policies continue to move away from traditional cost-of-service regulation and toward incentive mechanisms. SDG&E implemented performance-based ratemaking (PBR) in 1993 for natural-gas procurement and transportation, and for electric generation and purchased energy. These mechanisms measure SDG&E's ability to purchase and transport natural gas, and to generate or purchase energy at the lowest possible cost, by comparing SDG&E's performance against various market benchmarks. In 1994 SDG&E implemented its Base Rates PBR, which includes the measurement of company performance indicators against a set of predetermined standards. Under all of the PBR mechanisms, SDG&E's shareholders and customers share in any savings or excess costs within predetermined ranges. A discussion of the current status of these programs is contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein.

#### Energy Conservation Programs

Over the past several years, SDG&E has promoted conservation programs to encourage efficient use of energy. The programs are designed to use energy-efficiency measures that will reduce customers' energy costs and ultimately reduce the need to build additional power plants. The costs of these programs have been recovered from customers. The programs contained an incentive mechanism that could increase or decrease SDG&E's earnings, depending upon the performance of the programs in meeting specified efficiency and expenditure targets. However, consistent with the industry trend toward increased competition, the CPUC has issued a decision that the IOUs are to transfer the control of their energy-efficiency programs to the competitive market beginning in October 1998. The decision directs the creation of an oversight board that will develop program policies and procedures and select program administrators. The utilities no longer will be involved with program delivery to customers, but will be allowed to bid to become administrators. Until the transition to a fully competitive market is complete, customers will continue to provide the funding. A discussion of the status of these programs is contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein.

#### Low-Emission Vehicle Programs

SDG&E has conducted a CPUC-approved natural-gas-vehicle (NGV) program since 1991. The program includes building refueling stations, demonstrating new technology, providing incentives and converting portions of SDG&E's vehicle fleet to natural gas. The cost of this program is being recovered in natural-gas rates. In November 1995 the CPUC issued its decision authorizing funding for limited electric-vehicle (EV) and NGV programs through the year 2000 to allow recovery of costs for operation and maintenance of SDG&E's EV and NGV fleets and NGV fueling stations, and to allow recovery of transition costs to meet existing commitments to customers. The decision requires the sale of SDG&E's NGV fueling stations located on customer property within six years. The CPUC approved a six-year program that provides a total of \$5.3 million for SDG&E's electric-vehicle program and \$6.7 million for its natural-gas-vehicle program over the six-year period.

#### Electric Rates

The average price per kilowatt-hour (kwh) charged to electric customers was 9.8 cents in 1997 and 9.6 cents in 1996. California's electric restructuring law (AB 1890) included a rate freeze for all customers. Beginning on January 1, 1998 SDG&E's average system rate cannot exceed

9.43 cents per kwh. Additional information on electric rates is discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein.

#### Natural-Gas Rates

The average price per therm of natural gas charged to customers was 65.0 cents in 1997 and 58.4 cents in 1996.

#### ENVIRONMENTAL MATTERS

Discussions about environmental issues affecting SDG&E, including electric and magnetic fields, hazardous substances, asbestos, air quality and water quality, are included in "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein. The following should be read in conjunction with those discussions.

##### Hazardous Substances

In 1994 the CPUC approved the Hazardous Waste Collaborative Memorandum account, allowing utilities to recover 90 percent of certain costs to clean up hazardous waste contamination at past and present utility sites and to obtain recovery of some or all of such costs from responsible parties, and to recover 70 percent of the related insurance litigation expenses. SDG&E has asked the CPUC that, beginning on January 1, 1998, the electric-generation portion of the hazardous waste memorandum account be eliminated, and that the electric-generation-related cleanup costs be eligible for transition cost recovery. A CPUC decision is still pending. A discussion on transition costs and electric industry restructuring is included in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Note 10 of the "Notes to Consolidated Financial Statements" herein.

Due to the fact that SDG&E disposes of its hazardous wastes at facilities owned and operated by other entities, applicable environmental laws may impose an obligation on SDG&E and others to undertake corrective actions if the owner or operator of such a facility fails to complete any required corrective actions. This type of obligation has been imposed upon SDG&E with respect to a site in Pico Rivera, California. SDG&E and 10 other entities have been named potential responsible parties by the California Department of Toxic Substances Control (DTSC) and are liable for any required corrective action regarding contamination at the site. DTSC has taken this action because SDG&E and others sold used electrical transformers to the site's owner. The DTSC considers SDG&E to be responsible for 7.4 percent of the transformer-related contamination at the site. The estimate for the development of the cleanup plan is \$850,000. SDG&E has contributed \$73,000 to the effort. The estimate for the actual cleanup, which commenced in 1997, is in the \$2 million to \$8 million range.

**Underground Storage:** California has enacted legislation to protect ground water from contamination by hazardous substances. Underground storage containers require permits, inspections and periodic reports, as well as specific requirements for new tanks, closure of old tanks and monitoring systems for all tanks. It is expected that cleanup of sites previously contaminated by underground tanks will occur for an unknown number of years. SDG&E cannot predict the cost of such cleanup. Pending assessment and remediation proceedings are described below.

In May 1987 the San Diego Regional Water Quality Control Board issued SDG&E a cleanup and abatement order for gasoline contamination originating from an underground storage tank located at SDG&E's Mountain Empire Operation and Maintenance facility. SDG&E assessed the extent of

the contamination, removed all contaminated soil and completed remediation of the site. Monitoring of the site confirms its remediation. SDG&E has applied for and is awaiting a site-closure letter from the Regional Water Quality Control Board.

Station B: Station B is located in downtown San Diego and was operated as a steam and electric-generating facility between 1911 and June 1993. Pursuant to a cleanup and abatement order, SDG&E remediated hydrocarbon contamination discovered as a result of the removal of three 100,000-gallon underground diesel-fuel storage tanks from an adjacent substation. SDG&E has applied for and is awaiting a site-closure letter from the San Diego County Department of Environmental Health.

#### OTHER

##### Research, Development and Demonstration (RD&D)

SDG&E has been conducting RD&D in areas that provided value to SDG&E and its customers. Annual RD&D costs have averaged \$6 million over the past three years. The CPUC historically has permitted rate recovery of these expenditures. In association with California's restructuring of the electric utility industry, the CPUC has established a new structure and initial funding levels to manage RD&D programs. A discussion of this is included in "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein.

##### Year 2000 Plans

A discussion of Enova's plans to prepare the company's computer systems and applications for the year 2000 and beyond is included in "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein.

##### Wages

SDG&E and Local 465, International Brotherhood of Electrical Workers have two labor agreements, a generation contract that runs through February 28, 1998 and a utility contract (transmission and distribution) that runs through August 31, 1998. Negotiations for a new generation contract are ongoing.

##### Employees of Registrant

As of December 31, 1997 SDG&E had 3,576 employees, compared to 3,688 at December 31, 1996. Enova and its other consolidated subsidiaries had 89 employees at December 31, 1997 compared to 49 at December 31, 1996.

##### Foreign Operations

SDG&E's foreign operations in 1997 included power purchases and sales with CFE in Mexico; purchases of natural gas from suppliers in Canada; and purchases of uranium from suppliers in Canada, Niger and Russia. Enova International is part of two consortia that are developing and operating natural-gas distribution systems in Mexico.

Additional information concerning foreign operations is provided under "Electric Operations," "Natural Gas Operations," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Note 9 of the "Notes to Consolidated Financial Statements" herein.

#### ITEM 2. PROPERTIES

Substantially all utility plant is subject to the lien of the July 1, 1940 mortgage and deed of trust and its supplemental indentures between

SDG&E and the First Trust of California N.A. as trustee, securing the outstanding first-mortgage bonds.

Information concerning SDG&E's properties is provided below. Additional information is provided under "Electric Operations," "Gas Operations," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in Notes 2, 5, 9 and 10 of the "Notes to Consolidated Financial Statements" herein.

#### Electric Properties

SDG&E's generating capacity is described in "Electric Resources", herein.

The 1997 system load factor was 55 percent and ranged from 55 percent to 64 percent for the past five years.

SDG&E's electric transmission and distribution facilities include substations, and overhead and underground lines. Periodically various areas of the service territory require expansion to handle customer growth.

SDG&E owns an approved nuclear power-plant site near Blythe, California.

#### Natural-Gas Properties

SDG&E's natural-gas facilities are located in San Diego and Riverside counties and consist of the Moreno and Rainbow compressor stations, various high-pressure transmission pipelines, high-pressure distribution mains, and service lines. SDG&E's natural-gas system is sufficient to meet customer demand and short-term growth. SDG&E is currently undergoing an expansion of its high-pressure transmission lines to accommodate expected long-term customer growth.

#### Other SDG&E Properties

The 21-story corporate office building at 101 Ash Street, San Diego is occupied pursuant to a capital lease through the year 2005. The lease has four separate five-year renewal options. SDG&E also occupies an office complex at Century Park Court in San Diego pursuant to an operating lease ending in the year 2007. The lease can be renewed for two five-year periods.

In addition, SDG&E occupies eight operating and maintenance centers, two business centers, six district offices, and five branch offices.

#### Non-Utility Property

Phase One Development, a subsidiary of Pacific Diversified Capital, held one property in San Diego County during 1997. In December 1997 this property was sold for residential development.

### ITEM 3. LEGAL PROCEEDINGS

Management believes that the legal proceedings discussed below will not have a material adverse effect on Enova's results of operations, financial condition or liquidity.

#### Public Service Company of New Mexico

On October 27, 1993 SDG&E filed a complaint with the FERC against Public Service Company of New Mexico, alleging that charges under a 1985 power-purchase agreement are unjust, unreasonable and discriminatory. SDG&E requested that the FERC investigate the rates charged under the agreement and establish December 26, 1993 as the effective refund

date. The relief, if granted, would reduce annual demand charges paid by SDG&E to PNM by up to \$11 million per year through April 2001. If approved, the proceeds would be refunded principally to SDG&E customers. On December 8, 1993 PNM answered the complaint and moved that it be dismissed. PNM denied that the rates are unjust, unreasonable or discriminatory and asserted that SDG&E's claims were barred by certain orders issued by the FERC in 1988. On March 18, 1996 SDG&E filed a second complaint with FERC against PNM, alleging in part that applying the same methodology as SDG&E had used in the 1993 complaint, but based on more recent cost information, results in charges under the 1985 power purchase agreement that are unjust, unreasonable and discriminatory. SDG&E requested that the FERC investigate the rates charged under the 1985 agreement and establish May 17, 1996 as the effective refund date. The relief, if granted, would reduce annual demand charges paid by SDG&E to PNM, in addition to the amount from the first complaint, by up to \$12 million per year. On April 26, 1996 PNM answered the second complaint and moved that it be dismissed for the same reasons in its answer to the 1993 complaint. On August 22, 1997 SDG&E filed a third complaint against PNM alleging that the demand rate paid by SDG&E under the PNM power-purchase agreement during 1996 was unjust and unreasonable, resulting in an overcharge of up to \$9.6 million during this period. On September 29, 1997 PNM answered the third complaint and moved that it be dismissed for the same reasons stated in its answer to the 1993 complaint.

#### Canadian Natural Gas

During early 1991 SDG&E signed four long-term natural gas supply contracts with Husky Oil Ltd., Canadian Hunter Ltd. and Noranda Inc., Bow Valley Energy Inc., and Summit Resources Ltd. Canadian-sourced natural gas began flowing to SDG&E under these contracts on November 1, 1993. Disputes have arisen with each of these producers with respect to events which are alleged by the producers to have occurred justifying a revision to the pricing terms of each contract, and possibly their termination. Consequently, during December 1993 SDG&E filed complaints in the United States Federal District Court, Southern District of California, seeking a declaration of SDG&E's contract rights. Specifically, SDG&E states that neither price revision nor contract termination is warranted.

On March 14, 1994 SDG&E voluntarily dismissed its complaint against Bow Valley without prejudice. On April 24, 1994 the court denied the other defendants' motions to dismiss SDG&E's complaints. These motions were based on jurisdictional grounds. Two of the defendants, Bow Valley and Husky Oil, filed claims on June 12, 1994 and June 29, 1994, respectively, against SDG&E with the Queen's Bench in Alberta, Canada, seeking a declaration that they are entitled to damages or, in the alternative, that they may terminate their respective contracts with SDG&E. SDG&E has answered these claims. On March 1, 1995 SDG&E and Husky Oil reached an agreement dismissing all of their respective claims with prejudice.

Bow Valley and Summit Resources gave SDG&E notice that their natural-gas supply contracts with SDG&E were terminated pursuant to provisions in the contract that purportedly give them the right to do so. SDG&E has responded that the notices were inappropriate and that it will seek both contract and tort damages. Bow Valley and Summit have subsequently ceased deliveries of natural gas to SDG&E.

On May 10, 1996 the U.S. District Court granted Canadian Hunter's and Summit's motions to dismiss the case, finding that the Alberta Sales of Goods Act rendered the gas-purchase agreements between SDG&E and the defendants voidable by either party. On June 1, 1996 Canadian Hunter

ceased deliveries of gas to SDG&E. On September 11, 1996 SDG&E filed in the Ninth Circuit Federal Court of Appeals an appeal of the U.S. District Court's judgment granting Canadian Hunter's and Summit's motions to dismiss the case.

On October 22, 1997 with respect to the Summit appeal and on December 31, 1997 with respect to the Canadian Hunter appeal, the Ninth Circuit Federal Court of Appeals held that the long-term contracts for SDG&E to buy Canadian natural gas were invalidated by changes in the Federal Energy Regulatory Commission's regulation of transportation rates and by a change in California's regulation of SDG&E gas rates. The Court upheld the U.S. District Court's order allowing both Summit and Canadian Hunter to void the 1991 gas-purchase agreements. The question of the value of the gas delivered remains before the U.S. District Court.

#### North City West

On June 14, 1993 the Peninsula at Del Mar Highlands Homeowners Association filed a complaint with the Superior Court of San Diego County against the City of San Diego and SDG&E to prevent SDG&E from constructing and operating an electric substation in an area which is known as North City West. Construction was completed, and the substation became operational in June 1994. In the complaint, the plaintiffs sought to have the city either revoke previously issued permits or reopen the hearing process to address alleged electric and magnetic field concerns. On July 6, 1993 the court denied the plaintiffs' motion for a temporary restraining order. On July 30, 1993 the court denied the plaintiffs' motion for a preliminary injunction. On September 28, 1993 the plaintiffs withdrew their complaint and the court dismissed it without prejudice.

On August 18, 1993 the plaintiffs filed a complaint with the California Public Utilities Commission requesting that the CPUC conduct an environmental assessment. This complaint still is pending at the CPUC.

#### SONGS Personal Injury Litigation

As previously discussed, SDG&E holds a 20-percent interest in the San Onofre Nuclear Generating Station. There have been seven radiation personal injury cases filed against various parties including Southern California Edison, SDG&E, Combustion Engineering, and the Institute of Nuclear Power Operations in Federal District Court, Southern District of California: James (filed July 12, 1994), McLandrich (February 6, 1995), Mettler (July 5, 1995), Knapp (August 31, 1995), Kennedy (November 17, 1995), Rock (November 28, 1995), and Keltsch (November 11, 1997). The plaintiffs allege their various types of leukemia or other forms of cancers were caused by radiation exposure from "fuel fleas" (radioactive fuel particles).

On October 12, 1995 the jury in the James case determined that there was no scientific link between the plaintiff's leukemia and the amount of radiation he was allegedly exposed to while employed at SONGS as an employee of a SONGS contractor. On August 15, 1996 the Ninth Circuit Court of Appeals upheld the decision. The time has lapsed for a petition for certiorari to the Supreme Court of the United States. Therefore, this matter is concluded.

McLandrich, Mettler and Knapp are wrongful death cases filed by the heirs of former SONGS employees seeking unspecified amounts in compensatory and punitive damages. Edison has been dismissed from McLandrich and Mettler based upon the District Court's ruling that Edison is an employer and workers' compensation is the exclusive remedy for the plaintiffs. The Ninth Circuit Court of Appeals rejected SDG&E's

petition for permission to challenge the lower court's determination that SDG&E is not an employer and thus may not avail itself of the workers' compensation exclusivity rule. McLandrich, Mettler and Knapp are stayed pending the outcome of a plaintiff's appeal in McLandrich, challenging the District Court's ruling that Southern California Edison can avail itself of the workers' compensation exclusivity rule.

The Kennedy and Rock cases involve family members of current or former SONGS employees who allege that the employees carried home fuel fleas which caused the family members' illnesses. The plaintiffs are alleging unspecified amounts of compensatory and punitive damages. Jury trial commenced in the Kennedy case on January 27, 1998 and is expected to last approximately six weeks. In the Keltsch case, no punitive damages are alleged. A motion to dismiss the case is scheduled to be heard on March 10, 1998. SDG&E has not been named in these actions; however, because of its ownership interest SDG&E may be adversely affected if plaintiffs are successful.

#### SONGS Pricing

In May 1997 Ayad Rubaii, an employee of Edison, filed a complaint under the federal False Claims Act against Edison and SDG&E in United States District Court for the Southern District of California. The complaint was unsealed in July 1997 and sent to Edison and SDG&E on September 3, 1997. In the complaint, the plaintiff alleges that Edison and SDG&E have overcharged customers since early 1996 for energy produced at SONGS under a pricing mechanism approved by the CPUC and codified by the State Legislature. The plaintiff alleges that he filed the lawsuit on behalf of the United States Government. The Department of Justice has elected not to intervene in the lawsuit, but could elect to do so in the future if new information becomes available which, in its view, justifies intervention. The plaintiff is claiming damages of \$383 million from Edison and \$102 million from SDG&E. Under the False Claims Act, any damages are subject to trebling and penalties could be assessed. On November 7, 1997, SDG&E filed a motion to dismiss this complaint. A hearing before the U.S. District Court was held on January 20, 1998. The Court has not yet issued its decision on SDG&E's motion to dismiss.

#### Employee Benefits

On September 16, 1997 two individual plaintiffs filed a complaint (Mascari v. SDG&E) in United States District Court for the Southern District of California on behalf of themselves and a purported class consisting of a significant number of temporary employees and independent contractors employed at SDG&E. Plaintiffs allege that they are and have been common law employees of SDG&E and, as such, under recent Ninth Circuit decisional law, are and have been entitled to participate in SDG&E's health and welfare, defined benefit and defined contribution plans. They seek to recover past and future benefits under each plan. On October 6, 1997 SDG&E filed its answer to the complaint, denying that the plaintiffs were or are entitled to any benefits and denying the appropriateness of a class.

#### Environmental and Regulatory Issues

Other legal matters related to environmental and regulatory issues are described under "Environmental Matters," "Rate Regulation" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS  
None.

ITEM 4. EXECUTIVE OFFICERS OF THE REGISTRANT (ENOVA)

Name	Age*	Positions (1993 - Current)
Stephen L. Baum	56	Chairman and Chief Executive Officer since January 1998. President and Chief Executive Officer from January 1996 through December 1997. Executive Vice President from December 1994 through December 1995. Executive Vice President (SDG&E) from January 1993 through December 1995.
Donald E. Felsing	50	President and Chief Operating Officer since January 1998. Executive Vice President from December 1994 through December 1995 and from April 1996 through December 1997. President and Chief Executive Officer (SDG&E) from January 1996 through December 1997. Executive Vice President (SDG&E) from January 1993 through December 1995.
Edwin A. Guiles	48	Executive Vice President since January 1998. Senior Vice President from January 1997 through December 1997. Senior Vice President - Energy Supply (SDG&E) from January 1993 through January 1997.
David R. Kuzma	52	Senior Vice President, Chief Financial Officer and Treasurer since November 1995. Senior Vice President, Chief Financial Officer and Treasurer (SDG&E) from June 1995 through December 1997. Senior Vice President, Chief Financial Officer and Treasurer of Florida Progress Corporation from 1991 to 1995.
Frank H. Ault	53	Vice President and Controller since December 1994. Vice President and Controller (SDG&E) from January 1993 through December 1997.
Jerry W. Deems	52	Vice President and Chief Information Technology Officer since October 1997. Manager of NonStop Software Division of Tandem Computers from 1993 to 1997. Vice President - Sales and Marketing of Objectivity, Inc. from 1991 to 1993.
Margot A. Kyd	44	Vice President - Human Resources since January 1996. Vice President - Human Resources (SDG&E) from January 1993 through December 1996.
William L. Reed	45	Vice President - Regulatory and Governmental Affairs since August 1997. Vice President - Regulatory Affairs (SDG&E) from January 1996 through July 1997. Vice President - Strategic Planning (SDG&E) from August 1995 through December 1995. Division Manager - Strategic Plans & Projects (SDG&E) from August 1994 through July 1995. Director - Energy Management (SDG&E) from April 1993 through July 1994. Director - Regulatory Affairs (SDG&E) from 1990 through March 1993.

\* As of December 31, 1997.

ITEM 4. EXECUTIVE OFFICERS OF THE REGISTRANT (SDG&E)

Name	Age*	Positions (1993 - Current)
Edwin A. Guiles	48	President since January 1998. Senior Vice President (Enova) from January 1997 through December 1997. Senior Vice President - Energy Supply from January 1993 through January 1997.
Gary D. Cotton	57	Senior Vice President - Energy Supply since August 1997. Senior Vice President - Customer Operations from January 1993 through July 1997.
Frank H. Ault	53	Vice President, Chief Financial Officer, Treasurer and Controller since January 1998. Vice President and Controller from January 1993 through December 1997.
Kathleen A. Flanagan	46	Vice President - Corporate Communications and Public Affairs since August 1997. Vice President - Corporate Communications from July 1994 through July 1997. Manager - Corporate Communications of Southern California Edison from 1991 to 1994.
Margot A. Kyd	44	Vice President - Human Resources, Marketing and Customer Service since January 1997. Acting Vice President - Marketing and Customer Service from January 1996 through December 1996. Vice President - Human Resources from January 1993 through December 1996.
William L. Reed	45	Vice President - Regulatory and Governmental Affairs since August 1997. Vice President - Regulatory Affairs from January 1996 through July 1997. Vice President - Strategic Planning from August 1995 through December 1995. Division Manager - Strategic Plans & Projects from August 1994 through July 1995. Director - Energy Management from April 1993 through July 1994. Director - Regulatory Affairs from 1990 through March 1993.

\* As of December 31, 1997.

PART II

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

Enova Corporation

Common stock of Enova Corporation is traded on the New York and Pacific stock exchanges. At December 31, 1997 there were 72,639 holders of common stock. The quarterly common stock information required by Item 5 is included in the Enova Corporation schedule of Quarterly Financial Data herein.

San Diego Gas & Electric Company

All the common stock of San Diego Gas & Electric Company is owned by Enova Corporation and is not publicly traded. The following table sets forth the cash distributions on common stock paid to Enova Corporation by SDG&E:

	1997
First Quarter	45,479,582
Second Quarter	44,310,518
Third Quarter	44,310,518
Fourth Quarter	44,322,572

In addition, in March 1997 SDG&E paid Enova a special dividend of \$70,000,000 to be used for the repurchase of 3 million shares of Enova Corporation common stock.

Dividend Restrictions

The CPUC regulates SDG&E's capital structure, limiting the dividends it may pay to Enova. At December 31, 1997 \$152 million of common equity was available for future dividends. In addition, at December 31, 1997 approximately one half of the \$658 million of rate-reduction bonds was also available for future dividends. Of this available amount, \$100 million in dividends was paid by SDG&E to Enova on January 2, 1998, in conjunction with the acquisition of Sempra Energy Trading.

## ITEM 6. SELECTED FINANCIAL DATA

## Enova Corporation

In millions of dollars except per share amounts

For the years ended December 31

	1997	1996	1995	1994	1993
	-----	-----	-----	-----	-----
Operating revenues	\$2,217.0	\$1,993.5	\$1,870.7	\$1,912.2	\$1,897.5
Operating income	\$344.2	\$335.0	\$345.7	\$317.2	\$303.9
Income from continuing operations	\$251.6	\$230.9	\$225.6	\$199.3	\$219.0
Earnings applicable to common shares	\$251.6	\$230.9	\$225.8	\$135.8	\$210.2
Earnings per common share from continuing operations	\$2.20	\$1.98	\$1.94	\$1.71	\$1.89
Earnings per common share (basic and diluted)	\$2.20	\$1.98	\$1.94	\$1.17	\$1.81
Dividends declared per common share	\$1.56	\$1.56	\$1.56	\$1.52	\$1.48

At December 31

Total assets	\$5,233.9	\$4,649.2	\$4,748.6	\$4,662.9	\$4,694.7
Long-term debt and preferred stock subject to mandatory redemption (excludes current portion)*	\$2,082.0	\$1,504.3	\$1,490.1	\$1,479.2	\$1,523.6

\*Includes long-term debt redeemable within one year.

This summary should be read in conjunction with the Enova Corporation consolidated financial statements and notes to consolidated financial statements.

## ITEM 6. SELECTED FINANCIAL DATA

## San Diego Gas &amp; Electric Company

In millions of dollars except per share amounts

For the years ended December 31	1997	1996	1995	1994	1993
	-----	-----	-----	-----	-----
Operating revenues	\$2,167.5	\$1,938.9	\$1,814.1	\$1,856.5	\$1,861.3
Operating income	\$317.1	\$308.8	\$315.0	\$302.6	\$288.2
Income from continuing operations	\$238.2	\$222.8	\$219.0	\$206.3	\$215.9
Net income (before preferred dividend requirement)	\$238.2	\$222.8	\$233.5	\$143.5	\$218.7
Preferred dividends	\$6.6	\$6.6	\$7.7	\$7.7	\$8.5
Earnings applicable to common shares	\$231.7	\$216.2	\$225.8	\$135.8	\$210.2
At December 31					
Total assets	\$4,654.5	\$4,160.5	\$4,472.6	\$4,353.3	\$4,370.0
Long-term debt and preferred stock subject to mandatory redemption (excludes current portion)*	\$1,812.8	\$1,309.8	\$1,242.0	\$1,239.1	\$1,347.5

\*Includes long-term debt redeemable within one year.

This summary should be read in conjunction with the San Diego Gas & Electric Company consolidated financial statements and notes to consolidated financial statements.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS -- Enova Corporation/San Diego Gas & Electric Company

GENERAL

Enova Corporation (referred to herein as Enova, which includes the parent and its wholly owned subsidiaries) was formed in January 1996 to become the parent company of San Diego Gas & Electric (SDG&E). At that time SDG&E's outstanding common stock was converted on a share-for-share basis into Enova Corporation common stock. SDG&E's debt securities, preferred stock and preference stock were unaffected and remained with SDG&E.

SDG&E is an operating public utility engaged in the electric and gas businesses. It generates and purchases electric energy and distributes it to 1.2 million customers in San Diego County and an adjacent portion of Orange County, California. It also purchases and distributes natural gas to 721,000 customers in San Diego County and transports electricity and gas for others. California has enacted an electric-restructuring law that affects the operations of SDG&E and the other California investor-owned electric utilities. This information is discussed below under "Electric Industry Restructuring." Enova has several other subsidiaries (referred to herein as nonutility subsidiaries). Enova Financial invests in limited partnerships representing approximately 1,200 affordable-housing properties located throughout the United States. Califia leases computer equipment. These two subsidiaries are expected to provide income tax benefits over the next several years. Enova International is involved in energy projects outside the United States. Pacific Diversified Capital is the parent company of Phase One Development, which has been involved in real estate development. Enova Energy is an energy management and consulting firm offering services to utilities and large consumers. In December 1997, subsidiaries of Enova Energy and Houston Industries formed a joint venture, El Dorado Energy, to build, own and operate a natural gas-fired power plant in Boulder City, Nevada. Enova Technologies is in the business of developing new technologies generally related to utilities and energy. In January 1997, Enova Energy, Enova Technologies and certain subsidiaries of Pacific Enterprises (discussed below) formed Energy Pacific, a joint venture to market integrated energy and energy-related products and services. Energy Pacific has recently changed its name to Sempra Energy Solutions. In January 1998, Sempra Energy Solutions completed the acquisition of CES/Way International, a leading national energy-service provider. In December 1997, Enova and Pacific Enterprises completed the joint acquisition of AIG Trading Corporation (AIG), a leading natural gas and power marketing firm based in Greenwich, Connecticut. AIG has subsequently changed its name to Sempra Energy Trading. Additional information regarding Enova's nonutility subsidiaries is described herein under "Electric Generation" and "Liquidity and Capital Resources - Investing Activities," and in Notes 1, 2 and 3 of the notes to consolidated financial statements.

BUSINESS COMBINATION

In October 1996, Enova and Pacific Enterprises (PE), parent company of Southern California Gas Company (SoCalGas), announced that they have agreed to combine the two companies. Enova and PE have selected Sempra Energy as the name of the new company formed by the business combination. As a result of the combination, which was unanimously approved by the boards of directors of both companies, (i) each outstanding share of common stock of Enova will be converted into one share of common stock of Sempra Energy, (ii) each outstanding share of common stock of PE will be converted into 1.5038 shares of Sempra Energy's common stock and (iii) the preferred stock and preference stock

of SDG&E, PE and SoCalGas will remain outstanding. In March 1997, the shareholders of Enova and PE approved the combination. Consummation of the combination is conditional upon the approvals of the California Public Utilities Commission (CPUC) and various other regulatory bodies (see below).

In June 1997, the CPUC revised its procedural schedule for the business combination after delaying until July 1997 its final decision on the Performance-Based Ratemaking (PBR) proceeding for SoCalGas. (The CPUC's decision on SoCalGas' PBR proceeding adopted a rate-setting mechanism for SoCalGas that provides incentives for cost control and efficiency improvement, including comparisons of productivity and other factors against benchmarks based on industry performance. SoCalGas had been operating under traditional "cost of service" regulation. The decision provides for, among other things, a net rate reduction of \$160 million.) In accordance with the CPUC's revised schedule, the administrative law judge handling the proceeding issued a draft decision on February 23, 1998. That draft decision proposed approval of the combination. Among other things, the draft decision proposed 50/50 sharing of the net cost savings resulting from the combination between shareholders and customers, but only for five years rather than the 10 years sought. The draft decision would reduce the net shareable savings from \$1.1 billion to \$340 million. The CPUC decision is scheduled for the end of March 1998.

In November 1997, the California attorney general issued an advisory opinion concluding that the business combination would not adversely affect competition within either the wholesale electricity or interstate gas markets. The opinion included a recommendation that the CPUC consider requiring SoCalGas to auction offsetting volumes of natural gas transportation rights equal to the load with SDG&E that will be withdrawn if the CPUC concludes that SDG&E would be eliminated as a potential competitor in the partially regulated intrastate gas transmission market.

In September 1997, the CPUC staff issued a final Negative Declaration, concluding that the business combination will not result in any activities or operational changes that may cause a significant adverse effect on the environment.

In June 1997, the Federal Energy Regulatory Commission (FERC) approved the business combination, subject to the conditions that the combined company will not unfairly use any potential market power regarding natural gas transportation to gas-fired electric-generation plants. The FERC acknowledged that this issue is clearly within the jurisdiction of the CPUC and the conditions will be considered during the CPUC review process. Therefore, the FERC's final decision is not expected to be issued before the CPUC's approval.

In August 1997, the Nuclear Regulatory Commission approved the business combination, ruling that the creation of the new company will not affect SDG&E's qualifications to hold the license for its 20-percent interest in the San Onofre Nuclear Generating Station (SONGS).

Remaining regulatory reviews, which are not expected to be concluded prior to the CPUC decision, include clearance by the U.S. Department of Justice, under the Hart-Scott-Rodino Antitrust Act, and approval by the Securities and Exchange Commission. Both agencies will review the business combination for its impacts on competition.

The commencement of combined operations is expected in the summer of 1998. Earnings of the combined company could be negatively impacted in 1998, and to a lesser extent in subsequent years, by delays in achieving cost savings from the combination caused by the later-than-expected effective combination date, CPUC limitations on transactions between SDG&E and SoCalGas, which may be modified by the CPUC combination proceedings (discussed below), the possibility that the CPUC

might not permit recovery of certain costs of the combination and might reduce the period or percentage for shareholder participation in the related cost savings, and slower-than-anticipated growth in revenues from Sempra Energy Solutions. Additional information regarding the proposed business combination is described in Note 1 of the notes to consolidated financial statements.

## RESULTS OF OPERATIONS

**Operating Results** Electric revenues increased 11 percent in 1997, primarily due to an increase in sales for resale to other utilities and increased retail sales volume due to weather. Electric revenues increased 6 percent in 1996, primarily due to the accelerated recovery of SONGS Units 2 and 3 which commenced in April 1996. Gas revenues increased 14 percent in 1997, primarily due to weather-related higher sales volume and higher purchased-gas prices, offset by an increase in customer purchases of gas directly from other suppliers (for whom SDG&E provides transportation). Gas revenues increased 12 percent in 1996, reflecting higher purchased-gas prices.

**Operating Expenses** Electric fuel expense increased 22 percent in 1997, primarily due to increased natural gas prices and increased natural gas-fired generation resulting from SONGS Units 2 and 3 refuelings. Electric fuel expense increased 34 percent in 1996, primarily due to increased generation and increases in natural gas prices.

Purchased-power expenses increased 42 percent in 1997, primarily due to increased volume, which resulted from lower nuclear-generation availability from the SONGS refuelings and increased use of purchased power due to decreased purchased-power prices. Purchased-power expenses decreased 9 percent in 1996, reflecting the availability of lower-cost nuclear generation and decreases in purchased-power capacity charges.

Gas purchased for resale increased 20 percent in 1997 and 34 percent in 1996, primarily due to increases in sales volume and in natural gas prices.

The changes in maintenance expenses reflect the nuclear refuelings in 1997 and 1995.

General and administrative expenses decreased 15 percent in 1997, primarily due to higher 1996 costs for customer service, partially offset by the expenses relating to the proposed business combination with Pacific Enterprises.

**Earnings** 1997 earnings per common share were \$2.20 compared to \$1.98 in 1996 and \$1.94 in 1995. The increase in earnings in 1997 is primarily due to incentive rewards for Performance-Based Ratemaking (PBR) and Demand-Side Management (DSM) programs, retirements of debt and common shares, and improved earnings of Enova Financial, partially offset by expenses relating to the proposed business combination with Pacific Enterprises. Other events that improved 1997 earnings included income tax benefits from the 1995 sale of Wahlco Environmental Systems and capital gains from the sale of property held by Pacific Diversified Capital. The increase in earnings in 1996 is primarily due to DSM rewards, partially offset by SDG&E's lower authorized return on equity.

Earnings per share for the quarter ended December 31, 1997, were \$0.72, compared to \$0.47 for the same period in 1996. The increase in earnings for the quarter was due to numerous offsetting factors, including PBR and DSM rewards, retirement of common shares, higher off-system electric sales, previously announced seasonal variability related to the elimination of electric balancing accounts, and expenses relating to the proposed business combination with Pacific Enterprises. Although the elimination of the balancing accounts did not have any effect on 1997 full-year earnings, quarterly earnings now fluctuate significantly, depending on monthly or seasonal changes in electric sales and fuel

prices. In general, earnings are expected to be higher in high sales-volume months and lower in others. In 1998 and future years, full-year earnings also will be affected by sales volumes.

Some of the PBR rewards recorded in 1997 had been pending with the CPUC for several years. During 1998, SDG&E will not have a multiple-year backlog of these PBR rewards to record. In addition, because of the elimination of the Generation and Dispatch PBR mechanism and the San Onofre Nuclear Generating Station Target Capacity Factor mechanism, the impact of performance rewards on future earnings will be reduced.

Califia and Enova Financial's contributions to earnings for the year were \$0.21 in 1997, \$0.19 in 1996 and \$0.17 in 1995. Contributions to earnings by Enova Energy and Enova Technologies were negatively impacted in 1997 by the slower-than-anticipated growth in revenues from Sempra Energy Solutions.

#### LIQUIDITY AND CAPITAL RESOURCES

SDG&E's operations continue to be a major source of liquidity. In addition, financing needs are met primarily through issuances of short-term and long-term debt. These capital resources are expected to remain available. Cash requirements include utility capital expenditures, nonutility subsidiaries' investments, and repayments and retirements of long-term debt. Nonutility cash requirements include capital expenditures associated with subsidiary activities related to the plans to distribute natural gas in Mexico and the eastern United States; new products; investments in Sempra Energy Trading, CES/Way International and El Dorado Energy; and affordable-housing, leasing and other investments. Additional information on these activities is discussed under "Cash Flows from Investing Activities" below. In addition to changes described elsewhere, major changes in cash flows are described below.

**Cash Flows from Operating Activities** The major changes in cash flows from operations among the three years result from changes in income taxes, accounts receivable, other current assets, accounts payable, and regulatory balancing accounts. The changes in cash flows related to income taxes were primarily due to the timing of certain deductions in 1997 and higher 1996 income tax payments in connection with settlements with the Internal Revenue Service. The changes in cash flows related to accounts and notes receivable were primarily due to increases in sales in December 1997. The changes in cash flows related to other current assets were primarily due to advances made to unconsolidated subsidiaries during late 1997. The changes in cash flows related to accounts payable were primarily due to fluctuations in natural gas purchases and prices from year to year. The changes in cash flows related to regulatory balancing accounts were primarily due to overcollections in the Electric Revenue Adjustment Mechanism (ERAM) account as a result of higher-than-authorized sales volumes in 1997 and changes in prices for natural gas in 1996.

Quarterly cash dividends of \$0.39 per share were declared for the year ended December 31, 1997. The dividend payout ratios for the years ended December 31, 1997, 1996, 1995, 1994 and 1993 were 71 percent, 79 percent, 80 percent, 130 percent, and 82 percent, respectively. The increase in the payout ratio for the year ended December 31, 1994, was due to writedowns recorded during 1994. For additional information regarding the writedowns, see Enova Corporation's 1996 Annual Report. The payment of future dividends is within the discretion of the Enova Board of Directors and is dependent upon future business conditions, earnings and other factors. Net cash flows provided by operating activities currently are sufficient to maintain the payment of dividends at the present level.

Enova has initiated an enterprise-wide program to prepare the company's computer systems and applications for the year 2000 and beyond. A comprehensive review has been conducted to identify the systems that could be affected by the year 2000 issue and an implementation plan has been developed. The year 2000 issue results from time-sensitive software applications that recognize a date using only two digits. For example, "00" may be recognized as the year 1900 rather than the year 2000. This could result in a system failure or miscalculations. This year 2000 problem creates risk for the company from unforeseen problems in its own computer systems and from third parties with whom the company deals on financial transactions. Management has not yet assessed whether the company's date-conversion project will be completed on a timely basis nor the impact of third-party computer system failures. The company expects to incur internal staff costs as well as consulting and other expenses related to infrastructure and facilities enhancements necessary to prepare the systems for the year 2000. Expenditures for the testing and conversion of system applications were \$4 million in 1997 and are expected to be between \$20 million and \$25 million over the next two years. These costs are expensed as incurred.

**Cash Flows from Financing Activities** Enova did not issue additional stock or long-term debt in 1997, except for SDG&E-related refinancings and electric industry restructuring-related rate-reduction bonds. Additional information concerning the rate-reduction bonds is discussed below and under "Electric Industry Restructuring." Enova and SDG&E do not plan any issuances in 1998.

In October 1997, SDG&E issued \$25 million of tax-exempt Industrial Development Bonds (IDBs) through the City of Chula Vista. The variable-rate bonds were issued at an initial rate of 3.5 percent. The proceeds from the bonds, which will mature in 2023, were used to redeem \$25 million of 8.75 percent IDBs with the City of San Diego. Also during 1997, SDG&E purchased and retired \$62 million of 9.625 percent and 8.5 percent first mortgage bonds.

In December 1997, \$658 million of rate-reduction bonds were issued on SDG&E's behalf at an average interest rate of 6.26 percent. A portion of the bond proceeds was used to retire \$14.9 million of variable-rate, taxable IDBs in December 1997 and \$15.7 million of variable-rate, taxable IDBs in January 1998. Additional retirements are planned. Additional information concerning the rate-reduction bonds is provided below under "Electric Industry Restructuring."

SDG&E currently has approximately \$83 million of temporary investments that will be maintained into the future. The purpose of maintaining such a level of investments is to offset a like amount of long-term debt. The specific debt series being offset consists of variable-rate IDBs. The CPUC has approved specific ratemaking treatment which allows SDG&E to offset IDBs as long as there is at least a like amount of temporary investments. If and when SDG&E requires all or a portion of the \$83 million of IDBs to meet future needs for long-term debt, such as to finance new construction, the amount of investments which is being maintained will be reduced below \$83 million and the level of IDBs being offset will be reduced by the same amount.

During 1997, Enova Corporation repurchased three million shares of its outstanding common stock. During 1998, the \$1.82-series preferred stock becomes callable at \$26 per share.

SDG&E maintains its capital structure so as to obtain long-term financing at the lowest possible rates. The following table shows the percentages of capital represented by the various components. In 1993 the capital structure is net of the construction funds held by a trustee.

	1993	1994	1995	1996	1997		Goal
					(A)	(B)	
Common equity	47 %	48 %	49 %	50 %	51 %	41 %	46-49 %
Preferred stock	4	4	4	4	4	3	3-5
Debt and leases	49	48	47	46	45	56	46-49
Total	100 %	100 %	100 %	100 %	100 %	100 %	100 %

(A) Excludes rate reduction bonds (\$658 million at December 31, 1997).

(B) Includes rate reduction bonds (\$658 million at December 31, 1997).

The CPUC regulates SDG&E's capital structure, limiting the dividends it may pay Enova. At December 31, 1997, \$152 million of common equity was available for future dividends. In addition, at December 31, 1997, approximately one half of the \$658 million of rate-reduction bonds was also available for future dividends. Of this available amount, \$100 million in dividends were paid by SDG&E to Enova on January 2, 1998, in conjunction with the acquisition of Sempra Energy Trading. This restriction is not expected to affect Enova's ability to meet its cash obligations.

In December 1997, Moody's Investors Service upgraded SDG&E's long-term-bond rating from an A1/stable outlook to an A1/positive outlook, reflecting SDG&E's business mix, which is heavily weighted toward distribution and transmission. The outlook upgrade also reflects the probability of recovery of stranded costs and the expected proceeds from the sale of generating assets (see discussion under "Electric Generation"). Standard & Poor's Ratings Group affirmed SDG&E's long-term-bond rating of A+/positive outlook.

**Cash Flows from Investing Activities** Cash used in investing activities in 1997 included SDG&E's construction expenditures and payments to its nuclear decommissioning trusts. SDG&E's capital expenditures were \$197 million in 1997 and are estimated to be \$242 million in 1998. Actual capital expenditures in 1997 were lower than anticipated due to changes in the scope and timing of several major capital projects. Estimated 1998 capital expenditures are closer to normal levels, with increases to meet industry restructuring needs and improvements to the electric distribution system. SDG&E continuously reviews its construction, investment and financing programs and revises them in response to changes in competition, customer growth, inflation, customer rates, the cost of capital, and environmental and regulatory requirements. Among other things, the level of expenditures in the next few years will depend heavily on the impacts of industry restructuring and the sale of SDG&E's Encina and South Bay power plants and other electric-generating assets, as well as the timing and extent of expenditures to comply with air-emission reduction and other environmental requirements. Additional information concerning the proposed sale of SDG&E's electric-generating assets is provided below under "Electric Generation."

Payments to the nuclear-decommissioning trusts are expected to continue until SONGS is decommissioned, which is not expected to occur before 2013. Although Unit 1 was permanently shut down in 1992, it is scheduled to be decommissioned concurrently with Units 2 and 3. However, this will depend on the outcome of the proposed sale of SDG&E's electric-generating assets, including its interest in SONGS.

Enova's level of nonutility expenditures in the next few years will depend primarily on the activities of its subsidiaries other than SDG&E, including Sempra Energy Solutions and the natural gas distribution projects in Mexico and the eastern United States. Nonutility expenditures were \$158 million in 1997 and are estimated to be \$100

million in 1998, not including special projects. The decrease in expected expenditures in 1998 is primarily attributable to a decrease in expected investments by Enova Financial.

As discussed previously, in January 1997, certain subsidiaries of Enova and Pacific Enterprises formed Sempra Energy Solutions, a joint venture to market integrated energy and energy-related products and services. During 1997, Enova invested \$21 million in Sempra Energy Solutions. In addition, in January 1998, Sempra Energy Solutions completed the acquisition of CES/Way International, a leading national energy-service provider.

In September 1997, Sempra Energy Solutions formed a joint venture with Bangor Hydro to build, own and operate a \$40 million natural gas distribution system in Bangor, Maine. In addition, in December 1997 Sempra Energy Solutions signed a partnership agreement with Frontier Utilities to build and operate a \$55 million natural gas distribution system in North Carolina.

In December 1997, Enova and Pacific Enterprises completed the joint acquisition of AIG Trading Corporation, a leading natural gas and power marketing firm. Enova contributed \$110.6 million to that acquisition, which was subsequently renamed Sempra Energy Trading.

In July 1997, Enova International and its partners, Pacific Enterprises International and Proxima S.A. de C.V., delivered their first supply of natural gas to Baja California. The Mexican company formed by the three partners, Distribuidora de Gas Natural de Mexicali, will invest up to \$25 million during the first five years of the 30-year license period to supply natural gas to the region. The partnership is expected to serve 25,000 customers over the next four years. In March 1997, the Mexican Energy Regulatory Commission awarded the partners their second natural gas privatization license in Mexico, allowing Distribuidora de Gas Natural de Chihuahua to build and operate a natural gas distribution system in Chihuahua. That partnership plans to invest approximately \$50 million in the project and is expected to serve 50,000 customers over the next five years. In January 1998, Enova International and its partner, Union Fenosa ACEX of Spain, submitted a bid to build, own and operate a natural gas distribution system in Monterrey, Mexico. The project will consist of an initial investment of \$190 million for a system that will serve 320,000 customers, with an additional \$60 million invested over five years to serve a total of 400,000 customers. Two other international consortia have submitted bids on the project. The Mexican Energy Regulatory Commission is expected to announce the winning bidder in March 1998.

In December 1997, Enova Power Corporation, a subsidiary of Enova Energy, and Houston Industries Power Generation formed El Dorado Energy, a joint venture to build, own and operate a natural gas power plant in Boulder City, Nevada. Enova invested \$2.3 million in El Dorado Energy in 1997 and expects to invest an additional \$37 million in 1998 and \$17 million in 1999.

Additional information about these acquisitions and joint ventures is discussed in Note 3 of the notes to consolidated financial statements.

**Derivative Financial Instruments** The policy of Enova is to use derivative financial instruments to reduce exposure to fluctuations in interest rates, foreign currency exchange rates and natural gas prices. These financial instruments are with major investment firms and expose Enova to market and credit risks. At times, these risks may be concentrated with certain counterparties, although counterparty nonperformance is not anticipated.

SDG&E periodically enters into interest-rate swap and cap agreements to moderate its exposure to interest-rate changes and to lower its overall cost of borrowing. These swap and cap agreements generally

remain off the balance sheet as they involve the exchange of fixed- and variable-rate interest payments without the exchange of the underlying principal amounts. The related gains or losses are reflected in the income statement as part of interest expense. SDG&E would be exposed to interest-rate fluctuations on the underlying debt should other parties to the agreement not perform. Such nonperformance is not anticipated. At December 31, 1997, SDG&E had an agreement for a floating-to-fixed-rate swap associated with \$45 million of variable-rate bonds maturing in 2002.

SDG&E's pension fund periodically uses foreign-currency forward contracts to reduce its exposure to exchange-rate fluctuations associated with certain investments in foreign equity securities. These contracts generally have maturities ranging from three to six months. At December 31, 1997, and 1996, there were no foreign-currency forward contracts outstanding.

In November 1996, SDG&E commenced price risk management activities, on a limited basis, in the area of hedging price volatility of natural gas requirements. SDG&E uses energy derivatives for both hedging and trading purposes within certain limitations imposed by company policies. These derivative financial instruments include forward contracts, swaps, options and other contracts which have maturities ranging from 30 days to nine months. Additional information on derivative financial instruments of SDG&E is provided in Note 8 of the notes to consolidated financial statements and under "Market Risk" below.

Sempra Energy Trading Corp. derives a substantial portion of its revenue from trading activities in natural gas, petroleum and electricity. Trading profits are earned as Sempra Energy Trading acts as a dealer in structuring and executing transactions that permit its counterparties to manage their risk profiles. In addition, Sempra Energy Trading takes positions in energy markets based on the expectations of future market conditions. These positions may be offset with similar positions or may be offset in the exchange traded markets. These positions include options, forwards, futures and swaps. Additional information on derivative financial instruments of Sempra Energy Trading is provided in Note 3 of the notes to consolidated financial statements and under "Market Risk" below.

**Market Risk** Market risk arises from the potential change in the value of financial instruments and physical commodities based on fluctuations in natural gas, petroleum and electricity commodity exchange prices and basis. Market risk is also affected by changes in volatility and liquidity in markets in which these instruments are traded. SDG&E utilizes a variety of financial structures, products and terms which require the company to manage, on a portfolio basis, the resulting market risks inherent in these transactions, subject to parameters established by company policies. Market risks are monitored separately from the groups that create or actively manage these risk exposures to ensure compliance with the company's stated risk management policies at both the Enova and subsidiary levels.

SDG&E measures the risk in its portfolio on a daily basis in accordance with value-at-risk methodologies, which simulate forward price curves in the energy markets to estimate the size and probability of future potential losses. The quantification of market risk using value-at-risk provides a consistent measure of risk across diverse energy markets and products. The use of this methodology requires a number of key assumptions, including the selection of a confidence level for losses and the holding period chosen for the value-at-risk calculation.

SDG&E expresses value-at-risk as the amount of SDG&E's earnings at risk based on a 95 percent confidence level using a time horizon of the average life of the portfolio. As of December 31, 1997, SDG&E's value-

at-risk for its price-risk management activities was \$2.8 million (net of income taxes) of SDG&E's net earnings. Since this is not an absolute measure of risk under all conditions for all products, SDG&E performs alternative scenario analyses to estimate the economic impact of a sudden market movement on the value of the portfolio. This and the professional judgment of experienced business and risk managers is used to supplement the value-at-risk methodology.

Based upon the ongoing policies and controls discussed above, SDG&E does not anticipate a material adverse effect on its financial position or results of operations as a result of market fluctuations.

A Risk Management Committee, composed of Enova and Pacific Enterprises officers, is responsible for monitoring operating performance and compliance with established risk management policies for Sempra Energy Solutions and its subsidiaries. Sempra Energy Trading has established position and stop-loss limits for each line of business to monitor its market risk and traders are required to maintain positions within these market-risk limits. The position limits are monitored during the day by Sempra Energy Trading's senior management, which determines whether to adjust its market-risk profile.

All of Sempra Energy Trading's market-risk sensitive instruments are entered into for trading purposes. The following table provides the potential changes in net principal transaction revenues resulting from hypothetical 10-percent increases and 10-percent decreases in the applicable commodity prices for significant commodity market-price sensitive instruments held on December 31, 1997. This quantitative information about market risk is limited because it does not take into account potential hedging transactions or changes to the market-risk profile of the portfolio by management in reaction to such changes in market conditions. Additionally, it does not take into account anticipated management reaction to breaches of counterparty credit limitations caused by the shocks within a given risk category. Further, inherent limitations arise from assuming that hypothetical 10-percent increases and 10-percent decreases in commodity prices move in the same direction, and this information does not recognize co-movements in prices.

The following table presents the impact on Sempra Energy Trading's net principal transaction revenues resulting from a 10-percent increase and a 10-percent decrease in the respective December 31, 1997 commodity prices:

In thousands of dollars

Commodity	10% Increase	10% Decrease
Crude oil and derivatives	\$ 3,288	\$ (3,288)
Natural gas	(2,441)	2,441
Emission credits	(81)	81
Electricity	(540)	540

SDG&E's payments to the externally managed nuclear decommissioning trust funds expose SDG&E to market risk. Market risk can result from fluctuations in the volatility and liquidity in markets in which these instruments are traded. These fluctuations can also correspondingly affect the level of funding of the decommissioning trust.

**Credit Risk** Credit risk relates to the risk of loss that would be incurred as a result of nonperformance by counterparties pursuant to the terms of their contractual obligations. SDG&E and Sempra Energy Trading avoid concentration of counterparties and maintain credit policies with regard to counterparties that management believes significantly minimize

overall credit risk. These policies include an evaluation of potential counterparties' financial condition (including credit rating), collateral requirements under certain circumstances, and the use of standardized agreements which allow for the netting of positive and negative exposures associated with a single counterparty.

The companies monitor credit risk exposure through an approval process and the assignment of credit limits. These credit limits are established based on risk and return considerations under terms customarily available in the industry.

#### ELECTRIC INDUSTRY RESTRUCTURING

**Background** In September 1996, the state of California enacted a law restructuring California's electric utility industry (AB 1890). The legislation adopts the December 1995 CPUC policy decision that restructures the industry to stimulate competition and reduce rates.

In May 1997, the CPUC issued a decision providing for direct access to be available to all California electric customers on January 1, 1998. The CPUC concluded that there were no technical or operational barriers to justify limiting direct access availability once electric restructuring commenced. The decision allowed customers to begin choosing electricity providers in November 1997. In December 1997, the CPUC agreed to delay the initiation of electric restructuring until March 31, 1998, to allow California's Power Exchange (PX) and Independent System Operator (ISO) to resolve computer software problems and conduct additional user training. Beginning on March 31, 1998, customers will be given the choice to continue to purchase electricity from their local utility under regulated tariffs, to enter into contracts with other energy service providers (i.e., private generators, brokers, etc.) or buy their power from the independent PX that serves as a wholesale power pool allowing all energy producers to participate competitively. The PX obtains power from qualifying facilities, nuclear units and, lastly, from the lowest-bidding suppliers. The ISO will schedule the power transactions and access to the transmission system. To facilitate this, the utilities will transfer the operational control of their transmission facilities to the ISO. The local utility will continue to provide distribution services, regardless of which source the consumer chooses. These customer choices will, in effect, open up the service territories of all California utilities. This will allow Enova, through Sempra Energy Solutions, to pursue customers outside of SDG&E's traditional service territory to provide electricity and other energy-related services. This also allows other energy-service providers to enter SDG&E's service territory to compete for generation customers.

**Transition Costs** Both the CPUC decision and the California legislation allow utilities, within certain limits, the opportunity to recover their stranded costs incurred for certain above-market CPUC-approved facilities, contracts and obligations through the establishment of a nonbypassable competition transition charge (CTC). The CPUC's direction is that traditional cost-of-service regulation will move toward performance-based regulation.

Utilities are allowed a reasonable opportunity to recover their stranded costs through December 31, 2001. Stranded costs such as reasonable employee-related costs directly caused by restructuring and purchased-power contracts (including those with qualifying facilities) may be recovered beyond 2001, subject to a reasonableness review.

SDG&E's transition-cost application, filed in October 1996, identified \$2 billion of estimated stranded costs, including generation, purchased-power and qualifying facilities' contracts, and regulatory assets. The amount includes sunk costs, as well as ongoing costs the CPUC finds necessary to maintain generation facilities through December 31, 2001. These identified transition costs were determined to be

reasonable by independent auditors selected by the CPUC, with \$73 million identified as requiring further action before being deemed recoverable transition costs. Through December 31, 1997, SDG&E has recovered transition costs of \$0.2 billion for nuclear generation and \$0.1 billion for nonnuclear generation. Additionally, overcollections of \$0.1 billion recorded in the Energy Cost Adjustment Clause (ECAC) and the Electric Revenue Adjustment Mechanism (ERAM) balancing accounts as of December 31, 1997, have been applied to transition cost recovery, leaving approximately \$1.6 billion for future CTC recovery. Included therein is \$0.4 billion for post-2001 purchased-power-contract payments that may be recovered after 2001, subject to an annual reasonableness review. Outside of the exceptions discussed above, transition costs not recovered by December 31, 2001, will not be collected from customers. Such costs, if any, would be written off as a charge against earnings. AB 1890 clarifies that all existing and future consumers must pay CTC, except for a segment of self-generators and irrigation districts. SDG&E has very few, if any, of these types of customers and does not anticipate a material impact from the exemption. During the 1998-2001 period, the recovery of transition costs is limited by the rate freeze (discussed below). Management believes that the rates within the rate freeze and the proceeds from the sale of electric-generating assets (discussed below) will be sufficient to recover all of SDG&E's approved transition costs by December 31, 2001.

In November 1997, the CPUC issued a decision allowing SDG&E the opportunity to recover all of its sunk nonnuclear generation costs, with the exception of \$39 million in fixed costs relating to gas transportation to power plants, which SDG&E believes will be recovered through contracts with the ISO. The decision does not include generation plant additions made after December 20, 1995. Instead, SDG&E must file an application seeking a CPUC reasonableness review thereof. In October 1997, SDG&E filed an application with the CPUC seeking recovery of \$14.5 million in 1996 capital additions for the Encina and South Bay power plants. A final CPUC decision is expected in 1998.

**Rate-Reduction Bonds** AB 1890 required a 10-percent rate reduction for residential and small-commercial customers beginning in January 1998. AB 1890 also provided for the issuance of rate-reduction bonds by an agency of the state of California to enable California's investor-owned electric utilities (IOUs) to use the proceeds to finance this rate reduction. In December 1997, \$658 million of rate-reduction bonds were issued on behalf of SDG&E at an average interest rate of 6.26 percent. These bonds are being repaid over 10 years by SDG&E's residential and small-commercial customers via a nonbypassable charge on their electricity bills. In September 1997, SDG&E and the other California IOUs received a favorable ruling by the Internal Revenue Service on the tax treatment of the bond transaction. The ruling states, among other things, that the receipt of the bond proceeds does not result in gross income to SDG&E at the time of issuance, but rather the proceeds are taxable over the life of the bonds. The Securities and Exchange Commission determined that these bonds should be reflected on the utilities' balance sheets as debt, even though the bonds are not secured by, or payable from, utility assets, but rather by the revenue streams collected from customers. SDG&E formed a subsidiary, SDG&E Funding LLC, to facilitate the issuance of the rate-reduction bonds. In exchange for the bond proceeds, SDG&E sold to SDG&E Funding all of its rights to the revenue streams. Consequently, the revenue streams are not the property of SDG&E nor are they available to satisfy any claims of SDG&E's creditors. There was no gain or loss recorded from the issuance of the bonds or the receipt of the proceeds. SDG&E has begun to use a portion of the proceeds to redeem its higher cost debt, described herein under "Liquidity and Capital Resources - Financing Activities." In December

1997, the California Supreme Court dismissed a petition submitted by a coalition of consumer groups to overturn the CPUC's Rate-Reduction Bond financing orders. A related coalition of consumer groups has also put together a California ballot initiative that, among other things, would possibly result in an additional 10-percent rate reduction, require that this rate reduction be achieved through the elimination or reduction of CTC payments and prohibit the collection of the charge on customer bills that would finance the rate reduction. SDG&E cannot predict the final outcome of the initiative. If the initiative were to be voted into law and upheld by the courts, the financial impact on SDG&E could be substantial.

**Electric Rates** AB 1890 included a rate freeze for all customers. Until the earlier of March 31, 2002, or when transition cost recovery is complete, SDG&E's average system rate will be frozen at 9.64 cents per kilowatt-hour, except for the impacts of natural gas price changes and the mandatory 10-percent rate reduction. As a result of significant increases in natural gas prices during the first quarter of 1997, SDG&E received CPUC authority to increase rates, but rates could not be increased above 9.985 cents per kwh. With the 10-percent rate reduction beginning on January 1, 1998, the maximum system-average rate became 9.43 cents per kwh. SDG&E's ability to recover its transition costs is dependent on its total revenues under the rate freeze exceeding normal cost-of-service revenues during the transition period by at least the amount of the CTC less any proceeds from the sale of electric-generating assets (discussed below). During the transition period, SDG&E will not earn awards from special programs, such as DSM, unless total revenues are also adequate to cover the awards. Fuel-price volatility is the most significant variable in the ability of SDG&E to recover its transition costs and program awards.

**Balancing Accounts** In October 1997, the CPUC issued a decision eliminating the ECAC and the ERAM balancing accounts, effective December 31, 1997. As of December 31, 1997, net overcollections for these accounts of \$130 million have been transferred to the interim transition-cost-balancing account to be applied to CTC recovery, subject to a reasonableness review. The decision eliminates further ECAC proceedings for generation costs incurred beginning in January 1998. Additionally, the decision eliminates all other electric balancing accounts, except for those associated with the administration of DSM, low-income assistance, and research and development (R&D) programs, which will be used to assist in the administration of public-purpose funds (discussed below). In addition, SDG&E has requested the retention of the Electric Vehicle balancing account through December 31, 1998. The elimination of ERAM and ECAC resulted in earnings volatility that began in the first quarter of 1997. Although no effect in 1997 was seen for the full year, quarterly earnings fluctuated significantly, as was the case for the other California IOUs. The largest impacts were reduced first-quarter earnings and increased third-quarter earnings. This quarterly volatility pattern is expected to continue in the future. Beginning in 1998, annual earnings also will be affected by sales volumes.

**Regulatory Accounting Standards** SDG&E had been accounting for the economic effects of regulation on all of its utility operations in accordance with Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation." Under SFAS No. 71, a regulated entity records a regulatory asset if it is probable that, through the ratemaking process, the utility will recover that asset from customers. Regulatory liabilities represent future reductions in revenues for amounts due to customers.

The SEC indicated a concern that the California IOUs may not meet the criteria of SFAS No. 71 with respect to their electric-generation net regulatory assets. SDG&E has ceased the application of SFAS No. 71 to its generation business, in accordance with the conclusion by the Emerging Issues Task Force of the Financial Accounting Standards Board that the application of SFAS No. 71 should be discontinued when deregulatory legislation is issued that determines that a portion of an entity's business will no longer be regulated. SDG&E's discontinuance of SFAS No. 71 applied to its generation business will not result in a write-off of its net regulatory assets, since the CPUC has approved the recovery of these assets by the distribution portion of its business, subject to the rate freeze.

**Consumer Education** In August 1997, the CPUC authorized \$89 million in rate recovery to fund California's Customer Education Program (CEP). SDG&E's share of this amount is approximately \$9 million. The CEP's objective is to provide information to California electric customers to help them compare and choose among electric products and services in a competitive environment. The CEP began in September 1997 and is expected to end by May 31, 1998.

**Public-Purpose Programs** The CPUC has established a new administrative structure and initial funding levels to manage DSM, renewable-energy, low-income assistance and R&D programs beginning in January 1998. The CPUC has formed independent boards to oversee a competitive bidding process to administer DSM and low-income programs. On an interim basis, the CPUC has required that the California IOUs transfer their administration of DSM and low-income programs to these boards by October 1998, and January 1999, respectively. Until the transition to a fully competitive energy-service market is complete, customers will be required to provide the funding. For 1998, SDG&E will be funded \$32 million and \$12 million for DSM and renewables programs, respectively. Low-income assistance funding will remain at 1996 authorized levels. The California Energy Commission will be allocated most of the \$63 million authorized to administer the R&D programs, of which SDG&E will be funded \$4 million. SDG&E's earnings potential from DSM programs will be reduced when the transition to the competitive market is complete.

**Federal Restructuring Activities** In October 1997, the FERC approved key elements of the California IOUs' restructuring proposal effective January 1, 1998. This includes the transfer by the IOUs of the operational control of their transmission facilities to the ISO, which is under FERC jurisdiction. The FERC also approved, on an interim basis, the establishment of the California PX to operate as an independent wholesale power pool. The California IOUs will pay to the PX a restructuring charge (in four annual installments) and an administrative-usage charge for each megawatt-hour of volume transacted. SDG&E's share of the restructuring charge is approximately \$10 million, which is eligible for transition-cost recovery. The IOUs have jointly guaranteed \$300 million of commercial loans to the PX and ISO for their development and initial start-up. SDG&E's share of the guarantee is \$30 million.

#### ELECTRIC GENERATION

In November 1997, SDG&E's Board of Directors approved a plan to auction the company's power plants and other electric-generating assets, enabling SDG&E to continue to concentrate its business on the transmission and distribution of electricity and natural gas as California opens its electric utility industry to competition in 1998. The plan includes the divestiture of SDG&E's fossil power plants - the Encina (Carlsbad, California) and South Bay (Chula Vista, California)

plants - and its combustion turbines, as well as its 20-percent interest in the San Onofre Nuclear Generating Station (SONGS) and its portfolio of long-term purchased-power contracts, including those with qualifying facilities. The power plants, including the interest in SONGS, have a net book value as of December 31, 1997, of \$800 million (\$200 million for fossil and \$600 million for SONGS) and a combined generating capacity of 2,400 megawatts. The proceeds from the auction will be applied directly to SDG&E's transition costs. In December 1997, SDG&E filed with the CPUC for its approval of the auction plan. The sale of the nonnuclear generating assets is expected to be completed by the end of the first quarter of 1999.

Although the other California IOUs are required by the CPUC to divest themselves of at least 50 percent of their fossil power plants as a part of industry restructuring, SDG&E is not under the same mandate. Other companies in the free market, not bound by the rules that apply to the state's regulated utilities, are expected to have a greater opportunity to provide competitive generation services with SDG&E's plants. The FERC has ruled that it has jurisdiction over all electricity sales into the California PX, meaning that the buyers of divested California power plants would qualify as wholesale power generators. The FERC's ruling has increased the interest in the nonnuclear plants owned by the other California IOUs, and is expected to have the same impact on SDG&E's fossil plants.

As previously discussed, subsidiaries of Enova Energy and Houston Industries have formed a joint venture to build, own and operate a 480-megawatt natural gas-fired power plant in Boulder City, Nevada, 40 miles southeast of Las Vegas. The joint venture, called El Dorado Energy, plans to sell the plant's electricity into the wholesale market to utilities throughout the western United States. The new plant will employ an advanced combined-cycle gas-turbine technology, enabling it to become one of the more efficient and environmentally friendly power plants in the nation. Its proximity to existing natural gas pipelines and electric transmission lines will allow El Dorado to actively compete in the deregulated electric-generation market. Construction on the \$280 million project, which will be funded 50 percent each by Enova and Houston Industries, began in the first quarter of 1998, with an expected operational date set for the fourth quarter of 1999.

#### AFFILIATE TRANSACTION GUIDELINES

In December 1997, the CPUC issued a decision on the rules governing transactions between a regulated utility and its affiliates that are not regulated by the CPUC. The decision adopts guidelines that are more favorable to consumers and less restrictive to utilities and their affiliates than the conditions that were recommended in October 1997 by a CPUC administrative law judge's proposed decision and an alternate decision by two CPUC commissioners. Key elements of the decision include: allowing the unregulated affiliates to operate within the utility's service territory without limitation; permitting utilities to share logos with their parent company and unregulated affiliates as long as proper disclaimers to California customers clearly communicate the utility-affiliate relationship; and allowing officers or board of directors of the parent company to also hold positions with the utility or unregulated affiliate, but not both. The rules adopted require separating functions between the utility and the affiliates with the exception of sharing certain corporate support services. These guidelines include transactions between affiliated utilities. However, these transactions have been addressed by the CPUC in the Enova/Pacific Enterprises business combination proceedings and the draft decision arising from that proceeding would exclude transactions between SDG&E and SoCalGas from the guidelines.

## PERFORMANCE-BASED RATEMAKING (PBR)

**Background** The CPUC has affirmed its belief that the new competitive environment should be based on policies that encourage efficient operation and improved productivity rather than on reasonableness reviews and disallowances. SDG&E has been participating in a PBR process for base rates, gas procurement, and electric generation and dispatch. SDG&E has applied to extend the Gas Procurement mechanism. The Generation and Dispatch mechanism has been terminated. SDG&E has filed a proposal for a new Distribution PBR mechanism to replace the current experimental Base-Rate PBR when it terminates at the end of 1998.

**Base Rates** In December 1997, the CPUC approved \$6.5 million in performance rewards for SDG&E's 1996 PBR. The CPUC has eliminated the price-performance benchmark indicator, which compares SDG&E's average electric-system rate to a national average, from SDG&E's Base-Rate PBR effective in 1997 due to the electric-rate freeze. For the 1998 PBR, all customer sharing amounts will be credited to the transition-cost balancing account rather than refunded to customers.

In December 1997, the CPUC eliminated SDG&E's 1999 General Rate Case filing requirement, and replaced it with a 1999 Cost of Service study in its new Distribution PBR application for electric distribution and gas operations (filed in January 1998 to begin in 1999). The Distribution PBR, which includes six categories of performance indicators, will measure SDG&E's ability to provide efficient, safe and reliable utility transmission (gas only) and distribution services. The application requests a \$60 million increase in SDG&E's revenue requirements (\$35 million for electric distribution and \$25 million for gas). The electric distribution increase does not affect rates and, therefore, reduces the amount available to recover transition costs. Under the new mechanism, all customer-sharing amounts will be reflected as reductions to future rates rather than refunded directly to customers. SDG&E's ability to control its costs within the limits of the revenues authorized by the study will impact future earnings.

**1998 Revenues** In December 1997, the CPUC approved a \$67 million increase in SDG&E's authorized electric distribution revenue requirements and a \$7 million increase in gas base rates, effective on January 1, 1998. The electric distribution increase, which reflects 1998 PBR escalations, does not affect rates and, therefore, reduces the amount available to recover transition costs.

**Natural Gas** In September 1997, SDG&E filed with the CPUC its application for a permanent Gas Procurement PBR mechanism. The filing proposes a mechanism structured around a commodity price cap plus an incremental adjustment, designed to recover transportation costs to the California border. SDG&E is holding settlement discussions with the CPUC's Office of Ratepayer Advocates over the proposed new mechanism.

## NATURAL GAS OPERATIONS

The ongoing restructuring of the natural gas utility industry has allowed customers to bypass utilities as suppliers and, to a lesser extent, as transporters of natural gas. Currently, nonutility electricity producers and other large customers may use a natural gas utility's facilities to transport gas purchased from other suppliers. Also, smaller customers may form groups to buy natural gas from another supplier.

In January 1998, the CPUC opened a rulemaking proceeding designed to open the natural gas industry to all customers, expanding the opportunities of residential and small commercial customers to have access to competing natural gas suppliers. The rulemaking will allow

smaller customers to receive the price and service benefits already realized by larger customers. A potential benefit from future natural gas reform, benefiting both customers and industry participants, would be the opportunity for energy providers to offer integrated retail electric and natural gas service to develop synergies between the two energy markets. In developing a natural gas retail restructuring proposal, the CPUC has provided several guiding principles: replace traditional regulation with competition in those markets where competition or the potential for competition exists, thereby allowing market forces to dictate prices; reform regulation for those utility functions that are not fully competitive; maintain a standard of consumer protection in both competitive and noncompetitive markets; and maintain supply reliability and ensure the safety of consumers' natural gas service. Hearings on the proposed restructuring are scheduled to begin in April 1998, with a final CPUC decision expected to be issued before the end of 1998.

Enova's nonutility subsidiaries are involved in several projects to develop natural gas systems in the United States and in Mexico. Discussion on these activities is included herein under "Liquidity and Capital Resources - Investing Activities."

#### COST OF CAPITAL

In October 1997, SDG&E filed with the CPUC its 1998 Market Indexed Capital Adjustment Mechanism (MICAM). MICAM, approved by the CPUC in 1996, adjusts SDG&E's authorized cost of capital based on changes in interest rates. For the current MICAM review, interest-rate movements over the corresponding 12 months did not trigger the mechanism to change, resulting in SDG&E's 1998 cost of capital remaining at 1997 authorized levels of 11.60 percent for the rate of return on equity and 9.35 percent for the rate of return on rate base. Beginning in 1998, MICAM only applies to electric distribution and gas rate base, and excludes the rates of return on nuclear and nonnuclear generating assets (recovered as transition costs), which are authorized at rates of 7.14 percent and 6.75 percent, respectively. During 1998, the CPUC will conduct proceedings to establish separate rates for the electric and gas components. SDG&E's authorized capital structure, which excludes the rate-reduction bonds, remains 49.75 percent common equity, 44.5 percent long-term debt and 5.75 percent preferred stock.

Electric transmission rates are regulated by the FERC. SDG&E's 1998 rate of return for transmission is 9.54 percent.

#### RESOURCE PLANNING

Sources of Fuel and Energy SDG&E's primary sources of fuel and purchased power include natural gas from Canada and the Southwest, surplus power from other utilities in the Southwest and the Northwest, and uranium from Canada. Although short-term natural gas supplies are volatile due to weather and other conditions, these sources should provide SDG&E with an adequate supply of competitively priced natural gas. SDG&E has been involved in litigation concerning its long-term contracts for natural gas with four Canadian suppliers. SDG&E has settled with one supplier, with gas being delivered under the terms of the settlement agreement. The remaining suppliers have ceased deliveries pending legal resolution. A U.S. Court of Appeals has upheld a U.S. District Court's decision to invalidate the contracts with two of the suppliers, although the value of the gas delivered has not yet been determined by the court. SDG&E has long-term pipeline capacity commitments related to these contracts for natural gas supplies. If the supply of Canadian natural gas to SDG&E is not resumed, SDG&E intends to use the capacity in other ways, including the release of a portion of this capacity to third parties. SDG&E cannot predict the final outcome of the litigation, but does not expect that an unfavorable outcome would

have a material effect on its financial condition, results of operations or liquidity. Additional information on Canadian gas litigation is discussed in Note 9 of the notes to consolidated financial statements.

**San Onofre Nuclear Generating Station** In January 1996, the CPUC approved the accelerated recovery of the existing capital costs of Units 2 and 3. The decision allowed SDG&E to recover its remaining investment in the units at a lower rate of return (7.14 percent) over an eight-year period beginning in 1996, rather than over the life of the units' license, which extends to 2013. The accelerated recovery began in April 1996. At December 31, 1997, approximately \$600 million was not yet recovered. California electric-industry-restructuring legislation requires that all generation-related stranded assets, which includes the uneconomic sunk costs of Units 2 and 3, be recovered by 2001. The 1996 decision also includes a performance incentive plan that encourages continued, efficient operation of the plant. Under this plan, customers will pay about \$0.04 per kilowatt-hour through December 31, 2003. This pricing structure replaces the traditional method of recovering the units' operating expenses and capital improvements. This is intended to make the units more competitive with other sources.

The California Coastal Commission (CCC) approved the SONGS owners' preliminary plan to provide 150 acres of wetlands restoration, 150 acres of kelp reef and other mitigation that was ordered by the CCC in April 1997. SDG&E's share of the cost is estimated to be \$23 million. Additional information is included under "Water Quality" below.

While conducting routine inspections of Unit 3 during its scheduled refueling in the second quarter of 1997, it was noted that, in several areas, the thickness of the heat transfer tubes' structural supports was significantly reduced, apparently due to erosion. In June 1997, the Nuclear Regulatory Commission approved the removal of the affected tubes from service as a corrective action and the unit's return to service. Unit 2, which also had this inspection during its scheduled refueling in the first quarter of 1997, showed no signs of this type of erosion. As a precautionary measure, Unit 2 was shut down in January 1998 for a 30-day mid-cycle outage for an inspection of its steam generators. The SONGS owners have scheduled a 30-day outage for Unit 3 in March 1998, for this inspection. The discovery of such problems in the future could increase the possibility that the units would be removed from service prior to 2013.

#### ENVIRONMENTAL MATTERS

SDG&E's operations are conducted in accordance with federal, state and local environmental laws and regulations governing hazardous wastes, air and water quality, land use and solid-waste disposal. SDG&E incurs significant costs to operate its facilities in compliance with these laws and regulations, and to clean up the environment as a result of prior operations of SDG&E or of others.

The costs of compliance with environmental laws and regulations are normally recovered in customer rates. However, restructuring of the California electric-utility industry (see "Electric Industry Restructuring" above) will change the way utility rates are set and costs are recovered. SDG&E has proposed a change in the hazardous waste memorandum account to exclude cleanup costs related to electric-generation activities, as described below. Capital costs related to environmental regulatory compliance for electric generation are intended to be included in transition costs for recovery through 2001. However, depending on the final outcome of industry restructuring and the impact of competition, the costs of compliance with future environmental regulations may not be fully recoverable.

Capital expenditures to comply with environmental laws and regulations were \$4 million in 1997, \$6 million in 1996 and \$4 million

in 1995, and are expected to be \$38 million in the aggregate over the next five years. These expenditures primarily include the estimated cost of retrofitting SDG&E's power plants to reduce air emissions. However, in November 1997 SDG&E announced a plan to auction its power plants and other electric-generating resources. Additional information on SDG&E's plan to divest its electric-generating assets is discussed in Note 10 of the notes to consolidated financial statements.

**Hazardous Wastes** In 1994, the CPUC approved the Hazardous Waste Collaborative, which allows utilities to recover cleanup costs of hazardous waste contamination at sites where the utility may have responsibility or liability under the law to conduct or participate in any required cleanup. In general, utilities are allowed to recover 90 percent of their cleanup costs and any related costs of litigation with responsible parties. SDG&E has asked the CPUC that beginning on January 1, 1998, the hazardous waste memorandum account be modified to exclude cleanup costs related to electric-generation activities. Electric-generation-related cleanup costs are intended to be eligible for transition cost recovery. A CPUC decision is still pending.

SDG&E lawfully disposed of hazardous wastes at facilities owned and operated by other entities. Operations at these facilities may result in actual or threatened risks to the environment or public health. Where the owner or operator of such a facility fails to complete any corrective action required by regulatory agencies to abate such risks, applicable environmental laws may impose an obligation to undertake corrective actions on SDG&E and others who disposed of hazardous wastes at the facility.

During the early 1900s, SDG&E and its predecessors manufactured gas from coal and oil at its Station A facility and at two small facilities in Escondido and Oceanside. Certain amounts of residual by-products from the gas manufacturing process and subsurface hydrocarbon contamination were discovered on portions of the Station A site during an environmental assessment which was completed in 1996. A risk assessment has been completed for Station A and demolition was performed during 1997 at a cost of \$1 million. Cleanup will commence in 1998, to be completed in 1999, and is estimated to cost \$5 million for subsurface remediation. SDG&E also may be required to assess certain off-site contamination which, in part, may have originated from the gas manufacturing process or other operations at Station A. Not included in this estimate are potential costs related to a previously removed shallow underground tank-like structure found under a public street immediately west of Station A. Any potential costs related to this tank would be immaterial. SDG&E is completing negotiations for an appropriate site-remediation work plan for Station A with the County of San Diego Department of Environmental Health.

The Escondido facility was remediated during 1990 through 1993 at a cost of \$3 million and a site-closure letter from the Department of Environmental Health has been received. However, contaminants similar to those on the Escondido site have been observed on adjacent property. In 1997, SDG&E assessed the nature and extent of these off-site contaminants at a cost of \$75,000. Hazardous contaminants were found on property to the east of the site and are believed to have originated from SDG&E operations. Remediation of these contaminants was initiated in 1997 and completed in 1998 at a total cost of \$250,000. A site-closure letter has been requested from the Department of Environmental Health. Nonhazardous contaminants were determined to be present on property to the north, but may not require further action subject to future land-use decisions. Finally, potential contaminants resulting from the gas manufacturing process by-products were assessed at the Oceanside facility, as well as on adjacent property. The cost to remediate the hazardous contaminants discovered in the assessment at the

property adjacent to the Oceanside facility and at the facility itself is estimated to be \$150,000.

Asbestos was used in the construction of SDG&E's Station B power plant, which closed in 1993. Activities to dismantle and decommission the facility require the removal of the asbestos in a manner complying with all applicable environmental, health and safety laws. This work also includes the removal or cleanup of paints containing heavy metals and small amounts of PCBs, fuel oil and other substances. These activities commenced in 1997 at a cost of \$3 million. This work effort is expected to be completed in 1998 at an estimated additional cost of \$3 million.

Electric and Magnetic Fields (EMFs) In property-damage litigation in 1996, the California Supreme Court agreed with SDG&E and unanimously affirmed the 1995 California Court of Appeal decision that the CPUC has exclusive jurisdiction over EMF health and safety issues. The California Supreme Court also stated that scientific evidence is insufficient to conclude that EMFs pose a health hazard. In addition, in a December 1997 case involving Pacific Gas & Electric, the California Court of Appeal held that the CPUC has exclusive jurisdiction over EMF personal injury, as well as EMF property-damage cases. Plaintiffs have sought review of this case at the California Supreme Court, which request is still pending.

Although scientists continue to research the possibility that exposure to EMFs causes adverse health effects, to date, science has demonstrated no cause-and-effect relationship between adverse health effects and exposure to the type of EMFs emitted by utilities, power lines and other electrical facilities. 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 certain 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 has directed California utilities 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. However, consistent with the major scientific reviews of the available research literature, the CPUC has indicated that no health risk has been identified.

**Air Quality** The San Diego Air Pollution Control District (APCD) regulates air quality in San Diego County in conformance with the California and Federal Clean Air Acts. California's standards are more restrictive than federal standards.

During 1996 and 1997, SDG&E installed equipment on South Bay Unit 1 in order to comply with the nitrogen oxide emission limits that the APCD imposed on electric-generating boilers through its Rule 69. Under this rule, SDG&E must maintain the total nitrogen oxide emissions from its entire system below a prescribed emissions cap, which decreases periodically through 2005. The estimated capital costs for compliance with the rule through 2005 are \$60 million. The California Air Resources Board has expressed concern that Rule 69 does not meet the requirements of the California Clean Air Act and may advocate or propose more restrictive emissions limitations which will likely cause SDG&E's Rule 69 compliance costs to increase.

Under a South Coast Air Quality Management District program called RECLAIM, SDG&E is required to reduce its nitrogen oxide emission levels

of the natural gas compressor engines at its Moreno gas-compression facility by 10 percent a year through 2003. This will be accomplished through the installation of new emission-monitoring equipment, operational changes to take advantage of low-emission engines and engine retrofits. The cost of complying with RECLAIM may be as much as \$3 million.

Water Quality Wastewater discharge permits issued by the Regional Water Quality Control Board (RWQCB) for SDG&E's Encina and South Bay power plants are required to enable SDG&E to discharge its cooling water and certain other wastewaters into the Pacific Ocean and into San Diego Bay. Wastewater discharge permits are prerequisite to the continued cooling-water and other wastewater discharges and, therefore, the continued operation of the power plants as they are currently configured. Increasingly stringent cooling-water and wastewater discharge limitations may be imposed in the future and SDG&E may be required to build additional facilities or modify existing facilities to comply with these requirements. Such facilities could include wastewater treatment facilities, cooling towers or offshore-discharge pipelines. Any required construction could involve substantial expenditures, and certain plants or units may be unavailable for electric generation during construction.

In 1981, SDG&E submitted a demonstration study in support of its request for two exceptions to certain thermal discharge requirements imposed by the California Thermal Plan for Encina power plant Unit 5. In November 1994, the RWQCB issued a new discharge permit, subject to the results of certain additional thermal discharge and cooling water related studies, to be used in considering SDG&E's earlier thermal discharge exception requests. The results of these additional studies were submitted to the RWQCB and the United States Environmental Protection Agency in 1997. If SDG&E's exception requests are denied, SDG&E could be required to construct off-shore discharge facilities at a cost of \$75 million to \$100 million or to perform mitigation, the costs of which may be significant.

In November 1996, the RWQCB issued a new discharge permit to SDG&E for the South Bay power plant. SDG&E filed an appeal to the State Water Resources Control Board (SWRCB) of various provisions which SDG&E considers unduly stringent. The SWRCB has not yet formally acted on the appeal. However, the SWRCB sponsored workshops with the RWQCB and the Environmental Health Coalition in November and December 1997, as a result of which several important issues may be resolved in 1998. As with the Encina power plant, increasingly stringent cooling-water and wastewater discharge limitations may require SDG&E to build additional facilities to comply with these requirements. To comply with its current permit, in 1997 SDG&E diverted its in-plant wastewater discharges from San Diego Bay to the sanitary sewer at a cost of \$2 million.

During 1997, in conjunction with its permit requirements to treat wastewater at its Encina and South Bay power plants, SDG&E evaluated whether any remediation activities may be required at the power plants based on currently available records and other information. In addition, SDG&E evaluated whether remediation is required at its Silvergate plant, which was shut down in 1984. As a result of these evaluations, only minor and localized remediation efforts were required. However, these evaluations did not include an extensive sampling and analysis of the property at such sites. Extensive sampling and analysis may identify additional contamination or other environmental conditions requiring remediation.

As previously discussed, in December 1997, SDG&E filed an application with the CPUC to divest its electric-generating assets, including its Encina and South Bay power plants, gas combustion turbines and its interest in the San Onofre Nuclear Generating Station. As a part

of the sale of any such facilities, SDG&E will complete an environmental baseline analysis of such sites, which may identify significant contamination or other environmental conditions requiring abatement or remediation.

The California Coastal Commission (CCC) required a study of the offshore impact on the marine environment from the cooling-water discharge by SONGS Units 2 and 3 as a condition of granting a construction permit. The study concluded that some environmental damage is caused by the discharge. To mitigate the damage, the CCC ordered Southern California Edison, SDG&E and the cities of Anaheim and Riverside to improve the plant's fish-protection system, build a 300-acre artificial reef to help restore kelp beds and restore 150 acres of coastal wetlands. SDG&E and Edison asked the CCC to reconsider and modify this mitigation plan to reduce the size of the artificial reef and shorten the monitoring period based on new studies that show that the environmental damage is much less than anticipated. During 1997 the CCC ordered that the plant owners proceed with a mitigation program that includes the enhanced fish-protection system, a 150-acre artificial reef and restoration of 150 acres of coastal wetlands. In addition, plant owners must deposit \$3.6 million with the state for the enhancement of marine fish hatchery programs and pay for state monitoring and oversight of the mitigation projects. SDG&E's share of the cost is estimated to be \$23 million. The pricing structure contained in the CPUC's decision regarding accelerated recovery of SONGS Units 2 and 3 (see "San Onofre Nuclear Generating Station" above) likely will accommodate most of these added mitigation costs.

#### NEW ACCOUNTING STANDARDS

In June 1997, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income." This statement, which is effective for 1998 financial statements, requires reporting and display of comprehensive income and its components (revenues, expenses, gains and losses) in a full set of general-purpose financial statements. The term "comprehensive income" describes all changes in equity of a business enterprise during a period from transactions and other events including, as applicable, foreign-currency items, minimum pension liability adjustments and unrealized gains and losses on certain investments in debt and equity securities. Upon adoption, financial statements for earlier periods provided for comparative purposes must be restated. The impact on Enova and SDG&E of the adoption of this new accounting standard is considered immaterial to the companies' financial statements.

Also in June 1997, the FASB issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." This statement, which is effective for 1998 financial statements, requires that public companies report certain information about operating segments in complete sets of financial statements of the enterprise and in condensed financial statements of interim periods. It also requires certain information about the company's products and services, geographic areas in which they operate, and their major customers. Under SFAS No. 131, operating segments are to be determined consistent with the way that management organizes and evaluates financial information internally for making operating decisions and assessing performance. Upon adoption, statements for earlier periods provided for comparative purposes must reflect this information. The impact of the adoption of this new accounting standard is the potential redefinition of the company's segments. The company estimates that the primary segments upon adoption of SFAS No. 131 will be electric operations, gas operations, energy services and other.

#### INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report to Shareholders includes forward-looking statements within the definition of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. When used in this "Management's Discussion and Analysis of Financial Condition and Results of Operations," the words "estimates," "expects," "anticipates," "plans" and "intends," variations of such words, and similar expressions are intended to identify forward-looking statements that involve risks and uncertainties.

Although Enova and SDG&E believe that their expectations are based on reasonable assumptions, they can give no assurance that those expectations will be realized. Important factors that could cause actual results to differ materially from those in the forward-looking statements herein include political developments affecting state and federal regulatory agencies, the pace and substance of electric-industry deregulation in California and in the United States, the ability to effect a coordinated and orderly implementation of both state legislation and the CPUC's restructuring regulations, the consummation and timing of the proposed business combination of Enova and Pacific Enterprises, the timing and level of proceeds of sales of SDG&E's electric-generating assets, the level of sales of electricity, the rate of growth of nonutility subsidiary revenues, international political developments, environmental regulations, and the timing and extent of changes in interest rates and prices for natural gas and electricity.

Item 8. Financial Statements and Supplementary Data - Enova Corporation

ENOVA CORPORATION  
 STATEMENTS OF CONSOLIDATED INCOME  
 In thousands except per share amounts

For the years ended December 31	1997	1996	1995
Operating Revenues			
Electric	\$1,769,421	\$1,590,882	\$1,503,926
Gas	398,127	348,035	310,142
Other	49,459	54,557	56,608
Total operating revenues	2,217,007	1,993,474	1,870,676
Operating Expenses			
Electric fuel	163,765	134,350	100,256
Purchased power	441,490	310,731	341,727
Gas purchased for resale	183,208	152,408	113,355
Maintenance	87,597	57,652	91,740
Depreciation and decommissioning	347,438	332,490	278,239
Property and other taxes	43,419	44,764	45,566
General and administrative	223,032	262,058	210,207
Other	222,727	212,245	209,358
Income taxes	160,161	151,813	134,578
Total operating expenses	1,872,837	1,658,511	1,525,026
Operating Income	344,170	334,963	345,650
Other Income and (Deductions)			
Allowance for equity funds used during construction	5,192	5,898	6,435
Taxes on nonoperating income	9,959	3,339	(27)
Other - net	1,653	(3,265)	(5,876)
Total other income	16,804	5,972	532
Income Before Interest Charges and Preferred Dividends	360,974	340,935	346,182
Interest Charges and Preferred Dividends			
Long-term debt	85,617	89,198	95,523
Short-term debt and other	19,474	17,516	20,215
Allowance for borrowed funds used during construction	(2,306)	(3,288)	(2,865)
Preferred dividend requirements of SDG&E	6,582	6,582	7,663
Net interest charges and preferred dividends	109,367	110,008	120,536
Income From Continuing Operations	251,607	230,927	225,646
Discontinued Operations, Net of Income Taxes	--	--	148
Earnings Applicable to Common Shares	\$ 251,607	\$ 230,927	\$ 225,794
Average Common Shares Outstanding	114,322	116,572	116,535
Earnings Per Common Share (basic and diluted)	\$ 2.20	\$ 1.98	\$ 1.94
Dividends Declared Per Common Share	\$ 1.56	\$ 1.56	\$ 1.56

See notes to consolidated financial statements.

ENOVA CORPORATION  
CONSOLIDATED BALANCE SHEETS  
In thousands of dollars

Balance at December 31	1997	1996
	-----	-----
<b>ASSETS</b>		
Utility plant - at original cost	\$5,888,539	\$5,704,464
Accumulated depreciation and decommissioning	(2,952,455)	(2,630,093)
	-----	-----
Utility plant - net	2,936,084	3,074,371
	-----	-----
Investments in partnerships and unconsolidated subsidiaries	516,113	271,035
	-----	-----
Nuclear decommissioning trust	399,143	328,042
	-----	-----
<b>Current assets</b>		
Cash and temporary investments	624,375	173,079
Accounts receivable	231,678	186,529
Notes receivable	27,083	33,564
Inventories	67,074	63,437
Other	89,826	47,094
	-----	-----
Total current assets	1,040,036	503,703
	-----	-----
Deferred taxes recoverable in rates	184,837	189,193
	-----	-----
Deferred charges and other assets	157,711	282,893
	-----	-----
Total	\$5,233,924	\$4,649,237
	=====	=====
<b>CAPITALIZATION AND LIABILITIES</b>		
Capitalization (see Statements of Consolidated Capital Stock and of Long-Term Debt)		
Common equity	\$1,570,383	\$1,569,670
Preferred stock not subject to mandatory redemption	78,475	78,475
Preferred stock subject to mandatory redemption	25,000	25,000
Long-term debt	2,057,033	1,479,338
	-----	-----
Total capitalization	3,730,891	3,152,483
	-----	-----
<b>Current liabilities</b>		
Current portion of long-term debt	121,700	69,902
Accounts payable	163,395	175,815
Dividends payable	46,050	47,213
Interest accrued	23,160	21,259
Regulatory balancing accounts overcollected - net	58,063	35,338
Other	146,267	158,317
	-----	-----
Total current liabilities	558,635	507,844
	-----	-----
Customer advances for construction	37,661	34,666
Accumulated deferred income taxes - net	501,030	497,400
Accumulated deferred investment tax credits	62,332	64,410
Deferred credits and other liabilities	343,375	392,434
Contingencies and commitments (Notes 9 and 10)	--	--
	-----	-----
Total	\$5,233,924	\$4,649,237
	=====	=====

See notes to consolidated financial statements.

ENOVA CORPORATION  
STATEMENTS OF CONSOLIDATED CASH FLOWS

In thousands of dollars

For the years ended December 31

	1997	1996	1995
	-----	-----	-----
<b>Cash Flows from Operating Activities</b>			
Income from continuing operations	\$ 251,607	\$ 230,927	\$ 225,646
Adjustments to reconcile income from continuing operations to net cash provided by operating activities			
Depreciation and decommissioning	347,438	332,490	278,239
Amortization of deferred charges and other assets	6,246	6,556	12,068
Amortization of deferred credits and other liabilities	(37,802)	(38,399)	(32,975)
Allowance for equity funds used during construction	(5,192)	(5,898)	(6,435)
Deferred income taxes and investment tax credits	18,749	(6,875)	(42,237)
Other - net	55,817	73,850	57,475
Changes in working capital components			
Accounts and notes receivable	(38,668)	(7,440)	7,141
Inventories	(3,637)	4,522	7,648
Other current assets	(23,322)	(14,242)	(5,609)
Interest and taxes accrued	(30,350)	(28,199)	23,131
Accounts payable and other current liabilities	(24,470)	49,427	26,983
Regulatory balancing accounts	22,725	(37,313)	59,030
Cash flows provided by discontinued operations	--	--	6,148
Net cash provided by operating activities	----- 539,141	----- 559,406	----- 616,253
<b>Cash Flows from Financing Activities</b>			
Dividends paid	(179,586)	(181,849)	(180,625)
Issuances of long-term debt	677,850	228,946	124,641
Repayment of long-term debt	(171,133)	(286,668)	(165,871)
Short-term borrowings - net	--	--	(89,325)
Redemption of common stock	(74,122)	(480)	(241)
Redemption of preferred stock	--	(15,155)	(18)
Net cash provided (used) by financing activities	----- 253,009	----- (255,206)	----- (311,439)
<b>Cash Flows from Investing Activities</b>			
Utility construction expenditures	(197,184)	(208,850)	(220,748)
Contributions to decommissioning funds	(22,038)	(22,038)	(22,038)
Other - net	(121,632)	3,338	3,874
Discontinued operations	--	--	5,122
Net cash used by investing activities	----- (340,854)	----- (227,550)	----- (233,790)
Net increase	451,296	76,650	71,024
Cash and temporary investments, beginning of year	173,079	96,429	25,405
Cash and temporary investments, end of year	----- \$ 624,375	----- \$ 173,079	----- \$ 96,429
<b>Supplemental Schedule of Noncash Investing and Financing Activities</b>			
Real estate investments	\$ 125,726	\$ 96,832	\$ 50,496
Cash paid	(309)	--	(2,550)
Liabilities assumed	----- \$ 125,417	----- \$ 96,832	----- \$ 47,946

See notes to consolidated financial statements.

ENOVA CORPORATION  
 STATEMENTS OF CONSOLIDATED CHANGES IN  
 CAPITAL STOCK AND RETAINED EARNINGS

In thousands of dollars  
 For the years ended December 31, 1995, 1996, 1997

	Preferred Stock		Common Stock	Premium on Capital Stock	Retained Earnings
	Not Subject to Mandatory Redemption	Subject to Mandatory Redemption			
Balance, January 1, 1995	\$ 93,493	\$ 25,000	\$ 291,341	\$ 564,508	\$ 618,581
Earnings applicable to common shares					225,794
Long-term incentive plan activity-net			117	1,530	
Preferred stock retired (880 shares)	(18)			8	
Common stock dividends declared					(181,809)
Balance, December 31, 1995	93,475	25,000	291,458	566,046	662,566
Earnings applicable to common shares					230,927
Long-term incentive plan activity-net			113	582	
Preferred stock retired (150,000 shares)	(15,000)			(155)	
Common stock dividends declared					(181,867)
Balance, December 31, 1996	78,475	25,000	291,571	566,473	711,626
Earnings applicable to common shares					251,607
Long-term incentive plan activity-net			172	1,158	
Common stock retired (3,062,490 shares)			(7,656)	(66,145)	
Common stock dividends declared					(178,423)
Balance, December 31, 1997	\$ 78,475	\$ 25,000	\$ 284,087	\$ 501,486	\$ 784,810

See notes to consolidated financial statements.

ENOVA CORPORATION  
 STATEMENTS OF CONSOLIDATED CAPITAL STOCK  
 In thousands of dollars except call price

Balance at December 31		1997	1996
		-----	-----
<b>COMMON EQUITY</b>			
Common stock, without par value, authorized 300,000,000 shares, outstanding: 1997, 113,634,744 shares; 1996, 116,628,735 shares		\$ 284,087	\$ 291,571
Premium on capital stock		501,486	566,473
Retained earnings		784,810	711,626
		-----	-----
Total common equity		\$1,570,383	\$1,569,670
		=====	=====
<b>PREFERRED STOCK (A)</b>			
Not subject to mandatory redemption	Trading Symbol(B)	Call Price	
\$20 par value, authorized 1,375,000 shares	-----	-----	
5% Series, 375,000 shares outstanding	SDOPrA	\$24.00	\$ 7,500
4.50% Series, 300,000 shares outstanding	SDOPrB	\$21.20	6,000
4.40% Series, 325,000 shares outstanding	SDOPrC	\$21.00	6,500
4.60% Series, 373,770 shares outstanding	--	\$20.25	7,475
Without par value (C)			
\$1.70 Series, 1,400,000 shares outstanding	--	\$25.85(D)	35,000
\$1.82 Series, 640,000 shares outstanding	SDOPrH	\$26.00(D)	16,000
		-----	-----
Total not subject to mandatory redemption		\$ 78,475	\$ 78,475
		=====	=====
Subject to mandatory redemption			
Without par value (C)			
\$1.7625 Series, 1,000,000 shares outstanding(E)	--	\$25.00(D)	\$ 25,000
		-----	-----

- (A) All series of preferred stock have cumulative preferences as to dividends. The \$20 par value preferred stock has two votes per share, whereas the no par value preferred stock is nonvoting. The \$20 par value preferred stock has a liquidation value at par. The no par value preferred stock has a liquidation value of \$25 per share.
- (B) All listed shares are traded on the American Stock Exchange.
- (C) SDG&E is authorized to issue 10,000,000 shares total (both subject to and not subject to mandatory redemption). Enova is authorized to issue 30,000,000 shares total, of which no shares were issued and outstanding at December 31, 1997.
- (D) The \$1.70 and \$1.7625 series are not callable until 2003; the \$1.82 series is not callable until November 1998. All other series are currently callable.
- (E) The \$1.7625 series has a sinking fund requirement to redeem 50,000 shares per year from 2003 to 2007. The remaining 750,000 shares must be redeemed in 2008.

See notes to consolidated financial statements.

ENOVA CORPORATION  
STATEMENTS OF CONSOLIDATED LONG-TERM DEBT  
In thousands of dollars

Balance at December 31	First Call Date	1997	1996
	-----	-----	-----
<b>SDG&amp;E</b>			
First mortgage bonds			
5.5% Series I, due March 1, 1997	4/15/67	\$ --	\$ 25,000
8.75% Series II, due March 1, 2023(A)	9/1/97	--	25,000
9.625% Series JJ, due April 15, 2020	4/15/00	54,260	100,000
6.8% Series KK, due June 1, 2015(B)	Non-callable	14,400	14,400
8.5% Series LL, due April 1, 2022	4/1/02	43,725	60,000
7.625% Series MM, due June 15, 2002	Non-callable	80,000	80,000
6.1% and 6.4% Series NN, due September 1, 2018 and 2019(A)	9/1/02	118,615	118,615
Various % Series OO, due December 1, 2027(C)	(D)	250,000	250,000
5.9% Series PP, due June 1, 2018(A)	6/1/03	70,795	70,795
Variable % Series QQ, due June 1, 2018(A)	(E)	--	14,915
5.85% Series RR, due June 1, 2021(B)	6/1/03	60,000	60,000
5.9% Series SS, due September 1, 2018(A)	9/1/03	92,945	92,945
Variable % Series TT, due September 1, 2020(A)	(E)	57,650	57,650
Variable % Series UU, due September 1, 2020(A)	(E)	16,700	16,700
	-----	-----	-----
Total		859,090	986,020
		-----	-----
Unsecured bonds			
5.90% Series CPCFA96A, due June 1, 2014(B)	Non-callable	129,820	129,820
Variable % Series CV96A, due July 1, 2021(C)	(E)	38,900	38,900
Variable % Series CV96B, due December 1, 2021(C)	(E)	60,000	60,000
Variable % Series CV97A, due March 1, 2023(C)	(E)	25,000	--
	-----	-----	-----
Total		253,720	228,720
		-----	-----
Rate reduction bonds (F)		658,000	--
Capitalized leases		95,301	105,315
Other long-term debt		465	528
Unamortized discount on long-term debt		(6,178)	(2,128)
Current portion of long-term debt		(72,575)	(33,639)
		-----	-----
Total SDG&E		1,787,823	1,284,816
		-----	-----
<b>Other Subsidiaries</b>			
Debt incurred to acquire limited partnerships, various rates, payable annually through 2008		312,862	219,051
Other long-term debt		5,473	11,734
Current portion of long-term debt		(49,125)	(36,263)
		-----	-----
Total Other Subsidiaries		269,210	194,522
		-----	-----
Total Enova		\$2,057,033	\$1,479,338
		=====	=====

(A) Issued to secure SDG&E's obligation under a series of loan agreements with the City of San Diego under which the city loaned the proceeds from the sale of industrial-development revenue bonds to the company to finance certain qualified facilities. All series are tax-exempt except QQ and UU.

(B) Issued to secure SDG&E's obligation under a series of loan agreements with the California Pollution Control Financing Authority under which the Authority loaned proceeds from the sale of tax-exempt pollution-control revenue bonds to the company to finance certain qualified facilities.

(C) Issued to secure SDG&E's obligation under a series of loan agreements with the City of Chula Vista under which the city loaned the proceeds from the sale of tax-exempt industrial-development revenue bonds to the company to finance certain qualified facilities.

(D) The first call date for \$75 million is December 1, 2002. The remaining \$175 million of the bonds is currently variable rate and is callable at various dates within one year. Of this, \$45 million is subject to a floating-to-fixed rate swap, which expires December 15, 2002 (Note 8).

(E) Callable at various dates within one year.

(F) Issued to facilitate 10-percent rate reduction mandated by California's electric restructuring law. Issued in December 1997 at an average interest rate of 6.26 percent. Bonds are secured by the revenue streams collected from customers over 10 years and are not secured by utility assets.

See notes to consolidated financial statements.

ENOVA CORPORATION  
 STATEMENTS OF CONSOLIDATED FINANCIAL  
 INFORMATION BY SEGMENTS OF BUSINESS

In thousands of dollars  
 At December 31 or for the  
 years then ended

	1997	1996	1995
Operating Revenues (A)	\$ 2,217,007	\$ 1,993,474	\$ 1,870,676
Operating Income			
Electric operations	\$ 257,706	\$ 269,038	\$ 263,346
Gas operations	59,382	39,724	51,654
Other	27,082	26,201	30,650
Total	\$ 344,170	\$ 334,963	\$ 345,650
Depreciation and Decommissioning			
Electric operations	\$ 286,804	\$ 279,251	\$ 227,616
Gas operations	37,078	35,027	33,225
Other	23,556	18,212	17,398
Total	\$ 347,438	\$ 332,490	\$ 278,239
Utility Plant Additions (B)			
Electric operations	\$ 160,689	\$ 167,166	\$ 171,151
Gas operations	36,495	41,684	49,597
Total	\$ 197,184	\$ 208,850	\$ 220,748
Identifiable Assets			
Utility plant - net			
Electric operations	\$ 2,487,472	\$ 2,625,620	\$ 2,737,201
Gas operations	448,612	448,751	441,140
Total	2,936,084	3,074,371	3,178,341
Inventories			
Electric operations	50,354	47,445	53,828
Gas operations	15,036	15,633	14,131
Other	1,684	359	--
Total	67,074	63,437	67,959
Other identifiable assets			
Electric operations	770,885	697,145	802,172
Gas operations	128,525	161,252	148,714
Other	(C) 699,191	488,102	434,940
Total	1,598,601	1,346,499	1,385,826
Other Utility Assets	632,165	164,930	116,498
Total Assets	\$ 5,233,924	\$ 4,649,237	\$ 4,748,624

(A) The detail to operating revenues is provided in the Statements of Consolidated Income. The gas operating revenues shown therein include \$14 million in 1997, \$9 million in 1996 and \$9 million in 1995, representing the gross margin on sales to the electric segment. These margins arose from interdepartmental transfers of \$144 million in 1997, \$111 million in 1996 and \$85 million in 1995, based on transfer pricing approved by the California Public Utilities Commission in tariff rates.

(B) Excluding allowance for equity funds used during construction.

(C) Includes \$378 million in real estate investments.

Utility income taxes and corporate expenses are allocated between electric and gas operations in accordance with regulatory accounting requirements.

See notes to consolidated financial statements.



ENOVA CORPORATION  
 QUARTERLY FINANCIAL DATA (UNAUDITED)  
 In thousands except per share amounts

Quarter ended	March 31	June 30	September 30	December 31
<b>1997</b>				
Operating revenues	\$ 507,930	\$ 501,481	\$ 581,058	\$ 626,538
Operating expenses	438,535	416,241	485,699	532,362
Operating income	69,395	85,240	95,359	94,176
Other income and (deductions)	6,086	(124)	(3,425)	14,267
Net interest charges and preferred dividends	26,615	28,738	26,868	27,146
Earnings applicable to common shares	\$ 48,866	\$ 56,378	\$ 65,066	\$ 81,297
Average common shares outstanding	116,452	113,616	113,616	113,643
Earnings per common share (basic and diluted)*	\$ 0.42	\$ 0.50	\$ 0.57	\$ 0.72
<b>1996</b>				
Operating revenues	\$ 465,897	\$ 470,967	\$ 507,593	\$ 549,017
Operating expenses	372,905	396,442	420,307	468,857
Operating income	92,992	74,525	87,286	80,160
Other income	1,168	11	4,373	420
Net interest charges and preferred dividends	28,108	27,186	28,914	25,800
Earnings applicable to common shares	\$ 66,052	\$ 47,350	\$ 62,745	\$ 54,780
Average common shares outstanding	116,570	116,565	116,566	116,587
Earnings per common share (basic and diluted)*	\$ 0.57	\$ 0.41	\$ 0.54	\$ 0.47

These amounts are unaudited, but in the opinion of Enova reflect all adjustments necessary for a fair presentation.

\* The sum of quarterly earnings per share does not equal the annual total due to rounding.

Quarterly Common Stock Data (Unaudited)

	1997				1996			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Market price								
High	23	24 3/8	25 1/4	27 1/8	24 3/4	23 1/8	23	23
Low	21 5/8	21 3/8	23 3/8	23 15/16	21 5/8	20 3/8	20 1/2	21 5/8
Dividends declared	\$0.39	\$0.39	\$0.39	\$0.39	\$0.39	\$0.39	\$0.39	\$0.39

ENOVA CORPORATION  
Ratings at December 31, 1997 (Unaudited)

Issue	Standard & Poor's	Moody's
Bonds	A+	A1
Commercial paper	A-1	P-1
Preferred stock	A	a2

The presentation of these ratings is not a recommendation to buy, sell or hold these securities.

INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of Enova Corporation:

We have audited the accompanying consolidated balance sheets and the statements of consolidated capital stock and of consolidated long-term debt of Enova Corporation and subsidiaries as of December 31, 1997 and 1996, and the related statements of consolidated income, consolidated changes in capital stock and retained earnings, consolidated cash flows, and consolidated financial information by segments of business for each of the three years in the period ended December 31, 1997. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Enova Corporation and subsidiaries as of December 31, 1997 and 1996, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1997, in conformity with generally accepted accounting principles.

/S/ DELOITTE & TOUCHE LLP

DELOITTE & TOUCHE LLP  
San Diego, California  
February 23, 1998

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### ENOVA CORPORATION

#### NOTE 1: BUSINESS COMBINATION

In October 1996 Enova Corporation and Pacific Enterprises (PE), parent company of Southern California Gas Company (SoCalGas), announced an agreement to combine the two companies. As a result of the combination, (i) each outstanding share of common stock of Enova will be converted into one share of common stock of the new company, (ii) each outstanding share of common stock of PE will be converted into 1.5038 shares of common stock of the new company and (iii) the preferred stock and preference stock of SDG&E, PE and SoCalGas will remain outstanding.

The combination was unanimously approved by the boards of directors of both companies and subsequently was approved by the shareholders of both companies. The combination will be a tax-free transaction and is expected to be accounted for as a pooling of interests. Enova and PE have selected Sempra Energy as the name of the new combined company, with the corporate headquarters to be located in San Diego, California. Headquarters for SDG&E and SoCalGas, whose names will be retained, will remain in San Diego and Los Angeles, California, respectively. Consummation of the combination is conditional upon the approvals of the California Public Utilities Commission and various other regulatory bodies, with completion expected in the summer of 1998. On February 23, 1998, the CPUC's administrative law judge handling the proceeding issued a draft decision that proposed approval of the combination. Among other things, the draft decision proposed 50/50 sharing of the net cost savings resulting from the combination between shareholders and customers, but only for five years rather than the 10 years sought. The draft decision would reduce the net shareable savings from \$1.1 billion to \$340 million. The CPUC decision is scheduled for the end of March 1998. Additional information concerning Enova/PE joint activities is discussed in Note 3.

#### NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

**Nature of Operations** On January 1, 1996, Enova Corporation (referred to herein as Enova, which includes the parent and its wholly owned subsidiaries) became the parent of SDG&E and its unregulated subsidiaries (referred to herein as nonutility subsidiaries). SDG&E's outstanding common stock was converted on a share-for-share basis into Enova common stock. SDG&E's debt securities, preferred and preference stock were unaffected and remain with SDG&E.

The consolidated financial statements include Enova and its wholly owned subsidiaries. The subsidiaries include SDG&E, Califia, Enova Financial, Enova Energy, Enova Technologies, Enova International and Pacific Diversified Capital. In 1997, nonutility subsidiaries contributed 8 percent to operating income (8 percent in 1996 and 9 percent in 1995).

**Utility Plant and Depreciation** Utility plant represents the buildings, equipment and other facilities used by SDG&E to provide electric and gas service. The cost of utility plant includes labor, materials, contract services and related items, and an allowance for funds used during construction. The cost of retired depreciable utility plant, plus removal costs minus salvage value is charged to accumulated depreciation. Information regarding industry restructuring and its effect on utility plant is included in Note 10. Utility plant in service by major functional categories at December 31, 1997, are: electric generation \$1.8 billion, electric distribution \$2.3 billion, electric transmission \$0.7 billion, other electric \$0.3 billion and gas operations \$0.8 billion. The corresponding amounts at December 31, 1996, were essentially the same as 1997. Accumulated depreciation and decommissioning of electric and gas utility plant in service at December 31, 1997, are \$2.6 billion and \$0.4 billion, respectively, and at December 31, 1996, were \$2.2 billion and \$0.4 billion, respectively.

Depreciation expense is based on the straight-line method over the useful lives of the assets or a shorter period prescribed by the California Public Utilities Commission (CPUC) (for SONGS, see below). The provisions for depreciation as a percentage of average depreciable utility plant (by major functional categories) in 1997 and (in 1996, 1995, respectively) are: electric generation 8.83 (7.57, 4.04), electric distribution 4.39 (4.38, 4.36), electric transmission 3.28 (3.25, 3.21), other electric 6.02 (5.95, 5.89) and gas operations 4.03 (4.07, 4.06). The increases for electric generation in 1997 and 1996 reflect the accelerated recovery of San Onofre Nuclear Generating Station (SONGS) Units 2 and 3 approved by the CPUC in April 1996.

**Inventories** Included in inventories at December 31, 1997, are SDG&E's \$43 million of materials and supplies (\$40 million in 1996), and \$22 million of fuel oil and natural gas (\$23 million in 1996). Materials and supplies are valued at average cost; fuel oil and natural gas are valued by the last-in first-out (LIFO) method.

**Other Current Assets** Included in other current assets at December 31, 1997, is \$44 million for Enova's current and deferred income taxes (\$47 million in 1996). Included therein is SDG&E's portion of \$26 million (\$33 million in 1996).

**Short-term Borrowings** There were no short-term borrowings at December 31, 1997, and 1996. At December 31, 1997, SDG&E had \$50 million of bank lines available to support commercial paper. Commitment fees are paid on the unused portion of the lines and there are no requirements for compensating balances.

**Other Current Liabilities** Included in other current liabilities at December 31, 1997, is Califia's \$21 million current portion of deferred lease revenue (\$33 million in 1996) and \$35 million for SDG&E's accrued vacation and sick leave (\$33 million in 1996). In 1996 the \$21 million noncurrent portion of Califia's deferred lease revenue is included in "Deferred Credits and Other Liabilities." The deferred revenue is amortized over the lease terms that end in 1998.

**Allowance for Funds Used During Construction (AFUDC)** The allowance represents the cost of funds used to finance the construction of utility plant and is added to the cost of utility plant. AFUDC also increases income, as an offset to interest charges shown in the Statements of Consolidated Income, although it is not a current source of cash. The average rate used to compute AFUDC was 9.35 percent in 1997, 9.36 percent in 1996 and 9.74 percent in 1995.

**Effects of Regulation** SDG&E's accounting policies conform with generally accepted accounting principles for regulated enterprises and reflect the policies of the CPUC and the Federal Energy Regulatory Commission. SDG&E has been preparing its financial statements in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation," under which a regulated utility may record a regulatory asset if it is probable that, through the ratemaking process, the utility will recover that asset from customers. Regulatory liabilities represent future reductions in revenues for amounts due to customers. To the extent that a portion of SDG&E's operations is no longer subject to SFAS No. 71, or recovery is no longer probable as a result of changes in regulation or SDG&E's competitive position, the related regulatory assets and liabilities would be written off. In addition, SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets to Be Disposed Of," affects utility plant and regulatory assets such that a loss must be recognized whenever a regulator excludes all or part of an asset's cost from rate base. As discussed in Note 10, California enacted a law restructuring the electric utility industry. The law adopts the December 1995 CPUC policy decision, and allows California utilities the opportunity to recover existing utility plant and regulatory assets over a transition period that ends in 2001. SDG&E has ceased the application of SFAS No. 71 with respect to its electric-generation business. SDG&E continues to evaluate the applicability of SFAS No. 121 as industry restructuring progresses. Additional information

concerning regulatory assets and liabilities is described below in "Revenues and Regulatory Balancing Accounts" and in Note 10.

**Revenues and Regulatory Balancing Accounts** Revenues from utility customers have consisted of deliveries to customers and the changes in regulatory balancing accounts. Earnings fluctuations from changes in the costs of fuel oil, purchased energy and natural gas, and consumption levels for electricity and the majority of natural gas previously were eliminated by balancing accounts authorized by the CPUC. This is still the case for natural gas sales. However, as a result of California's electric-restructuring law, beginning in 1997 overcollections recorded in the Energy Cost Adjustment Clause (ECAC) and Electric Revenue Adjustment Mechanism (ERAM) balancing accounts were transferred to the interim transition cost-balancing account, which is being applied to transition cost recovery (see Note 10). At December 31, 1997, overcollections of \$130 million were included in this account. Of this amount, \$98 million of overcollections were recorded at December 31, 1996. The elimination of ECAC and ERAM resulted in quarter-to-quarter earnings volatility in 1997. This earnings volatility will continue in future years. Additional information on industry restructuring is included in Note 10.

**Deferred Charges and Other Assets** Deferred charges include SDG&E's unrecovered premium on early retirement of debt and other regulatory-related expenditures that SDG&E expects to recover in future rates, excluding generation operations (discussed above). These items are amortized as recovered in rates. The net regulatory assets associated with SDG&E's generation operations at December 31, 1997, were credited to the interim transition cost balancing account.

**Deferred Credits and Other Liabilities** Other liabilities at December 31, 1997, include \$117 million of accumulated decommissioning costs associated with SONGS Unit 1 (\$96 million in 1996), which was permanently shut down in 1992. Additional information on SONGS Unit 1 decommissioning costs is included in Note 5.

#### Discontinued Operations

Enova's financial statements for periods prior to 1996 reflect the June 1995 sale of Wahlco Environmental Systems, Inc. as discontinued operations, in accordance with Accounting Principles Board Opinion No. 30, "Reporting the Effects of a Disposal of a Segment of Business." Discontinued operations are summarized in the table below:

In millions of dollars	1995
-----	-----
Revenues	\$ 24
Loss from operations before income taxes	--
Loss on disposal before income taxes	(12)
Income tax benefits	12

The loss on disposal of Wahlco reflects the sale of Wahlco and Wahlco's 1995 net operating losses prior to the sale.

**Use of Estimates in the Preparation of Financial Statements** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Statements of Consolidated Cash Flows** Temporary investments are highly liquid investments with original maturities of three months or less, or investments that are readily convertible to cash.

**Basis of Presentation** Certain prior-year amounts have been reclassified to conform to the current year's format.

NOTE 3: SIGNIFICANT ACQUISITIONS AND JOINT VENTURES

Sempra Energy Trading On December 31, 1997, Enova and Pacific Enterprises completed their acquisition (50% interest each) of Sempra Energy Trading (formerly AIG Trading Corporation), a leading natural gas and power marketing firm headquartered in Greenwich, Connecticut, for a total cost of \$225 million.

Sempra Energy Trading's primary business focus is wholesale trading and marketing of natural gas, power and oil to customers primarily in North America. Sempra Energy Trading had net assets of \$30 million at December 31, 1997.

An allocation of the purchase price has not yet been completed. The difference between the cost and underlying equity in the net assets will be amortized over a period of not more than 15 years.

As of December 31, 1997, Sempra Energy Trading's trading assets and trading liabilities approximate the following:

In millions of dollars

-----	
Trading Assets	
Unrealized gains on swaps and forwards	\$ 497
Due from commodity clearing organization and clearing brokers	41
OTC commodity options purchased	33
Due from trading counterparties	16
-----	
Total	\$ 587
=====	
Trading Liabilities	
Unrealized losses on swaps and forwards	\$ 487
Due to trading counterparties	41
OTC commodity options written	29
-----	
Total	\$ 557
=====	

The notional amounts of Sempra Energy Trading's financial instruments are provided below and include a maturity profile as of December 31, 1997, based upon the expected timing of the future cash flows. The notional amounts do not necessarily represent the amounts exchanged by parties to the financial instruments and do not measure Sempra Energy Trading's exposure to credit or market risks. The notional or contractual amounts are used to summarize the volume of financial instruments, but do not reflect the extent to which positions may offset one another. Accordingly, Sempra Energy Trading is exposed to much smaller amounts potentially subject to risk.

In millions of dollars	Within One Year	One to Five Years	Five to Ten Years	After Ten Years	Total
-----					
Forwards and commodity swaps	\$3,175	\$458	\$90	\$74	\$3,797
Futures	856	189	--	--	1,045
Options purchased	704	52	--	--	756
Options written	592	62	--	--	654
-----					
Total	\$5,327	\$761	\$90	\$74	\$6,252
=====					

Enova and Pacific Enterprises have jointly and severally guaranteed certain trading obligations of Sempra Energy Trading with credit worthy counterparties in connection with authorized transactions and in connection with funding. The total obligations guaranteed by the companies as of December 31, 1997, are \$190 million.

Sempra Energy Solutions In January 1998 Sempra Energy Solutions completed the acquisition of CES/Way International, a leading national energy-service

provider. In September 1997 Sempra Energy Solutions formed a joint venture with Bangor Hydro to build, own and operate a \$40 million natural gas distribution system in Bangor, Maine. In December 1997, Sempra Energy Solutions signed a partnership agreement with Frontier Utilities to build and operate a \$55 million natural gas distribution system in North Carolina.

**Enova International Gas Distribution Projects** Enova International, Pacific Enterprises International and Proxima S.A. de C.V., partners in the Mexican companies Distribuidora de Gas Natural de Mexicali and Distribuidora de Gas Natural de Chihuahua, are the licensees to build and operate natural gas distribution systems in Mexicali and Chihuahua. DGN - Mexicali will invest up to \$25 million during the first five years of the 30-year license period. DGN - Chihuahua plans to invest \$50 million in the gas distribution project in Chihuahua over the next five years.

**El Dorado Power Project** In December 1997 Enova Power Corporation, a subsidiary of Enova Energy, and Houston Industries Power Generation (HIPG) formed a joint venture, El Dorado Energy, to build, own and operate a 480-megawatt natural gas-fired plant in Boulder City, Nevada. Total cost of construction is expected to be \$280 million, with each company providing 50 percent of the funding. Enova Power and HIPG each will be responsible for 50 percent of the plant's fuel procurement and output marketing. Construction on the plant is expected to begin in the first quarter of 1998 and be completed in the fourth quarter of 1999.

#### NOTE 4: LONG-TERM DEBT

Amounts and due dates of long-term debt are shown on the Statements of Consolidated Long-Term Debt. Excluding capital leases, which are described in Note 9, maturities of long-term debt for SDG&E are \$66 million due in 1998, \$65 million due in 1999, 2000 and 2001, and \$145 million due in 2002. Total maturities of long-term debt for nonutility subsidiaries are \$49 million for 1998, \$53 million for 1999, \$44 million for 2000, \$35 million for 2001 and \$34 million for 2002. SDG&E has CPUC authorization to issue an additional \$185 million in long-term debt.

**First Mortgage Bonds** First mortgage bonds are secured by a lien on substantially all of SDG&E's utility plant. Additional first mortgage bonds may be issued upon compliance with the provisions of the bond indenture, which provides for, among other things, the issuance of an additional \$1.3 billion of first mortgage bonds at December 31, 1997. Certain first mortgage bonds may be called at SDG&E's option.

First mortgage bonds totaling \$249 million have variable-interest-rate provisions. During 1997, SDG&E retired \$127 million of first mortgage bonds, of which \$102 million were retired prior to scheduled maturity.

**Unsecured Bonds** During 1997, SDG&E issued \$25 million of unsecured bonds. Unsecured bonds totaling \$124 million have variable-interest-rate provisions.

**Rate-Reduction Bonds** In December 1997, \$658 million of rate-reduction bonds were issued on behalf of SDG&E at an average interest rate of 6.26 percent. These bonds were issued to facilitate the 10-percent rate reduction mandated by California's electric-restructuring law. These bonds are being repaid over 10 years by SDG&E's residential and small-commercial customers via a charge on their electricity bills. These bonds are secured by the revenue streams collected from customers and are not secured by, or payable from, utility assets. Additional information on rate-reduction bonds and electric industry restructuring is discussed in Note 10.

**Other** At December 31, 1997, SDG&E had \$340 million of bank lines, providing a committed source of long-term borrowings, with no debt outstanding. Bank lines, unless renewed by SDG&E, expire in 1998 (\$60 million) and in 2000 (\$280 million). Commitment fees are paid on the unused portion of the lines and there are no requirements for compensating balances.

Nonutility loans (Enova Financial and Califia) of \$318 million and \$231 million at December 31, 1997, and 1996, respectively, are secured by real estate and equipment.

SDG&E's interest payments, including those applicable to short-term borrowings, amounted to \$89 million in 1997, \$93 million in 1996 and \$100 million in 1995. Nonutility interest payments amounted to \$12 million in 1997, \$12 million in 1996 and \$14 million in 1995.

SDG&E periodically enters into interest-rate swap and cap agreements to moderate its exposure to interest-rate changes and to lower its overall cost of borrowings. At December 31, 1997, SDG&E had such an agreement, maturing in 2002, with underlying debt of \$45 million. See additional information in Note 8.

Although holders of variable-rate bonds may elect to redeem them prior to scheduled maturity, for purposes of determining the maturities listed above, it is assumed the bonds will be held to maturity.

**NOTE 5: FACILITIES UNDER JOINT OWNERSHIP**

SONGS and the Southwest Powerlink transmission line are owned jointly with other utilities. SDG&E's interests at December 31, 1997, are:

In millions of dollars

Project	SONGS	Southwest Powerlink
Percentage ownership	20	89
Utility plant in service	\$1,143	\$ 217
Accumulated depreciation	\$ 593	\$ 96
Construction work in progress	\$ 9	\$ --

SDG&E's share of operating expenses is included in the Statements of Consolidated Income. Each participant in the projects must provide its own financing. The amounts specified above for SONGS include nuclear production, transmission and other facilities.

SONGS Decommissioning Objectives, work scope and procedures for the future dismantling and decontamination of the SONGS units must meet the requirements of the Nuclear Regulatory Commission, the Environmental Protection Agency, the California Public Utilities Code and other regulatory bodies.

SDG&E's share of decommissioning costs for the SONGS units is estimated to be \$401 million in current dollars and is based on studies performed and updated periodically by outside consultants. The most recent study was performed in 1993. A new study is planned for 1998. A new escalation methodology was utilized to estimate the liability in 1997. This methodology was authorized by the CPUC in its 1996 Performance-Based Ratemaking decision for Southern California Edison (principal owner of SONGS), and incorporates an internal rate of return calculation that results in higher escalation amounts. Although electric industry restructuring legislation requires that stranded costs, which include SONGS plant costs, be amortized in rates by 2001, the recovery of decommissioning costs is allowed until the time as the costs are fully recovered.

The amount accrued each year is based on the amount allowed by regulators and is currently being collected in rates. This amount is considered sufficient to cover SDG&E's share of future decommissioning costs. The depreciation and decommissioning expense reflected on the Statements of Consolidated Income includes \$22 million of decommissioning expense for each of the years 1997, 1996 and 1995.

The amounts collected in rates are invested in externally managed trust funds. In accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," the securities held by the trust are considered available for sale and are adjusted to market value (\$399 million at December 31, 1997, and \$328 million at December 31, 1996) and shown on the Consolidated Balance Sheets. The fair values reflect unrealized gains of \$89 million and \$50 million at December 31, 1997, and 1996, respectively. The corresponding accumulated accrual is included on the Consolidated Balance Sheets in

"Accumulated Depreciation and Decommissioning" for SONGS Units 2 and 3 and in "Deferred Credits and Other Liabilities" for Unit 1. SONGS Unit 1 was permanently shut down in 1992.

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

Additional information regarding SONGS is included in Notes 9 and 10.

NOTE 6: EMPLOYEE BENEFIT PLANS

Pension Plan SDG&E has a defined-benefit pension plan, which covers substantially all of its employees. Benefits are related to the employees' compensation. Plan assets consist primarily of common stocks and bonds. SDG&E funds the plan based on the projected unit credit actuarial cost method. Net pension cost consisted of the following for the years ended December 31:

In thousands of dollars	1997	1996	1995
Cost related to current service	\$16,756	\$18,547	\$14,598
Interest on projected benefit obligation	39,089	37,253	30,760
Return on plan assets	(119,554)	(72,829)	(132,674)
Net amortization and deferral	63,500	25,315	93,708
Cost pursuant to general accounting standards	(209)	8,286	6,392
Regulatory adjustment	--	(15,286)	608
Net cost (benefit)	\$ (209)	\$(7,000)	\$7,000

The plan's status was as follows at December 31:

In thousands of dollars	1997	1996
Accumulated benefit obligation		
Vested	\$495,278	\$435,029
Non-vested	11,637	12,321
Total	\$506,915	\$447,350
Plan assets at fair value	\$699,000	\$598,610
Projected benefit obligation	589,911	539,391
Plan assets less projected benefit obligation	109,089	59,219
Unrecognized effect of accounting change	(761)	(950)
Unrecognized prior service cost	28,444	31,315
Unrecognized actuarial gains	(204,061)	(157,082)
Net liability	\$(67,289)	\$(67,498)

The projected benefit obligation assumes a 7.25 percent actuarial discount rate in 1997 (7.50 percent in 1996) and a 5.0 percent average annual compensation increase. The expected long-term rate of return on plan assets is 8.5 percent. The increase in the total accumulated benefit obligation and projected benefit obligation at December 31, 1997, is due primarily to a decrease in the actuarial discount rate. SDG&E's annual cost for a supplemental retirement plan for a limited number of key employees was approximately \$3 million in 1997, 1996 and 1995.

Post-Retirement Health Benefits SDG&E provides certain health and life insurance benefits to retired employees. These benefits are accrued during the employee's years of service, up to the year of benefit eligibility. SDG&E is recovering the cost of these benefits based upon actuarial calculations and funding limitations. The costs for the benefits were \$4 million in 1997, \$5 million in 1996 and \$5 million in 1995. These costs include \$2 million of amortization per year for the unamortized transition obligation (arising from the initial implementation of this accounting policy) of approximately \$31 million, which is being amortized through 2012.

Savings Plan Essentially all employees are eligible to participate in SDG&E's savings plan. Eligible employees may make a contribution of 1 percent to 15 percent of their base pay to the savings plan for investment in mutual funds or in Enova common stock. SDG&E contributes amounts equal to up to 3 percent of participants' compensation for investment in Enova common stock. SDG&E's annual compensation expense for this plan was \$3 million in 1997, \$2 million in 1996 and \$2 million in 1995.

Stock-Based Compensation Enova has a long-term incentive stock compensation plan that provides for aggregate awards of up to 2,700,000 shares of Enova common stock. The plan terminates in April 2005. In each of the last 10 years, 49,000 shares to 75,000 shares of stock were issued to officers and key employees, subject to forfeiture over four years if certain corporate goals are not met. The long-term incentive stock compensation plan also provides for the granting of stock options. In October 1997, Enova rescinded all options granted in October 1996. There were no stock options outstanding at December 31, 1997. As permitted by SFAS No. 123, "Accounting for Stock-Based Compensation," SDG&E has adopted the disclosure-only requirements of SFAS No. 123 and continues to account for stock-based compensation by applying the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." The differences between compensation cost included in net income and the related cost measured by the fair-value-based method defined in SFAS No. 123 are immaterial. SDG&E's compensation expense for this plan was approximately \$1 million in 1997, \$1 million in 1996 and \$2 million in 1995.

NOTE 7: INCOME TAXES

Income tax payments totaled \$162 million in 1997, \$176 million in 1996 and \$148 million in 1995.

The components of accumulated deferred income taxes at December 31 are as follows:

In thousands of dollars	1997	1996
-----		
Deferred tax liabilities		
Differences in financial and tax bases of utility plant	\$567,804	\$628,617
Loss on reacquired debt	30,535	26,399
Other	91,708	80,033
-----		
Total deferred tax liabilities	690,047	735,049
-----		
Deferred tax assets		
Unamortized investment tax credits	62,144	66,729
Equipment leasing activities	8,494	22,333
Regulatory balancing accounts	27,903	37,010
Unbilled revenue	22,365	21,923
Other	89,856	123,158
-----		
Total deferred tax assets	210,762	271,153
-----		
Net deferred income tax liability	479,285	463,896
Current portion (net asset)	21,745	33,504
-----		
Non-current portion (net liability)	\$501,030	\$497,400
=====		

The components of income tax expense are as follows:

In thousands of dollars	1997	1996	1995
-----			
Current			
Federal	\$93,040	\$115,410	\$134,212
State	38,413	39,939	42,630
-----			
Total current taxes	131,453	155,349	176,842
-----			
Deferred			
Federal	23,222	434	(23,914)
State	1,600	(1,518)	(13,464)
-----			
Total deferred taxes	24,822	(1,084)	(37,378)
-----			
Deferred investment tax credits - net			
	(6,073)	(5,791)	(4,859)
-----			
Total income tax expense	\$150,202	\$148,474	\$134,605
=====			

Federal and state income taxes are allocated between operating income and other income.

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

	1997	1996	1995
-----			
Statutory federal income tax rate	35.0 %	35.0 %	35.0 %
Depreciation	8.1	6.3	5.5
State income taxes - net of federal income tax benefit	7.0	6.9	5.5
Tax credits	(10.8)	(9.5)	(7.6)
Equipment leasing activities	(2.3)	(2.8)	(2.8)
Repair allowance	(1.9)	(1.2)	(3.0)
Other - net	2.3	4.4	4.8
-----			
Effective income tax rate	37.4 %	39.1 %	37.4 %
=====			

#### NOTE 8: FINANCIAL INSTRUMENTS

**Fair Value** The fair values of financial instruments (cash, temporary investments, funds held in trust, notes receivable, investments in limited partnerships, dividends payable, short- and long-term debt, deposits from customers, and preferred stock subject to mandatory redemption) are not materially different from the carrying amounts, except for long-term debt. The carrying amounts and fair value of long-term debt are \$2.1 billion and \$2.2 billion, respectively, at December 31, 1997, and \$1.5 billion and \$1.5 billion, respectively, at December 31, 1996. The fair values of SDG&E's first mortgage bonds are estimated based on quoted market prices for them or for similar issues. The fair values of long-term notes payable are based on the present values of the future cash flows, discounted at rates available for similar notes with comparable maturities. The fair values of the rate-reduction bonds issued in December 1997 are estimated to approximate carrying value due to the relatively short period of time between the issuance date and the valuation date, and the relative market stability during those periods.

**Off-Balance-Sheet Financial Instruments** Enova's policy is to use derivative financial instruments to reduce its exposure to fluctuations in interest rates, foreign-currency exchange rates and natural gas prices. These financial instruments expose Enova to market and credit risks which may at times be concentrated with certain counterparties, although counterparty nonperformance is not anticipated.

**Interest-Rate-Swap Agreements** SDG&E periodically enters into interest-rate-swap agreements to moderate its exposure to interest-rate changes and to lower its overall cost of borrowing. These swap agreements generally remain off the balance sheet as they involve the exchange of fixed- and variable-rate interest payments without the exchange of the underlying principal amounts. The related gains or losses are reflected in the income statement as part of interest expense. At December 31, 1997, SDG&E had one interest-rate-swap agreement: a floating-to-fixed-rate swap associated with \$45 million of variable-rate bonds maturing in 2002. SDG&E expects to hold this derivative financial instrument to its maturity. This swap agreement has effectively fixed the interest rate on the underlying variable-rate debt at 5.4 percent. SDG&E would be exposed to interest-rate fluctuations on the underlying debt should the counterparty to the agreement not perform. Such nonperformance is not anticipated. This agreement, if terminated, would result in an obligation of \$2 million at December 31, 1997, and at December 31, 1996.

**Foreign-Currency Forward Exchange Contracts** SDG&E's pension fund periodically uses foreign-currency forward contracts to reduce its exposure to exchange-rate fluctuations associated with certain investments in foreign equity securities. These contracts generally have maturities ranging from three to six months. At December 31, 1997, there were no foreign-currency forward contracts outstanding.

Energy Derivatives SDG&E uses energy derivatives for both hedging and trading purposes within certain limitations imposed by company policies. These derivative financial instruments include forward contracts, swaps, options and other contracts which have maturities ranging from 30 days to nine months. SDG&E's accounting policy is to adjust the book value of these derivatives to market each month with gains and losses recognized in earnings. These instruments are included in other current assets on the Consolidated Balance Sheet. Certain instruments such as swaps are entered into and closed out within the same month and, therefore, do not have any balance-sheet impact. Gains and losses are included in electric or gas revenue or expense, whichever is appropriate, on the Consolidated Income Statement.

As of December 31, 1997, the net fair value of open positions was \$5.9 million. The net unrealized profit of these open positions was \$0.3 million. These positions hedge approximately 6 percent of SDG&E's annual total purchased-gas volumes. The average fair value of derivative financial instruments during 1997 was an obligation of \$0.2 million. The net gains arising from these activities during 1997 were \$2.5 million. Information on derivative financial instruments of Sempra Energy Trading is provided in Note 3.

Market and Credit Risk SDG&E and Sempra Energy Trading utilize a variety of financial structures, products and terms which require the company to manage, on a portfolio basis, the resulting market risks inherent in these transactions, subject to parameters established by company policies. Market risks are monitored separately from the groups that create or actively manage these risk exposures to ensure compliance with the company's stated risk management policies.

Credit risk relates to the risk of loss that would incur as a result of nonperformance by counterparties pursuant to the terms of their contractual obligations. SDG&E and Sempra Energy Trading avoid concentration of counterparties and maintain credit policies with regard to counterparties that management believes significantly minimize overall credit risk.

A Risk Management Committee, composed of Enova and Pacific Enterprises officers, is responsible for monitoring operating performance and compliance with established risk management policies for Sempra Energy Solutions and its subsidiaries.

NOTE 9: CONTINGENCIES AND COMMITMENTS

Purchased-Power Contracts SDG&E buys electric power under several short-term and long-term contracts. Purchases are for up to 7 percent of plant capacity under contracts with other utilities and up to 100 percent of plant capacity under contracts with nonutility suppliers. No one supplier provides more than 3 percent of SDG&E's total system requirements. The contracts expire on various dates between 1998 and 2025.

At December 31, 1997, the estimated future minimum payments under the contracts were:

In millions of dollars

1998	\$234
1999	232
2000	200
2001	183
2002	134
Thereafter	2,462
Total minimum payments	\$3,445

These payments represent capacity charges and minimum energy purchases. SDG&E is required to pay additional amounts for actual purchases of energy that exceed the minimum energy commitments. Total payments, including energy payments, under the contracts were \$421 million in 1997, \$296 million in 1996

and \$329 million in 1995. Payments under purchased-power contracts increased in 1997 due to increased sales volume and lower nuclear generation availability.

In November 1997, SDG&E announced a plan to auction its power plants and other electric-generating resources, which include its long-term purchased-power contracts. Additional information on SDG&E's plan to divest its electric-generating assets is discussed in Note 10.

**Natural Gas Contracts** SDG&E has a contract with Southern California Gas Company (SoCalGas) that provides SDG&E with intrastate transportation capacity on SoCalGas' pipelines. This contract is currently being renegotiated and continues on a month-to-month basis under the original terms until a new agreement is reached. The commitment presumes a contract renewal for one year. SDG&E's long-term contracts with interstate pipelines for transportation capacity expire on various dates between 2007 and 2023. SDG&E's contract with SoCalGas for 8 billion cubic feet of natural gas storage capacity expires in March 1998. A new agreement has been reached for 6 billion cubic feet of natural gas storage capacity from April 1998 through March 1999. SDG&E has long-term natural gas supply contracts (included in the table below) with four Canadian suppliers that expire between 2001 and 2004. SDG&E has been involved in negotiations and litigation with the suppliers concerning the contracts' terms and prices. SDG&E has settled with one supplier, with gas being delivered under the terms of the settlement agreement. The remaining suppliers have ceased deliveries pending legal resolution. A U.S. Court of Appeals has upheld a U.S. District Court's invalidation of the contracts with two of these suppliers, although the value of the gas delivered has not yet been determined by the court.

At December 31, 1997, the future minimum payments under natural gas contracts were:

In millions of dollars	Transportation and Storage	Natural Gas
-----		
1998	\$65	\$19
1999	15	17
2000	14	19
2001	14	21
2002	14	24
Thereafter	234	25
-----		
Total minimum payments	\$356	\$125
=====		

Total payments under the contracts were \$125 million in 1997, \$100 million in 1996 and \$95 million in 1995.

Leases SDG&E has nuclear fuel, office buildings, a generating facility and other properties that are financed by long-term capital leases. Utility plant includes \$198 million at December 31, 1997, and \$200 million at December 31, 1996, related to these leases. The associated accumulated amortization is \$102 million and \$95 million, respectively. SDG&E and nonutility subsidiaries also lease office facilities, computer equipment and vehicles under operating leases. Certain leases on office facilities contain escalation clauses requiring annual increases in rent ranging from 2 percent to 7 percent.

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

In millions of dollars	Operating Leases		Capitalized Leases
	Enova	SDG&E	SDG&E
1998	\$35	\$13	\$26
1999	12	12	26
2000	12	12	20
2001	8	8	12
2002	8	8	12
Thereafter	36	36	20
Total future rental commitment	\$111	\$89	116
Imputed interest (6% to 9%)			(21)
Net commitment			\$95

Enova's rental payments totaled \$81 million in 1997, \$88 million in 1996 and \$85 million in 1995. Included in these amounts are SDG&E payments of \$43 million, \$46 million and \$44 million, respectively.

Environmental Issues SDG&E's operations are conducted in accordance with federal, state and local environmental laws and regulations governing hazardous wastes, air and water quality, land use, and solid-waste disposal. SDG&E incurs significant costs to operate its facilities in compliance with these laws and regulations. The costs of compliance with environmental laws and regulations have been recovered in customer rates. Capital expenditures to comply with environmental laws and regulations were \$4 million in 1997, \$6 million in 1996 and \$4 million in 1995, and are expected to be \$38 million over the next five years. These expenditures primarily include the estimated cost of retrofitting SDG&E's power plants to reduce air emissions.

SDG&E has been associated with various sites which may require remediation under federal, state or local environmental laws. SDG&E is unable to determine the extent of its responsibility for remediation of these sites until assessments are completed. Furthermore, the number of others that also may be responsible, and their ability to share in the cost of the cleanup, is not known. Environmental liabilities that may arise from these assessments are recorded when remedial efforts are probable, and the costs can be estimated. In 1994 the CPUC approved the Hazardous Waste Collaborative Memorandum account allowing utilities to recover their hazardous waste costs, including those related to Superfund sites or similar sites requiring cleanup. The decision allows recovery of 90 percent of cleanup costs and related third-party litigation costs and 70 percent of the related insurance-litigation expenses. As discussed in Note 10, restructuring of the California electric-utility industry will change the way utility rates are set and costs are recovered. Both the CPUC and state legislation have indicated that the California utilities will be allowed an opportunity to recover existing utility plant and regulatory assets over a transition period that ends in 2001. SDG&E has asked the CPUC that beginning on January 1, 1998, the collaborative account be modified, and that electric-generation-related cleanup costs be eligible for transition cost recovery. A CPUC decision is still pending. Depending on the final outcome of industry restructuring and the impact of competition, the

costs of compliance with environmental regulations may not be fully recoverable.

**Nuclear Insurance** SDG&E and the co-owners of SONGS have purchased primary insurance of \$200 million, the maximum amount available, for public-liability claims. An additional \$8.7 billion of coverage is provided by secondary financial protection required by the Nuclear Regulatory Commission and provides for loss sharing among utilities owning nuclear reactors if a costly accident occurs. SDG&E could be assessed retrospective premium adjustments of up to \$32 million in the event of a nuclear incident involving any of the licensed, commercial reactors in the United States, if the amount of the loss exceeds \$200 million. In the event the public-liability limit stated above is insufficient, the Price-Anderson Act provides for Congress to enact further revenue-raising measures to pay claims, which could include an additional assessment on all licensed reactor operators.

Insurance coverage is provided for up to \$2.8 billion of property damage and decontamination liability. Coverage is also provided for the cost of replacement power, which includes indemnity payments for up to three years, after a waiting period of 17 weeks. Coverage is provided primarily through mutual insurance companies owned by utilities with nuclear facilities. If losses at any of the nuclear facilities covered by the risk-sharing arrangements were to exceed the accumulated funds available from these insurance programs, SDG&E could be assessed retrospective premium adjustments of up to \$6 million.

**Department of Energy Decommissioning** The Energy Policy Act of 1992 established a fund for the decontamination and decommissioning of the Department of Energy nuclear-fuel-enrichment facilities. Utilities using the DOE services are contributing a total of \$2.3 billion, subject to adjustment for inflation, over a 15-year period ending in 2006. Each utility's share is based on its share of enrichment services purchased from the DOE. SDG&E's annual contribution is \$1 million, and will be recovered as part of decommissioning costs (see Note 10).

**Litigation** Enova and its subsidiaries, including SDG&E, are involved in various legal matters, including those arising out of the ordinary course of business. Management believes that these matters will not have a material adverse effect on Enova's results of operations, financial condition or liquidity.

**Distribution System Conversion** Under a CPUC-mandated program and through franchise agreements with various cities, SDG&E is committed, in varying amounts, to convert overhead distribution facilities to underground. As of December 31, 1997, the aggregate unexpended amount of this commitment was approximately \$100 million. Capital expenditures for underground conversions were \$17 million in 1997, \$15 million in 1996 and \$12 million in 1995.

**Concentration of Credit Risk** SDG&E grants credit to its utility customers, substantially all of whom are located in its service territory, which covers all of San Diego County and an adjacent portion of Orange County.

#### NOTE 10: INDUSTRY RESTRUCTURING

In September 1996, the state of California enacted a law restructuring California's electric-utility industry (AB 1890). The legislation adopts the December 1995 CPUC policy decision restructuring the industry to stimulate competition and reduce rates. The new law supersedes the CPUC policy decision when in conflict.

Beginning on March 31, 1998, customers will be able to buy their electricity through a power exchange that will obtain power from qualifying facilities, nuclear units and, lastly, from the lowest-bidding suppliers. The power exchange will serve as a wholesale power pool allowing all energy producers to participate competitively. An Independent System Operator will schedule power transactions and access to the transmission system. Consumers also may choose either to continue to purchase from their local utility under

regulated tariffs or to enter into private contracts with generators, brokers or others. The local utility will continue to provide distribution service regardless of which source the consumer chooses.

Utilities are allowed a reasonable opportunity to recover their stranded costs through December 31, 2001. Stranded costs, such as those related to reasonable employee-related costs directly caused by restructuring and purchased-power contracts (including those with qualifying facilities), may be recovered beyond December 31, 2001. Outside of those exceptions, stranded costs not recovered through 2001 will not be collected from customers. Such costs, if any, would be written off as a charge against earnings.

SDG&E's transition cost application filed in October 1996 identifies costs totaling \$2 billion (net present value in 1998 dollars). These identified transition costs were determined to be reasonable by independent auditors selected by the CPUC, with \$73 million requiring further action before being deemed recoverable transition costs. Of this amount, the CPUC has excluded from transition cost recovery \$39 million in fixed costs relating to gas transportation to power plants, which SDG&E believes will be recovered through contracts with the ISO. Total transition costs include sunk costs, as well as ongoing costs the CPUC finds reasonable and necessary to maintain generation facilities through December 31, 2001. Both the CPUC policy decision and AB 1890 provide that above-market costs for existing purchased-power contracts may be recovered over the terms of the contracts or sooner. Qualifying facilities purchases include approximately 100 existing contracts, which extend as far as 2025. Other power purchases consist of two long-term contracts expiring in 2001 and 2013. Transition costs also include other items SDG&E has accrued under cost-of-service regulation. Nuclear decommissioning costs are nonbypassable until fully recovered, but are not included as part of transition costs.

Through December 31, 1997, SDG&E has recovered transition costs of \$0.2 billion for nuclear generation and \$0.1 billion for nonnuclear generation. Additionally, overcollections of \$0.1 billion recorded in the ECAC and ERAM balancing accounts as of December 31, 1997, have been applied to transition cost recovery, leaving approximately \$1.6 billion for future recovery. Included therein is \$0.4 billion for post-2001 purchased-power-contract payments that may be recovered after 2001, subject to an annual reasonableness review. SDG&E has announced a plan to auction its power plants and other electric-generating assets. This plan includes the divestiture of SDG&E's fossil power plants and combustion turbines, its 20-percent interest in SONGS and its portfolio of long-term purchased-power contracts. The power plants, including the interest in SONGS, have a net book value as of December 31, 1997, of \$800 million (\$200 million for fossil and \$600 million for SONGS). The proceeds from the auction will be applied directly to SDG&E's transition costs. In December 1997, SDG&E filed with the CPUC for its approval of the auction plan. The sale of the nonnuclear-generating assets is expected to be completed by the end of the first quarter of 1999. During the 1998-2001 period, recovery of transition costs is limited by the rate freeze (discussed below). Management believes that the rates within the rate cap and the proceeds from the sale of electric-generating assets will be sufficient to recover all of SDG&E's approved transition costs by December 31, 2001.

The California legislation provides for a 10-percent reduction of residential and small commercial customers' rates, which began in January 1998, as a result of the utilities' receiving the proceeds of rate-reduction bonds issued by an agency of the state of California. In December 1997, \$658 million of rate-reduction bonds were issued on behalf of SDG&E at an average interest rate of 6.26 percent. These bonds are being repaid over 10 years by SDG&E's residential and small-commercial customers via a nonbypassable charge on their electric bills.

In addition, the California legislation includes a rate freeze for all customers. Until the earlier of March 31, 2002, or when transition cost recovery is complete, SDG&E's system-average rate will be frozen at June 1996 levels (9.64 cents per kwh), except for the impact of fuel cost changes and the 10-percent rate reduction described above. Beginning in 1998 system-average rates cannot be increased above 9.43 cents per kwh, which includes the mandatory rate reduction and any impact of fuel cost changes.

As discussed in Note 2, SDG&E has been accounting for the economic effects of regulation in accordance with SFAS No. 71. The SEC indicated a concern that the California investor-owned utilities may not meet the criteria of SFAS No. 71 with respect to their electric-generation net regulatory assets. SDG&E has ceased the application of SFAS No. 71 to its generation business, in accordance with the conclusion by the Emerging Issues Task Force of the Financial Accounting Standards Board that the application of SFAS 71 should be discontinued when deregulatory legislation is issued that determines that a portion of an entity's business will no longer be regulated. The discontinuance of SFAS No. 71 applied to the utilities' generation business did not result in a write-off of their net regulatory assets, since the CPUC has approved the recovery of these assets by the distribution portion of their business, subject to the rate cap.

Item 8. Financial Statements and Supplementary Data - San Diego Gas & Electric Company

SAN DIEGO GAS & ELECTRIC COMPANY  
STATEMENTS OF CONSOLIDATED INCOME  
In thousands except per share amounts

For the years ended December 31	1997	1996	1995
Operating Revenues			
Electric	\$1,769,421	\$1,590,882	\$1,503,926
Gas	398,127	348,035	310,142
Total operating revenues	2,167,548	1,938,917	1,814,068
Operating Expenses			
Electric fuel	163,765	134,350	100,256
Purchased power	441,400	310,731	341,727
Gas purchased for resale	183,078	152,151	113,355
Maintenance	87,597	57,652	91,740
Depreciation and decommissioning	323,882	314,278	260,841
Property and other taxes	43,261	44,764	45,566
General and administrative	212,634	247,653	207,078
Other	177,760	166,391	166,303
Income taxes	217,083	202,185	172,202
Total operating expenses	1,850,460	1,630,155	1,499,068
Operating Income	317,088	308,762	315,000
Other Income and (Deductions)			
Allowance for equity funds used during construction	5,192	5,898	6,435
Taxes on nonoperating income	(2,073)	4,227	(827)
Other - net	4,243	(5,431)	923
Total other income and (deductions)	7,362	4,694	6,531
Income Before Interest Charges	324,450	313,456	321,531
Interest Charges			
Long-term debt	69,545	76,463	82,591
Short-term debt and other	13,825	12,635	17,886
Amortization of debt discount and expense, less premium	5,154	4,881	4,870
Allowance for borrowed funds used during construction	(2,306)	(3,288)	(2,865)
Net interest charges	86,218	90,691	102,482
Income From Continuing Operations	238,232	222,765	219,049
Discontinued Operations, Net of Income Taxes	--	--	14,408
Net Income (before preferred dividend requirements)	238,232	222,765	233,457
Preferred Dividend Requirements	6,582	6,582	7,663
Earnings Applicable to Common Shares	\$ 231,650	\$ 216,183	\$ 225,794

See notes to consolidated financial statements.

SAN DIEGO GAS & ELECTRIC COMPANY  
CONSOLIDATED BALANCE SHEETS  
In thousands of dollars

Balance at December 31	1997	1996
	-----	-----
<b>ASSETS</b>		
Utility plant - at original cost	\$5,888,539	\$5,704,464
Accumulated depreciation and decommissioning	(2,952,455)	(2,630,093)
	-----	-----
Utility plant - net	2,936,084	3,074,371
	-----	-----
Nuclear decommissioning trust	399,143	328,042
	-----	-----
Current assets		
Cash and temporary investments	536,050	81,409
Accounts receivable	229,148	187,986
Due from affiliates	125,417	--
Inventories	65,390	63,078
Other	51,840	33,227
	-----	-----
Total current assets	1,007,845	365,700
	-----	-----
Deferred taxes recoverable in rates	184,837	189,193
	-----	-----
Deferred charges and other assets	126,584	203,210
	-----	-----
Total	\$4,654,493	\$4,160,516
	=====	=====
<b>CAPITALIZATION AND LIABILITIES</b>		
Capitalization		
Common equity	\$1,387,363	\$1,404,136
Preferred stock not subject to mandatory redemption	78,475	78,475
Preferred stock subject to mandatory redemption	25,000	25,000
Long-term debt	1,787,823	1,284,816
	-----	-----
Total capitalization	3,278,661	2,792,427
	-----	-----
Current liabilities		
Current portion of long-term debt	72,575	33,639
Accounts payable	161,039	174,884
Due to affiliates	--	7,214
Dividends payable	45,968	47,131
Interest accrued	10,468	12,824
Regulatory balancing accounts overcollected-net	58,063	35,338
Other	114,388	110,743
	-----	-----
Total current liabilities	462,501	421,773
	-----	-----
Customer advances for construction	37,661	34,666
Accumulated deferred income taxes - net	471,890	487,119
Accumulated deferred investment tax credits	62,332	64,410
Deferred credits and other liabilities	341,448	360,121
Contingencies and commitments (Notes 9 and 10)	--	--
	-----	-----
Total	\$4,654,493	\$4,160,516
	=====	=====

See notes to consolidated financial statements.

SAN DIEGO GAS & ELECTRIC COMPANY  
STATEMENTS OF CONSOLIDATED CASH FLOWS

In thousands of dollars

For the years ended December 31

	1997	1996	1995
	-----	-----	-----
<b>Cash Flows from Operating Activities</b>			
Income from continuing operations	\$ 238,232	\$ 222,765	\$ 219,049
Adjustments to reconcile income from continuing operations to net cash provided by operating activities			
Depreciation and decommissioning	323,882	314,278	260,841
Amortization of deferred charges and other assets	6,247	5,926	12,068
Amortization of deferred credits and other liabilities	(4,238)	(3,901)	(1,169)
Allowance for equity funds used during construction	(5,192)	(5,898)	(6,435)
Deferred income taxes and investment tax credits	10,713	(16,369)	(42,046)
Other - net	19,416	25,570	21,108
Changes in working capital components			
Accounts and notes receivable	(41,162)	19,573	9,159
Inventories	(2,312)	4,881	7,648
Other current assets	(4,464)	(14,119)	(5,550)
Interest and taxes accrued	(40,169)	(24,897)	15,737
Accounts payable and other current liabilities	(142,831)	50,235	25,288
Regulatory balancing accounts	22,725	(37,313)	59,030
Cash flows provided(used) by discontinued operations	--	(11,544)	49,188
Net cash provided by operating activities	----- 380,847	----- 529,187	----- 623,916
<b>Cash Flows from Financing Activities</b>			
Dividends paid	(256,168)	(188,700)	(188,288)
Issuances of long-term debt	677,850	226,646	123,734
Repayment of long-term debt	(133,267)	(257,772)	(126,164)
Short-term borrowings-net	--	--	(58,325)
Repurchase of common stock	--	--	(241)
Redemption of preferred stock	--	(15,155)	(18)
Net cash provided (used) by financing activities	----- 288,415	----- (234,981)	----- (249,302)
<b>Cash Flows from Investing Activities</b>			
Utility construction expenditures	(197,184)	(208,850)	(220,748)
Contributions to decommissioning funds	(22,038)	(22,038)	(22,038)
Other - net	4,601	(2,664)	(2,456)
Discontinued operations	--	--	(120,222)
Net cash used by investing activities	----- (214,621)	----- (233,552)	----- (365,464)
Net increase	454,641	60,654	9,150
Cash and temporary investments, beginning of year	81,409	20,755	11,605
Cash and temporary investments, end of year	----- \$ 536,050	----- \$ 81,409	----- \$ 20,755
<b>Supplemental Disclosure of Cash Flow Information</b>			
Interest payments, net of amounts capitalized	\$ 88,574	\$ 93,652	\$ 104,373
Net assets of affiliates transferred to parent	----- \$ --	----- \$ 150,095	----- \$ --

See notes to consolidated financial statements.

SAN DIEGO GAS & ELECTRIC COMPANY  
 STATEMENTS OF CONSOLIDATED CHANGES IN  
 CAPITAL STOCK AND RETAINED EARNINGS

In thousands of dollars  
 For the years ended December 31, 1995, 1996, 1997

	Preferred Stock			Premium on Capital Stock	Retained Earnings
	Not Subject to Mandatory Redemption	Subject to Mandatory Redemption	Common Stock		
Balance, January 1, 1995	\$ 93,493	\$ 25,000	\$ 291,341	\$ 564,508	\$ 618,581
Earnings applicable to common shares					225,794
Long-term incentive plan activity-net			117	1,530	
Preferred stock retired (880 shares) (18)				8	
Common stock dividends declared					(181,809)
-----	-----	-----	-----	-----	-----
Balance, December 31, 1995	93,475	25,000	291,458	566,046	662,566
Earnings applicable to common shares					216,183
Transfer to Enova Corporation				342	(150,437)
Preferred stock retired (150,000 shares) (15,000)	(15,000)			(155)	
Common stock dividends declared					(181,867)
-----	-----	-----	-----	-----	-----
Balance, December 31, 1996	78,475	25,000	291,458	566,233	546,445
Earnings applicable to common shares					231,650
Special dividend to Enova Corporation					( 70,000)
Common stock dividends declared					(178,423)
-----	-----	-----	-----	-----	-----
Balance, December 31, 1997	\$ 78,475	\$ 25,000	\$ 291,458	\$ 566,233	\$ 529,672
=====	=====	=====	=====	=====	=====

See notes to consolidated financial statements.

INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of San Diego Gas & Electric Company:

We have audited the accompanying consolidated balance sheets of San Diego Gas & Electric Company and subsidiary as of December 31, 1997 and 1996, and the related statements of consolidated income, consolidated changes in capital stock and retained earnings, and consolidated cash flows for each of the three years in the period ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of San Diego Gas & Electric Company and subsidiary of December 31, 1997 and 1996, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1997 in conformity with generally accepted accounting principles.

/S/ DELOITTE & TOUCHE LLP

DELOITTE & TOUCHE LLP  
San Diego, California  
February 23, 1998

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SAN DIEGO GAS & ELECTRIC COMPANY

Except as modified below, the Notes to Consolidated Financial Statements of Enova Corporation are incorporated herein by reference insofar as they relate to San Diego Gas & Electric Company:

- Note 1 -- Business Combination
- Note 2 -- Significant Accounting Policies
- Note 4 -- Long-Term Debt
- Note 5 -- Facilities Under Joint Ownership
- Note 6 -- Employee Benefit Plans
- Note 8 -- Financial Instruments
- Note 9 -- Contingencies and Commitments
- Note 10 -- Industry Restructuring

Note 3: Significant Affiliate Transactions

In January 1996 Enova Corporation (Enova) became the parent of San Diego Gas & Electric (SDG&E) and its subsidiaries. At that time SDG&E's ownership interests in its subsidiaries were transferred to Enova at book value. SDG&E's financial statements for periods prior to 1996 reflect the results of these subsidiaries as discontinued operations in accordance with Accounting Principles Board Opinion No. 30 "Reporting the Effects of a Disposal of a Segment of Business." Discontinued operations are summarized in the table below:

	Year Ended December 31, 1995
----- (millions of dollars)	
Revenues	\$81
Loss from operations before income taxes	(24)
Loss on disposal before income taxes	(12)
Income tax benefits	32
-----	

In December 1997 SDG&E and Enova signed a promissory note agreement for an amount not to exceed \$400 million to be loaned by SDG&E to Enova due within one year. Interest on the outstanding balance under the note is accrued monthly at the current three-month commercial paper rate. As of December 31, 1997 \$130 million had been issued and was outstanding under the promissory note agreement.

In March 1997 SDG&E paid to Enova a special dividend of \$70 million to be used for the repurchase of three million shares of Enova common stock.

Note 4: Long-Term Debt

The information contained in Enova Corporation's Statements of Consolidated Long-Term Debt is incorporated herein by reference.

Note 7: Income Taxes

SDG&E's income tax payments totaled \$217 million in 1997, \$245 million in 1996 and \$200 million in 1995.

The components of accumulated deferred income taxes at December 31 are as follows:

in thousands of dollars	1997	1996
-----		
Deferred tax liabilities		
Differences in financial and tax bases of utility plant	\$567,804	\$628,617
Loss on reacquired debt	30,535	26,399
Other	65,675	63,081
-----		
Total deferred tax liabilities	664,014	718,097
-----		
Deferred tax assets		
Unamortized investment tax credits	64,873	68,239
Regulatory balancing accounts	27,903	37,010
Unbilled revenue	22,365	21,923
Other	90,232	123,534
-----		
Total deferred tax assets	205,373	250,706
-----		
Net deferred income tax liability	458,641	467,391
Current portion (net asset)	13,249	19,728
-----		
Non-current portion (net liability)	\$471,890	\$487,119
=====		

The components of income tax expense are as follows:

in thousands of dollars	1997	1996	1995
-----			
Current			
Federal	\$164,642	\$169,309	\$170,212
State	43,801	45,018	44,863
-----			
Total current taxes	208,443	214,327	215,075
-----			
Deferred			
Federal	12,922	(8,666)	(23,647)
State	1,600	(1,518)	(13,464)
-----			
Total deferred taxes	14,522	(10,184)	(37,111)
-----			
Deferred investment tax credits - net	(3,809)	(6,185)	(4,935)
-----			
Total income tax expense	\$219,156	\$197,958	\$173,029
=====			

Federal and state income taxes are allocated between operating income and other income.

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

	1997	1996	1995
-----			
Statutory federal income tax rate	35.0%	35.0%	35.0%
Depreciation	7.1	5.7	5.0
State income taxes - net of federal income tax benefit	5.7	6.1	4.8
Tax credits	(1.3)	(2.1)	(1.8)
Repair allowance	(1.6)	(1.1)	(2.8)
Other - net	3.0	3.4	3.9
-----			
Effective income tax rate	47.9%	47.0%	44.1%
=====			

Note 11: Capital Stock

The information contained in SDG&E's Statements of Changes in Capital Stock and Retained Earnings is incorporated herein by reference. The information contained in Enova Corporation's Statements of Consolidated Capital Stock as it relates to preferred and preference stock is incorporated herein by reference.

Note 12: Segments of Business

The information contained in Enova Corporation's Statements of Consolidated Financial Information by Segments of Business is incorporated herein by reference.

Note 13: Quarterly Financial Data (Unaudited)  
SAN DIEGO GAS & ELECTRIC

In thousands

Quarter ended	March 31	June 30	September 30	December 31
1997				
Operating revenues	\$ 494,636	\$ 491,892	\$ 566,297	\$ 614,723
Operating expenses	431,706	413,670	480,303	524,781
	-----	-----	-----	-----
Operating income	62,930	78,222	85,994	89,942
Other income and (deductions)	164	(444)	(17)	7,659
Net interest charges	21,165	22,875	21,058	21,120
	-----	-----	-----	-----
Net income (before preferred dividend requirements)	41,929	54,903	64,919	76,481
Preferred dividend requirements	1,646	1,645	1,646	1,645
	-----	-----	-----	-----
Earnings applicable to common shares	<u>\$ 40,283</u>	<u>\$ 53,258</u>	<u>\$ 63,273</u>	<u>\$ 74,836</u>
	=====	=====	=====	=====
1996				
Operating revenues	\$ 451,942	\$ 458,221	\$ 493,485	\$ 535,269
Operating expenses	367,772	388,379	411,657	462,347
	-----	-----	-----	-----
Operating income	84,170	69,842	81,828	72,922
Other income and (deductions)	1,396	(884)	4,372	(190)
Net interest charges	22,994	22,786	24,073	20,838
	-----	-----	-----	-----
Net income (before preferred dividend requirements)	62,572	46,172	62,127	51,894
Preferred dividend requirements	1,646	1,645	1,646	1,645
	-----	-----	-----	-----
Earnings applicable to common shares	<u>\$ 60,926</u>	<u>\$ 44,527</u>	<u>\$ 60,481</u>	<u>\$ 50,249</u>
	=====	=====	=====	=====

These amounts are unaudited, but in the opinion of SDG&E reflect all adjustments necessary for a fair presentation.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure - Enova Corporation/San Diego Gas & Electric Company  
None.

PART III

Item 10. Directors and Executive Officers of the Registrant

Enova Corporation

The information required on Identification of Directors is incorporated by reference from "Election of Directors" in the March 1998 Enova Corporation Proxy Statement. The information required on executive officers is incorporated by reference from Item 4 herein.

San Diego Gas & Electric Company

The information required on Identification of Directors is incorporated by reference from "Election of Directors" in the March 1998 SDG&E Proxy Statement. The information required on executive officers is incorporated by reference from Item 4 herein.

Item 11. Executive Compensation

Enova Corporation

The information required by Item 11 is incorporated by reference from "Executive Compensation and Transactions with Management and Others" in the March 1998 Enova Corporation Proxy Statement.

San Diego Gas & Electric Company

The information required by Item 11 is incorporated by reference from "Executive Compensation and Transactions with Management and Others" in the March 1998 SDG&E Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management

Enova Corporation

The information required by Item 12 is incorporated by reference from "Security Ownership of Management and Certain Beneficial Holders" in the March 1998 Enova Corporation Proxy Statement.

San Diego Gas & Electric Company

The information required by Item 12 is incorporated by reference from "Security Ownership of Management and Certain Beneficial Holders" in the March 1998 SDG&E Proxy Statement.

Item 13. Certain Relationships and Related Transactions  
None.

PART IV - Enova Corporation/San Diego Gas & Electric Company:

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) The following documents are filed as part of this report:

1. Financial statements

	Enova Corporation	SDG&E
Independent Auditors' Report . . . . .	57	78
Statements of Income for the years ended December 31, 1997, 1996 and 1995. . . . .	47	74
Balance Sheets at December 31, 1997 and 1996 . . . . .	48	75
Statements of Cash Flows for the years ended December 31, 1997, 1996 and 1995. . . . .	49	76
Statements of Changes in Capital Stock and Retained Earnings for the years ended December 31, 1997, 1996 and 1995. . . . .	50	77
Statements of Capital Stock at December 31, 1997 and 1996. . . . .	51	--
Statements of Long-Term Debt at December 31, 1997 and 1996. . . . .	52	--
Statements of Financial Information by Segments of Business for the years ended December 31, 1997, 1996 and 1995. . . . .	54	--
Notes to Financial Statements. . . . .	58	79
Quarterly Financial Data (Unaudited) . . . . .	55	82

## 2. Financial statement schedules

The following documents may be found in this report at the indicated page numbers.

Report of Independent Auditors on Supplemental Schedule and Consent. . . . .	86
Schedule I--Condensed Financial Information of Parent. . . . .	87

Schedules I through V, inclusive, except those referred to above, are omitted as not required or not applicable.

## 3. Exhibits

See Exhibit Index on page 90 of this report.

### (b) Reports on Form 8-K

A Current Report on Form 8-K was filed on July 17, 1997 to announce the California Public Utilities Commission's decision on Southern California Gas Company's Performance-Based Ratemaking proceeding.

A Current Report on Form 8-K was filed on August 12, 1997 to announce the agreement for the joint acquisition of AIG Trading Corporation (now Sempra Energy Trading) by Enova Corporation and Pacific Enterprises, and the extension of the Enova Corporation and Pacific Enterprises merger agreement.

A Current Report on Form 8-K was filed on November 26, 1997 to announce the plans of San Diego Gas & Electric to auction its electric generation assets.

A Current Report on Form 8-K was filed on December 23, 1997 to announce the changes in the boards of directors and executive officers at Enova Corporation and San Diego Gas & Electric.

INDEPENDENT AUDITORS' CONSENT AND REPORT ON SCHEDULE

To the Shareholders and Boards of Directors of Enova Corporation and San Diego Gas & Electric Company:

We consent to the incorporation by reference in Post-Effective Amendment No. 2 to Registration Statement No. 33-59681 on Form S-3 and Post-Effective Amendment No. 1 to Registration Statement Nos. 33-59683 and 33-7108 on Form S-8 of Enova Corporation; in Registration Statement Nos. 33-45599, 33-52834 and 33-49837 on Form S-3 of San Diego Gas & Electric Company; in Registration Statement No. 333-30761 on Form S-3 of SDG&E Funding LLC; and in Registration Statement No. 333-21229 on Form S-4 of Mineral Energy Company of our reports dated February 23, 1998 on Enova Corporation and San Diego Gas & Electric Company, appearing in this Annual Report on Form 10-K of Enova Corporation and San Diego Gas & Electric Company for the year ended December 31, 1997.

Our audits of the financial statements referred to in our aforementioned reports also included the financial statement schedule of Enova Corporation, listed in Item 14. This financial statement schedule is the responsibility of the management of Enova Corporation. Our responsibility is to express an opinion based on our audits. In our opinion, such financial statement schedule, when considered in relation to the basic Enova Corporation financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/S/ DELOITTE & TOUCHE LLP

DELOITTE & TOUCHE LLP  
San Diego, California  
February 23, 1998

## Schedule I -- CONDENSED FINANCIAL INFORMATION OF PARENT

ENOVA CORPORATION  
 Schedule 1  
 Condensed Financial Information of Parent

Condensed Statements of Income  
 (In thousands, except per share amounts)

For the years ended December 31	1997	1996
	-----	-----
Operating revenues and other income	\$ 1,156	\$ 2,528
Operating expenses, interest and income taxes	3,834	2,594
	-----	-----
Loss before subsidiary earnings	2,678	66
Subsidiary earnings	254,285	230,993
	-----	-----
Earnings applicable to common shares	\$ 251,607	\$ 230,927
	=====	=====
Average common shares outstanding	114,322	116,572
	-----	-----
Earnings per common share (basic and diluted)	\$ 2.20	\$ 1.98
	=====	=====

Condensed Balance Sheets  
 (In thousands of dollars)

Balance at December 31	1997	1996
	-----	-----
Assets:		
Cash and temporary investments	\$ 6,037	\$ 11,927
Dividends receivable	44,323	45,485
Other current assets	25,490	16,612
	-----	-----
Total current assets	75,850	74,024
Investments in subsidiaries	1,716,548	1,564,256
Deferred charges and other assets	7,805	2,695
	-----	-----
Total Assets	\$1,800,203	\$1,640,975
	=====	=====
Liabilities and Shareholders' Equity:		
Dividends payable	\$ 44,323	\$ 45,485
Due to affiliates	180,274	24,711
Other current liabilities	5,223	295
	-----	-----
Total current liabilities	229,820	70,491
Common equity	1,570,383	1,570,484
	-----	-----
Total Liabilities and Shareholders' Equity	\$1,800,203	\$1,640,975
	=====	=====

ENOVA CORPORATION  
Schedule 1 (continued)  
Condensed Financial Information of Parent

Condensed Statements of Cash Flows  
(In thousands of dollars)

For the years ended December 31	1997	1996
	-----	-----
Cash flows from operating activities	\$ 158,929	\$ 1,536
Cash flows from financing activities	(253,708)	(163,389)
Cash flows from investing activities	88,889	173,780
Net cash flow	(5,890)	11,927
Cash and temporary investments, beginning of year	11,927	--
Cash and temporary investments, end of year	6,037	\$ 11,927
	=====	=====
Dividends received from San Diego Gas & Electric	\$ 249,585	\$ 181,849
	=====	=====
Net assets of affiliates transferred to Enova Corporation	\$ --	\$ 150,095
	=====	=====

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrants have duly caused this report to be signed on its behalf by the undersigned, hereunto duly authorized. The signatures of the undersigned companies relate only to matters having reference to such companies and their respective subsidiaries.

ENOVA CORPORATION

SAN DIEGO GAS & ELECTRIC COMPANY

By: /s/ Stephen L. Baum

By: /s/ Edwin A. Guiles

\_\_\_\_\_  
Stephen L. Baum  
Chairman and Chief Executive Officer

\_\_\_\_\_  
Edwin A. Guiles  
President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report is signed below by the following persons on behalf of the Registrants in the capacities and on the dates indicated. The signatures of the undersigned companies relate only to matters having reference to such companies and their respective subsidiaries.

Signature	Title	Date
Principal Executive Officers:		
/s/ Stephen L. Baum		
Stephen L. Baum	Chairman and Chief Executive Officer (Enova)	February 23, 1998
/s/ Edwin A. Guiles		
Edwin A. Guiles	President (SDG&E)	February 23, 1998
Principal Financial Officers:		
/s/ David R. Kuzma		
David R. Kuzma	Senior Vice President, Chief Financial Officer and Treasurer (Enova)	February 23, 1998
/s/ Frank H. Ault		
Frank H. Ault	Vice President, Chief Financial Officer, Treasurer and Controller (SDG&E)	February 23, 1998
Principal Accounting Officer:		
/s/ Frank H. Ault		
Frank H. Ault	Vice President and Controller (Enova and SDG&E)	February 23, 1998
Directors:		
/s/ Stephen L. Baum		
Stephen L. Baum	Chairman (Enova)	February 23, 1998
/s/ Daniel W. Derbes		
Daniel W. Derbes	Chairman (SDG&E) and Director (Enova)	February 23, 1998
/s/ Richard C. Atkinson		
Richard C. Atkinson	Director (Enova and SDG&E)	February 23, 1998
/s/ Ann Burr		
Ann Burr	Director (Enova and SDG&E)	February 23, 1998
/s/ Richard A. Collato		
Richard A. Collato	Director (Enova and SDG&E)	February 23, 1998
/s/ Robert H. Goldsmith		
Robert H. Goldsmith	Director (Enova and SDG&E)	February 23, 1998
/s/ Edwin A. Guiles		

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Edwin A. Guiles            Director (SDG&E)            February 23, 1998

/s/ Ralph R. Ocampo

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Ralph R. Ocampo            Director (Enova and SDG&E)            February 23, 1998

/s/ Thomas A. Page

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Thomas A. Page            Director (Enova and SDG&E)            February 23, 1998

/s/ Thomas C. Stickel

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Thomas C. Stickel            Director (Enova and SDG&E)            February 23, 1998

## EXHIBIT INDEX

The Forms 8, 8-B/A, 8-K, S-4, 10-K and 10-Q referred to herein were filed under Commission File Number 1-3779 (SDG&E), Commission File Number 1-11439 (Enova Corporation) and/or Commission File Number 333-30761 (SDG&E Funding LLC).

### Exhibit 1 -- Underwriting Agreements

1.1 Underwriting Agreement dated December 4, 1997 (Incorporated by reference from Form 8-K filed by SDG&E Funding LLC on December 23, 1997 (Exhibit 1.1)).

### Exhibit 3 -- Bylaws and Articles of Incorporation

#### Bylaws

3.1 Restated Bylaws of Enova Corporation as of January 27, 1997 (Incorporated by reference from 10-Q filed May 2, 1997 (Exhibit 3.1)).

3.2 Restated Bylaws of San Diego Gas & Electric as of January 27, 1997 (Incorporated by reference from 10-Q filed May 2, 1997 (Exhibit 3.2)).

#### Articles of Incorporation

3.3 Restated Articles of Incorporation of Enova Corporation (Incorporated by reference from the Registration Statement on Form 8-B/A of Enova Corporation (Exhibit 3.1)).

### Exhibit 4 -- Instruments Defining the Rights of Security Holders, Including Indentures

4.1 Mortgage and Deed of Trust dated July 1, 1940. (Incorporated by reference from SDG&E Registration No. 2-49810, Exhibit 2A.)

4.2 Second Supplemental Indenture dated as of March 1, 1948. (Incorporated by reference from SDG&E Registration No. 2-49810, Exhibit 2C.)

4.3 Ninth Supplemental Indenture dated as of August 1, 1968. (Incorporated by reference from SDG&E Registration No. 2-68420, Exhibit 2D.)

4.4 Tenth Supplemental Indenture dated as of December 1, 1968. (Incorporated by reference from SDG&E Registration No. 2-36042, Exhibit 2K.)

4.5 Sixteenth Supplemental Indenture dated August 28, 1975. (Incorporated by reference from SDG&E Registration No. 2-68420, Exhibit 2E.)

4.6 Thirtieth Supplemental Indenture dated September 28, 1983. (Incorporated by reference from SDG&E Registration No. 33-34017, Exhibit 4.3.)

Exhibit 10 -- Material Contracts (Previously filed exhibits are incorporated by reference from Forms 8-K, S-4, 10-K or 10-Q as referenced below).

- 10.1 Transition Property Purchase and Sale Agreement dated December 16, 1997 (Incorporated by reference from Form 8-K filed by SDG&E Funding LLC on December 23, 1997 (Exhibit 10.1)).
- 10.2 Transition Property Servicing Agreement dated December 16, 1997 (Incorporated by reference from Form 8-K filed by SDG&E Funding LLC on December 23, 1997 (Exhibit 10.2)).
- 10.3 Agreement and Plan of Merger and Reorganization, dated as of October 12, 1996, among Enova Corporation, Pacific Enterprises, Mineral Energy Company, G Mineral Energy Sub and B Mineral Energy Sub (8-K filed October 15, 1996, Exhibit 10.1).
- 10.4 Employment contract, dated as of October 12, 1996 between Mineral Energy Company and Stephen L. Baum (8-K filed October 15, 1996, Exhibit 10.2).
- 10.5 Employment contract, dated as of October 12, 1996 between Mineral Energy Company and Richard D. Farman (8-K filed October 15, 1996, Exhibit 10.3).
- 10.6 Employment contract, dated as of October 12, 1996 between Mineral Energy Company and Donald E. Felsing (8-K filed October 15, 1996, Exhibit 10.4).
- 10.7 Employment contract, dated as of October 12, 1996 between Mineral Energy Company and Warren I. Mitchell (8-K filed October 15, 1996, Exhibit 10.5).

#### Compensation

- 10.8 Form of Amendment to San Diego Gas & Electric Company Deferred Compensation Agreements for Officers #1 and #3 (1996 Form 10-K Exhibit 10.6).
- 10.9 Form of Enova Corporation 1998 Deferred Compensation Agreement for Officers #1 (1998 compensation, 1998 bonus).
- 10.10 Form of Enova Corporation 1997 Deferred Compensation Agreement for Officers #1 (1997 compensation, 1998 bonus) (1996 Form 10-K Exhibit 10.7).
- 10.11 Form of San Diego Gas & Electric Company Deferred Compensation Agreement for Officers #1 (1996 compensation, 1997 bonus)(1995 SDG&E Form 10-K Exhibit 10.1).
- 10.12 Form of Enova Corporation 1998 Deferred Compensation Agreement for Officers #3.
- 10.13 Form of Enova Corporation 1997 Deferred Compensation Agreement for Officers #3 (1997 compensation, 1998 bonus)(1996 Form 10-K Exhibit 10.10).
- 10.14 Form of San Diego Gas & Electric Company Deferred Compensation Agreement for Officers #3 (1996 compensation, 1997 bonus)(1995 SDG&E Form 10-K Exhibit 10.3).

- 10.15 Form of Enova Corporation 1998 Deferred Compensation Agreement for Nonemployee Directors.
- 10.16 Form of Enova Corporation 1997 Deferred Compensation Agreement for Nonemployee Directors (1996 Form 10-K Exhibit 10.13).
- 10.17 Form of San Diego Gas & Electric Company Deferred Compensation Agreement for Nonemployee Directors (1996 compensation)(1995 SDG&E Form 10-K Exhibit 10.5).
- 10.18 Form of Enova Corporation 1986 Long-Term Incentive Plan 1997 restricted stock award agreement.
- 10.19 Form of Enova Corporation 1986 Long-Term Incentive Plan 1996 restricted stock award agreement (1996 Form 10-K Exhibit 10.16).
- 10.20 Form of San Diego Gas & Electric Company 1986 Long-Term Incentive Plan 1995 restricted stock award agreement (1995 SDG&E Form 10-K Exhibit 10.7).
- 10.21 Form of San Diego Gas & Electric Company 1986 Long-Term Incentive Plan Special 1995 restricted stock award agreement (1995 SDG&E Form 10-K Exhibit 10.8).
- 10.22 Form of San Diego Gas & Electric Company 1986 Long-Term Incentive Plan 1994 restricted stock award agreement two-year vesting (1995 SDG&E Form 10-K Exhibit 10.9).
- 10.23 Form of San Diego Gas & Electric Company 1986 Long-Term Incentive Plan 1994 restricted stock award agreement (1994 SDG&E Form 10-K Exhibit 10.4).
- 10.24 Form of San Diego Gas & Electric Company 1986 Long-Term Incentive Plan 1993 restricted stock award agreement (1993 SDG&E Form 10-K Exhibit 10.4).
- 10.25 Amended 1986 Long-Term Incentive Plan, amended and restated effective April 25, 1995 (SDG&E's Amendment No. 2 to Form S-4 filed February 28, 1995).
- 10.26 Amended 1986 Long-Term Incentive Plan, Restatement as of October 25, 1993 (1993 SDG&E Form 10-K Exhibit 10.6).
- 10.27 San Diego Gas & Electric Company Severance Plan effective October 22, 1996 (1996 Form 10-K Exhibit 10.24).
- 10.28 San Diego Gas & Electric Company Severance Plan effective on the date of the Enova Corporation -- Pacific Enterprises business combination (1996 Form 10-K Exhibit 10.25).
- 10.29 San Diego Gas & Electric Company Retirement Plan for Directors, restated as of October 24, 1994 (1994 SDG&E Form 10-K Exhibit 10.5).
- 10.30 Executive Incentive Plan dated April 23, 1985 (1991 SDG&E Form 10-K Exhibit 10.39).

- 10.31 Employment agreement between San Diego Gas & Electric Company and Thomas A. Page, dated June 15, 1988 (1988 SDG&E Form 10-K Exhibit 10E).
- 10.32 Supplemental Pension Agreement with Thomas A. Page, dated as of April 3, 1978 (1988 SDG&E Form 10-K Exhibit 10V).
- 10.33 Supplemental Executive Retirement Plan restated as of July 1, 1994 (1994 SDG&E Form 10-K Exhibit 10.14).

#### Financing

- 10.34 Loan agreement with the City of Chula Vista in connection with the issuance of \$25 million of Industrial Development Bonds, dated as of October 1, 1997.
- 10.35 Loan agreement with the City of Chula Vista in connection with the issuance of \$38.9 million of Industrial Development Bonds, dated as of August 1, 1996 (1996 Form 10-K Exhibit 10.31).
- 10.36 Loan agreement with the City of Chula Vista in connection with the issuance of \$60 million of Industrial Development Bonds, dated as of November 1, 1996 (1996 Form 10-K Exhibit 10.32).
- 10.37 Loan agreement with City of San Diego in connection with the issuance of \$16.7 million of Industrial Development Bonds, dated as of June 1, 1995 (June 30, 1995 SDG&E Form 10-Q Exhibit 10.2).
- 10.38 Loan agreement with City of San Diego in connection with the issuance of \$57.7 million of Industrial Development Bonds, dated as of June 1, 1995 (June 30, 1995 SDG&E Form 10-Q Exhibit 10.3).
- 10.39 Loan agreement with the City of San Diego in connection with the issuance of \$92.9 million of Industrial Development Bonds 1993 Series C dated as of July 1, 1993 (June 30, 1993 SDG&E Form 10-Q Exhibit 10.2).
- 10.40 Loan agreement with the City of San Diego in connection with the issuance of \$70.8 million of Industrial Development Bonds 1993 Series A dated as of April 1, 1993 (March 31, 1993 SDG&E Form 10-Q Exhibit 10.3).
- 10.41 Loan agreement with the City of San Diego in connection with the issuance of \$118.6 million of Industrial Development Bonds dated as of September 1, 1992 (Sept. 30, 1992 SDG&E Form 10-Q Exhibit 10.1).
- 10.42 Loan agreement with the City of Chula Vista in connection with the issuance of \$250 million of Industrial Development Bonds, dated as of December 1, 1992 (1992 SDG&E Form 10-K Exhibit 10.5).
- 10.43 Loan agreement with the City of San Diego in connection with the issuance of \$25 million of Industrial Development Bonds, dated as of September 1, 1987 (1992 SDG&E Form 10-K Exhibit 10.6).

- 10.44 Loan agreement with the California Pollution Control Financing Authority in connection with the issuance of \$129.82 million of Pollution Control Bonds, dated as of June 1, 1996 (1996 Form 10-K Exhibit 10.41).
- 10.45 Loan agreement with the California Pollution Control Financing Authority in connection with the issuance of \$60 million of Pollution Control Bonds dated as of June 1, 1993 (June 30, 1993 SDG&E Form 10-Q Exhibit 10.1).
- 10.46 Loan agreement with the California Pollution Control Financing Authority, dated as of December 1, 1991, in connection with the issuance of \$14.4 million of Pollution Control Bonds (1991 SDG&E Form 10-K Exhibit 10.11).

Natural Gas Commodity, Transportation and Storage

- 10.47 Long-Term Natural Gas Storage Service Agreement dated January 12, 1994 between Southern California Gas Company and SDG&E (1994 SDG&E Form 10-K Exhibit 10.42).
- 10.48 Amendment to San Diego Gas & Electric Company and Southern California Gas Company Restated Long-Term Wholesale Natural Gas Service Contract dated March 26, 1993 (1993 SDG&E Form 10-K Exhibit 10.53).
- 10.49 San Diego Gas & Electric Company and Southern California Gas Company Restated Long-Term Wholesale Natural Gas Service Contract, dated September 1, 1990 (1990 SDG&E Form 10-K Exhibit 10.9).
- 10.50 Third Amending Agreement, dated November 1, 1997 between Husky Oil Operations Limited and San Diego Gas & Electric Company.
- 10.51 Second Amending Agreement, dated January 1, 1997 between Husky Oil Operations Limited and San Diego Gas & Electric Company.
- 10.52 Amending Agreement dated November 1, 1994 between Husky Oil Operations Limited and San Diego Gas & Electric Company.
- 10.53 Gas Purchase Agreement, dated March 12, 1991 between Husky Oil Operations Limited and San Diego Gas & Electric Company (1991 SDG&E Form 10-K Exhibit 10.1).
- 10.54 Gas Purchase Agreement, dated March 12, 1991 between Canadian Hunter Marketing Limited and San Diego Gas & Electric Company (1991 SDG&E Form 10-K Exhibit 10.2).
- 10.55 Gas Purchase Agreement, dated March 12, 1991 between Bow Valley Industries Limited and San Diego Gas & Electric Company (1991 SDG&E Form 10-K Exhibit 10.3).
- 10.56 Gas Purchase Agreement, dated March 12, 1991 between Summit Resources Limited and San Diego Gas & Electric Company (1991 SDG&E Form 10-K Exhibit 10.4).
- 10.57 Service Agreement Applicable to Firm Transportation Service under Rate Schedule FS-1, dated May 31, 1991 between Alberta Natural Gas Company Ltd. and San Diego Gas & Electric

Company (1991 SDG&E Form 10-K Exhibit 10.5).

- 10.58 Amendment to Firm Transportation Service Agreement, dated December 2, 1996, between Pacific Gas and Electric Company and San Diego Gas & Electric Company.
- 10.59 Firm Transportation Service Agreement, dated December 31, 1991 between Pacific Gas and Electric Company and San Diego Gas & Electric Company (1991 SDG&E Form 10-K Exhibit 10.7).
- 10.60 Firm Transportation Service Agreement, dated October 13, 1994 between Pacific Gas Transmission Company and San Diego Gas & Electric Company.

#### Nuclear

- 10.61 Uranium enrichment services contract between the U.S. Department of Energy (DOE assigned its rights to the U.S. Enrichment Corporation, a U.S. government-owned corporation, on July 1, 1993) and Southern California Edison Company, as agent for SDG&E and others; Contract DE-SC05-84UE07541, dated November 5, 1984, effective June 1, 1984, as amended (1991 SDG&E Form 10-K Exhibit 10.9).
- 10.62 Fuel Lease dated as of September 8, 1983 between SONGS Fuel Company, as Lessor and San Diego Gas & Electric Company, as Lessee, and Amendment No. 1 to Fuel Lease, dated September 14, 1984 and Amendment No. 2 to Fuel Lease, dated March 2, 1987 (1992 SDG&E Form 10-K Exhibit 10.11).
- 10.63 Nuclear Facilities Qualified CPUC Decommissioning Master Trust Agreement for San Onofre Nuclear Generating Station, approved November 25, 1987 (1992 SDG&E Form 10-K Exhibit 10.7).
- 10.64 Amendment No. 1 to the Qualified CPUC Decommissioning Master Trust Agreement dated September 22, 1994 (see Exhibit 10.63 herein)(1994 SDG&E Form 10-K Exhibit 10.56).
- 10.65 Second Amendment to the San Diego Gas & Electric Company Nuclear Facilities Qualified CPUC Decommissioning Master Trust Agreement for San Onofre Nuclear Generating Station (see Exhibit 10.63 herein)(1994 SDG&E Form 10-K Exhibit 10.57).
- 10.66 Third Amendment to the San Diego Gas & Electric Company Nuclear Facilities Qualified CPUC Decommissioning Master Trust Agreement for San Onofre Nuclear Generating Station (see Exhibit 10.63 herein)(1996 Form 10-K Exhibit 10.59).
- 10.67 Fourth Amendment to the San Diego Gas & Electric Company Nuclear Facilities Qualified CPUC Decommissioning Master Trust Agreement for San Onofre Nuclear Generating Station (see Exhibit 10.63 herein)(1996 Form 10-K Exhibit 10.60).
- 10.68 Nuclear Facilities Non-Qualified CPUC Decommissioning Master Trust Agreement for San Onofre Nuclear Generating Station, approved November 25, 1987 (1992 SDG&E Form 10-K Exhibit 10.8).
- 10.69 First Amendment to the San Diego Gas & Electric Company Nuclear Facilities Non-Qualified CPUC Decommissioning Master Trust Agreement for San Onofre Nuclear Generating Station (see Exhibit 10.68 herein)(1996 Form 10-K Exhibit 10.62).

- 10.70 Second Amendment to the San Diego Gas & Electric Company Nuclear Facilities Non-Qualified CPUC Decommissioning Master Trust Agreement for San Onofre Nuclear Generating Station (see Exhibit 10.68 herein)(1996 Form 10-K Exhibit 10.63).
- 10.71 Second Amended San Onofre Agreement among Southern California Edison Company, SDG&E, the City of Anaheim and the City of Riverside, dated February 26, 1987 (1990 SDG&E Form 10-K Exhibit 10.6).
- 10.72 U. S. Department of Energy contract for disposal of spent nuclear fuel and/or high-level radioactive waste, entered into between the DOE and Southern California Edison Company, as agent for SDG&E and others; Contract DE-CR01-83NE44418, dated June 10, 1983 (1988 SDG&E Form 10-K Exhibit 10N).

Purchased Power

- 10.73 Public Service Company of New Mexico and San Diego Gas & Electric Company 1988-2001 100 mw System Power Agreement dated November 4, 1985 and Letter of Agreement dated April 28, 1986, June 4, 1986 and June 18, 1986 (1988 SDG&E Form 10-K Exhibit 10H).
- 10.74 San Diego Gas & Electric Company and Portland General Electric Company Long-Term Power Sale and Transmission Service agreements dated November 5, 1985 (1988 SDG&E Form 10-K Exhibit 10I).

Other

- 10.75 U. S. Navy contract for electric service, Contract N62474-70-C-1200-P00414, dated September 29, 1988 (1988 SDG&E Form 10-K Exhibit 10C).
- 10.76 City of San Diego Electric Franchise (Ordinance No. 10466) (1988 SDG&E Form 10-K Exhibit 10Q).
- 10.77 City of San Diego Gas Franchise (Ordinance No. 10465) (1988 SDG&E Form 10-K Exhibit 10R).
- 10.78 County of San Diego Electric Franchise (Ordinance No. 3207) (1988 SDG&E Form 10-K Exhibit 10S).
- 10.79 County of San Diego Gas Franchise (Ordinance No. 5669) (1988 SDG&E Form 10-K Exhibit 10T).
- 10.80 Lease agreement dated as of March 25, 1992 with American National Insurance Company as lessor of an office complex at Century Park (1994 SDG&E Form 10-K Exhibit 10.70).
- 10.81 Lease agreement dated as of June 15, 1978 with Lloyds Bank California, as owner-trustee and lessor - Exhibit B to financing agreement of SDG&E's Encina Unit 5 equipment trust (1988 SDG&E Form 10-K Exhibit 10W).
- 10.82 Amendment to Lease agreement dated as of July 1, 1993 with Sanwa Bank California, as owner-trustee and lessor - Exhibit B to secured loan agreement of SDG&E's Encina Unit 5 equipment trust (See Exhibit 10.81 herein)(1994 SDG&E Form

10-K Exhibit 10.72).

10.83 Lease agreement dated as of July 14, 1975 with New England Mutual Life Insurance Company, as lessor (1991 SDG&E Form 10-K Exhibit 10.42).

10.84 Assignment of Lease agreement dated as of November 19, 1993 to Shapery Developers as lessor by New England Mutual Life Insurance Company (See Exhibit 10.83 herein)(1994 SDG&E Form 10-K Exhibit 10.74).

Exhibit 12 -- Statement re: computation of ratios

12.1 Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends for the years ended December 31, 1997, 1996, 1995, 1994 and 1993.

Exhibit 22 - Subsidiaries - See "Part I, Item 1. Description of Business."

Exhibit 23 - Independent Auditors' Consent, page 86.

Exhibit 27 - Financial Data Schedules

27.1 Financial Data Schedules for the year ended December 31, 1997.

## GLOSSARY

AB 1890	Assembly Bill 1890 - California's electric restructuring law
AFUDC	Allowance for Funds Used During Construction
AIG	AIG Trading Corporation
APCD	Air Pollution Control District
BCAP	Biennial Cost Allocation Proceeding
BRPU	Biennial Resource Plan Update
CCC	California Coastal Commission
CEC	California Energy Commission
CEP	Customer Education Program
CFE	Comision Federal de Electricidad
CPUC	California Public Utilities Commission
CTC	Competition transition charge
DOE	Department of Energy
DGN	Distribuidora de Gas Natural
DSM	Demand-Side Management
DTSC	Department of Toxic Substances Control
ECAC	Energy Cost Adjustment Clause
Edison	Southern California Edison Company
EMF	Electric and magnetic fields
Enova	Enova Corporation and its wholly owned subsidiaries
ERAM	Electric Revenue Adjustment Mechanism
EV	Electric vehicle
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
GFCA	Gas Fixed Cost Account
HIPG	Houston Industries Power Generation
IDBs	Industrial Development Bonds
IOUs	Investor-owned utilities
ISO	Independent System Operator
kv	Kilovolt
kwhr	Kilowatt hour
LG&E	Louisville Gas & Electric Power Marketing

LIFO	Last-in-first-out inventory measurement
MICAM	Market Indexed Capital Adjustment Mechanism
mw	Megawatt
NGV	Natural-Gas Vehicle
NRC	Nuclear Regulatory Commission
PBR	Performance-Based Ratemaking
PCB	Polychlorinated Biphenyl
PE	Pacific Enterprises
PGA	Purchased Gas Account
PG&E	Pacific Gas and Electric Company
PGE	Portland General Electric Company
PNM	Public Service Company of New Mexico
PX	Power Exchange
RD&D	Research, Development and Demonstration
RECLAIM	Regional Clean Air Incentive Market
RWQCB	Regional Water Quality Control Board
SDG&E	San Diego Gas & Electric Company
SEC	Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards
SoCalGas	Southern California Gas Company
SONGS/San Onofre	San Onofre Nuclear Generating Station
Southwest Powerlink	A transmission line connecting San Diego to Phoenix and intermediate points
WSPP	Western Systems Power Pool

(1998 BASE COMPENSATION)  
(1998 BONUS)

THIS AGREEMENT is made and entered into this \_\_\_\_\_ day of December, 1997, by and between Enova Corporation or any of its subsidiaries, (hereinafter "Company") and \_\_\_\_\_ (hereinafter "Participant"), an employee of Company.

WITNESSETH:

WHEREAS, in addition to 1998 base compensation, incentive compensation payable in the form of a cash bonus may be paid to Participant in 1998 or 1999 for outstanding performance in 1998 ("Bonus");

WHEREAS, Participant and Company desire that the payment of said 1998 base compensation and/or Bonus to Participant be deferred, pursuant to the terms and provisions of this Agreement; and

NOW, THEREFORE, the parties hereto hereby agree as follows:

1. This Agreement shall be effective on the first date after its execution upon which Participant's Bonus would otherwise be payable to Participant for outstanding performance in 1998 and shall continue in effect until this Agreement is terminated as provided herein.

2. Company shall credit to an account on Company's books, in Participant's name, that portion of such Participant's Bonus otherwise payable to Participant as may be specified by Participant on an Election Form submitted to Company simultaneously with the execution of this Agreement. If a Participant has elected to defer 100% of such Participant's Bonus (pursuant to Deferred Compensation Agreements for Participants #1 and #3) and the Participant is also participating in the Savings Plan of San Diego Gas & Electric, which has been adopted by the Company, to the maximum extent permissible, such Participant may also elect to defer, and Company shall credit to the Participant's account, a portion of such Participant's base compensation (in equal bi-weekly installments of whole dollar amounts).

3. There shall be credited to Participant's account an additional amount equal to eight and sixty-eight one-hundredths percent (8.68%) per annum computed on the balance in Participant's account as of the end of each month; provided, however, that Company reserves the right to increase or decrease from time to time such amounts to be credited to the account after the date of such increase or decrease, provided that upon a "change-in-control" (as defined in the Enova Corporation 1986 Long-Term Incentive Plan) the percentage used shall not decrease to

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less than the last published percentage shown in Moody's Average of Yields on Public Utility Bonds for a utility having a rating equivalent to SDG&E.

4. All amounts credited to Participant's account pursuant to paragraphs 2 and 3 hereof shall be paid to Participant on the date(s) specified by Participant on this Agreement's Election Form. In the event of Participant's death after installment payments to Participant have commenced hereunder, installment payments shall continue to be paid to the person(s) specified by Participant on the Election Form for the remainder of the period selected by Participant on this Agreement's Election Form. In the event of Participant's death before any payment has been made under this Agreement, Participant's account shall be distributed or commence to be distributed, as soon as administratively practicable after Participant's death, to the person(s) specified by Participant on this Agreement's Election Form in the form and over the period selected on such Election Form. The Company's

Board of Directors or Executive Compensation Committee may, in its sole discretion, provide instead for payment of the amount in Participant's account to Participant's beneficiary in a form and over a period determined by the Board or Committee except that the Board or Committee's authority and discretion to change the form or period of distribution shall terminate upon such a "change-in-control." If Participant's spouse is the beneficiary, the annual amount of any installment payments under this paragraph 4 shall at least equal the entire annual income earned by the account and if the spouse dies prior to distribution of all amounts in Participant's account, all undistributed income on such account shall be distributed to the spouse's estate. Upon the death of Participant's beneficiary, the balance in Participant's account (after the application of the previous sentence, if the spouse is the beneficiary) shall be distributed to the person(s) designated by the beneficiary on a form provided by Company or, if no designation is made, to the beneficiary's estate.

Notwithstanding the foregoing, a Participant (or former Participant whose services have terminated, hereinafter referred to in this paragraph as "Participant") may, at any time, elect to withdraw all or a portion of the balance in the Participant's account prior to the time such amount is otherwise due and payable, subject to a withdrawal penalty (the amount to be withdrawn prior to the application of the withdrawal penalty shall be referred to as the "Gross Withdrawal Amount", which may not exceed the balance of the account immediately prior to the withdrawal). The Participant shall make this election by filing a written notice with the Committee on a form provided by the Committee. Within thirty days following the Committee's receipt of such notice, an amount equal to 90% of the Gross Withdrawal Amount (less applicable withholding tax) shall be paid to the Participant in a cash lump sum. Upon payment of such withdrawal, (a) a withdrawal penalty equal to 10% of the Gross Withdrawal Amount shall be permanently forfeited, and the Company shall have no obligation to the Participant or the Participant's spouse or beneficiary with respect to such forfeited amount and (b) the Participant shall be ineligible to have any additional bonus or base compensation amounts credited to the Participant's account pursuant to this Agreement (or any subsequent Deferred Compensation Agreement) for the balance of the calendar year of withdrawal and the subsequent calendar year.

5. All amounts credited to Participant's account pursuant to paragraphs 2 and 3 hereof may be used to purchase common stock of Enova Corporation or other equity securities, subject to the following conditions:

a. All such purchases must be made through a stock equivalent tracking device, a "rabbi trust" or other similar instrument that causes the deferred amount not to become taxable;

b. Equity securities of other entities may be purchased only if the Participant has met or is expected to meet, under the normal course of events, the Company's Enova Corporation stock ownership requirement;

c. If the Participant becomes subject to a higher Enova Corporation stock ownership requirement, the Participant may retain any then current investment in equity securities of other entities, but shall not make additional purchases of other equity securities until the higher Enova Corporation stock ownership requirement has been met or is expected to be met under the normal course of events; and

d. All such purchases must be made in accordance with applicable Company procedures, as they may be amended from time to time.

6. No amounts credited to Participant's account may be assigned, transferred, encumbered, or made subject to any legal process for the payment of any claim against Participant, Participant's spouse or beneficiary. In no event shall Participant, Participant's spouse or beneficiary have the right to recover any amounts credited to Participant's account other than in accordance with this Agreement.

7. Nothing contained in this Agreement and no action taken pursuant to the provisions of this Agreement shall create or be construed to create a trust of any kind, or a fiduciary relationship between Company and the Participant or any other person. To the extent that any person acquires a right to receive payments from Company under this Agreement, such right shall be no greater than the right of any unsecured general creditor of Company. Except as provided in paragraph 5 of this Agreement, title to and beneficial ownership of any assets, whether cash or investments which Company may earmark to pay the deferred compensation hereunder, shall at all times remain assets of Company and neither the Participant nor any other person shall, under this Agreement, have any property interest whatsoever in any specific assets of Company.

8. The existence of this Agreement shall not confer upon any Participant any right to continue to serve as an officer or employee for any period of time.

9. This Agreement may be terminated by Company upon 30 days written notice to the Participant. Such termination shall be applicable only with respect to bonuses and/or base compensation payable to Participant on and after the first day of the calendar year following the date of termination. Funds previously deferred and credited (and income earned on such funds) will continue to be governed by the applicable year's Participant's Deferred Compensation Agreement Election Form and paragraph 3 of this Agreement.

10. Participant acknowledges that Participant has been advised that Participant may confer with and seek advice from a tax or financial advisor of Participant's choice concerning this deferral. Participant further acknowledges that Participant has not received tax advice from Company nor has Participant relied upon information provided by Company in electing to make this deferral.

IN WITNESS WHEREOF, this Agreement has been executed on the day and year written above.

PARTICIPANT

COMPANY

\_\_\_\_\_  
Signature of Participant

By \_\_\_\_\_  
Company \_\_\_\_\_  
Title \_\_\_\_\_

THIS AGREEMENT is made and entered into this \_\_\_\_ day of December, 1997, by and between Enova Corporation or any of its subsidiaries (hereinafter "Company") and \_\_\_\_\_ (hereinafter "Participant"), an employee of Company.

WITNESSETH:

WHEREAS, Company desires to provide Participant with the opportunity to defer base compensation and any Bonus that is payable for services to be rendered in 1998 and after the date of this Agreement and which, as a result of amendments to the Internal Revenue Code ("Code") made by the Tax Reform Act of 1986 ("1986 Tax Act"), cannot be contributed on Participant's behalf as Pretax Contributions to the San Diego Gas & Electric Company Savings Plan, which has been adopted by Company ("Savings Plan"); and

WHEREAS, Company desires to match, as an additional Company contribution, a percentage of the Participant's base compensation and bonus deferred pursuant to this Agreement; and

WHEREAS, Participant and Company desire that the payment of a portion of Participant's base compensation and bonus and the additional matching contribution be deferred pursuant to the terms and provisions of this Agreement.

NOW, THEREFORE, the parties hereto hereby agree as follows:

1. This Agreement shall be effective upon its execution by Company and Participant with respect to base compensation and bonus which would otherwise be payable to Participant for services rendered after such execution and shall continue in effect until this Agreement is terminated as provided herein. Participant shall be eligible to enter into this Agreement only if Participant has elected the maximum Basic Contribution under the Savings Plan for which Participant is eligible.

2. Company shall credit to an account on Company's books, in Participant's name, that percentage of Participant's 1998 base compensation (in equal biweekly installments of whole dollar amounts) and bonus otherwise payable to Participant as may be specified by Participant in this Agreement's Election Form. The amount credited under this paragraph 2 may not exceed the percentage of Participant's 1998 base compensation and Bonus that may be contributed as Pretax Contributions or After-tax Contributions under the terms of the Savings Plan (determined prior to any reduction of such percentage required under applicable law), reduced by any amount contributed by Participant as After-tax Contributions or on Participant's behalf as Pretax Contributions to the Savings Plan. Further, the amount credited under this paragraph 2 shall be

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limited to an amount which, when added to Company's matching contribution under paragraph 3 of this Agreement and all allocations to his or her accounts under the Savings Plan, does not exceed the maximum amount that could have been allocated to Participant's Savings Plan accounts pursuant to Section 415 of the Code, as in effect prior to the enactment of the 1986 Tax Act. For purposes of this paragraph 2, "base compensation and bonus" shall include Participant's Pretax Contributions to the Savings Plan. Company shall have the sole and complete authority to determine the maximum amount that may be credited under this paragraph 2.

3. In addition, as amounts are credited to Participant's account under paragraph 2, Company shall also credit to Participant's account, as a matching contribution, an amount equal to the Company Matching Contributions that would have been contributed on Participant's behalf to the Savings Plan, if any, (reduced by Matching Contributions actually made to the Savings

Plan for Participant) under the provisions of the Code prior to enactment of the 1986 Tax Act, if the amount deferred under paragraph 2 had been contributed to the Savings Plan as Pretax Contributions or After-tax Contributions.

4. There shall be credited to Participant's account an additional amount equal to eight and sixty-eight one-hundredths percent (8.68%) per annum computed on the balance in Participant's account as of the end of each month. Company reserves the right to increase or decrease from time to time such percentage credited with respect to amounts to be credited under paragraphs 2 and 3 to the account after the date of such increase or decrease, provided that upon a "change-in-control" (as defined in the Enova Corporation 1986 Long-Term Incentive Plan) no decrease will result in a percentage credited under the previous sentence of less than the last published interest rate shown in Moody's Average of Yields on Public Utility Bonds for a utility having a rating equivalent to SDG&E.

5. All amounts credited to Participant's account pursuant to paragraphs 2, 3, and 4 hereof shall be paid to Participant upon his or her termination of services as an Participant in the form and over the period specified by Participant on this Agreement's Election Form; provided, however, the Company's Board of Directors or Executive Compensation Committee may, in its sole discretion, provide instead for payment of the amount in Participant's account in a form and over a period determined by such Board or Committee except that the Board or Committee's authority and discretion to change the form or period of distribution shall terminate upon such a "change-in-control."

6. In the event of Participant's death after installment payments to Participant have commenced hereunder, installment payments shall continue to be paid to the person(s) specified by Participant on the Election Form for the remainder of the period selected by Participant on the Election Form. In the event of Participant's death before any payment has been made under this Agreement, Participant's account shall be distributed or commence to be distributed, as soon as administratively practicable after Participant's death, to the person(s) specified by Participant on this Agreement's Election Form in the form and over the period selected on such Election Form. The Board or Committee may, in its sole discretion, provide instead for payment of the amount in Participant's account to Participant's beneficiary in a form and over a period determined by the

Board or Committee except that the Board or Committee's authority and discretion to change the form or period of distribution shall terminate upon such a "change-in-control."

If Participant's spouse is the beneficiary, the annual amount of any installment payments under this paragraph 6 shall at least equal the entire annual income earned by the account and if the spouse dies prior to distribution of all amounts in Participant's account, all undistributed income on such account shall be distributed to the spouse's estate. Upon the death of Participant's beneficiary, the balance in Participant's account (after the application of the previous sentence, if the spouse is the beneficiary) shall be distributed to the person(s) designated by the beneficiary on a form provided by Company or, if no designation is made, to the beneficiary's estate.

Notwithstanding the foregoing, a Participant (or former Participant whose services have terminated, hereinafter referred to in this paragraph as Participant) may, at any time, elect to withdraw all or a portion of the balance in the Participant's account prior to the time such amount is otherwise due and payable, subject to a withdrawal penalty (the amount to be withdrawn prior to the application of the withdrawal penalty shall be referred to as the Gross Withdrawal Amount, which may not exceed the balance of the account immediately prior to the withdrawal). The Participant shall make this election by filing a written notice with the Committee on a form provided by the Committee. Within thirty days following the Committee's receipt of such notice, an amount equal to 90% of the Gross Withdrawal Amount (less applicable withholding tax) shall be paid to the Participant in a cash lump sum. Upon payment of such withdrawal, (a) a withdrawal penalty equal to 10% of the Gross Withdrawal Amount shall be permanently forfeited, and the Company shall have no obligation to the Participant or the Participant's spouse or beneficiary with respect to such forfeited amount and (b) the Participant shall be ineligible to have any additional bonus or base compensation amounts credited to the Participant's account pursuant to this Agreement (or any subsequent Deferred Compensation Agreement) for the balance of the calendar year of withdrawal and the subsequent calendar year.

7. All amounts credited to Participant's account pursuant to paragraphs 2, 3 and 4 hereof may be used to purchase common stock of Enova Corporation or other equity securities, subject to the following conditions:

a. All such purchases must be made through a stock equivalent tracking device, a rabbi trust or other similar instrument that causes the deferred amount not to become taxable;

b. Equity securities of other entities may be purchased only if the Participant has met or is expected to meet, under the normal course of events, the Company's Enova Corporation stock ownership requirement;

c. If the Participant becomes subject to a higher Enova Corporation stock ownership requirement, the Participant may retain any then current investment in equity securities of other entities, but shall not make additional purchases of other equity securities until

the higher Enova Corporation stock ownership requirement has been met or is expected to be met under the normal course of events; and

d. All such purchases must be made in accordance with applicable Company procedures, as they may be amended from time to time.

8. No amounts credited to Participant's account may be assigned, transferred, encumbered, or made subject to any legal process for the payment of any claim against Participant, Participant's spouse or other beneficiary. In no event shall Participant, Participant's spouse, or other beneficiary have the right to recover any amount credited to Participant's account other than in accordance with this Agreement.

9. Nothing contained in this Agreement and no action taken pursuant to the provisions of this Agreement shall create or be construed to create a trust of any kind, or a fiduciary relationship between Company and Participant or any other person. To the extent that any person acquires a right to receive payments from Company under this Agreement, such right shall be no greater than the right of any unsecured general creditor of Company. Except as provided in paragraph 7 of this Agreement, title to and beneficial ownership of any assets, whether cash or investments, which Company may earmark to pay the deferred compensation hereunder, shall at all times remain assets of Company and neither Participant nor any other person shall, under this Agreement, have any property interest whatsoever in any specific assets of Company.

10. The existence of this Agreement shall not confer upon Participant the right to continue to serve as an officer or employee for any period of time.

11. This Agreement shall be deemed to modify any provisions in an employment agreement between Participant and Company pertaining to the timing of payment of base compensation and bonus and, in the event of any conflict between this Agreement and such provisions of the employment agreement, this Agreement shall control.

12. This Agreement may be terminated by Company upon thirty days' written notice to Participant. This Agreement will also terminate upon Participant's filing of an election of a Basic Contribution percentage which is less than the maximum for which he or she is eligible under the Savings Plan. Termination of the Agreement shall be applicable only with respect to base compensation and bonus payable to Participant on and after the first day of the calendar year following the date of termination. Funds previously deferred and credited (and income earned on such funds) will continue to be governed by the applicable year's Participant's Deferred Compensation Agreement Election Form and Section 4 of this Agreement.

13. Participant acknowledges that Participant has been advised that Participant may confer with and seek advice from a tax or financial advisor of Participant's choice concerning this deferral. Participant further acknowledges that Participant has not received tax advice from Company nor has Participant relied upon information provided by Company in electing to make this deferral.

IN WITNESS WHEREOF, this Agreement has been executed on the day and year written above.

PARTICIPANT

COMPANY

\_\_\_\_\_  
Signature of Participant

By \_\_\_\_\_  
Company \_\_\_\_\_  
Title \_\_\_\_\_

ENOVA CORPORATION  
1998 DEFERRED COMPENSATION AGREEMENT  
FOR NONEMPLOYEE DIRECTORS

THIS AGREEMENT, made and entered into this \_\_\_\_ day of December, 1997, by and between Enova Corporation or any of its subsidiaries, (hereinafter "Company") and \_\_\_\_\_ (hereinafter "Director"), a member of the Board of Directors of Company (hereinafter the "Board"),

WITNESSETH:

WHEREAS, fees are paid to Directors as a retainer; and

WHEREAS, Director and Company desire that the payment of said fees to Director be deferred, pursuant to the terms and provisions of this Agreement;

NOW, THEREFORE, the parties hereto hereby agree as follows:

1. This Agreement shall be effective on the first date subsequent to its execution upon which Director's fees would otherwise be payable to Director for service as a member of the Board and shall continue in effect until this Agreement is terminated as provided herein.

2. Company shall credit to an account on Company's books, in Director's name, that portion of such Director's fees otherwise payable to Director as may be specified by Director on an election form submitted to Company simultaneously with the execution of this Agreement.

3. There shall be credited to Director's account an additional amount equal to eight and sixty-eight one-hundredths (8.68%) per annum computed on the balance in Director's account as of the end of each month; provided, however, that Company reserves the right to increase or decrease from time to time such amount with respect to amounts to be credited to the account subsequent to the date of such increase or decrease, provided that upon a "change-in-control" (as defined in the Enova Corporation 1986 Long-Term Incentive Plan) the percentage used shall not decrease to less than the last published rate shown in Moody's Average of Yields on Public Utility Bonds for a utility having a rating equivalent to Company.

4. All amounts credited to Director's account pursuant to paragraphs 2 and 3 hereof shall be paid to Director in a lump sum on the date specified by Director on the Director's election form. In the event of Director's death before any payment due under this paragraph 4 has been paid, such payment due shall be paid in a lump sum to the person specified by the Director on the election form as soon as administratively practicable.

Notwithstanding the foregoing, a Director (or former Director whose services have terminated, hereinafter referred to in this paragraph as "Director") may, at any time, elect to withdraw all or a portion of the balance in the Director's account prior to the time such amount is otherwise due and payable, subject to a withdrawal penalty (the amount to be withdrawn prior to the application of the withdrawal penalty shall be referred to as the "Gross Withdrawal Amount",

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which may not exceed the balance of the account immediately prior to the withdrawal). The Director shall make this election by filing a written notice with the Committee on a form provided by the Committee. Within thirty days following the Committee's receipt of such notice, an amount equal to 90% of the Gross Withdrawal Amount (less applicable withholding tax) shall be paid to the Director in a cash lump sum. Upon payment of such withdrawal, (a) a withdrawal penalty equal to 10% of the Gross Withdrawal Amount shall be permanently forfeited, and the Company shall have no obligation to the Director or the Director's spouse or beneficiary with respect to such forfeited amount and (b) the

Director shall be ineligible to have any additional bonus or base compensation amounts credited to the Director's account pursuant to this Agreement (or any subsequent Deferred Compensation Agreement) for the balance of the calendar year of withdrawal and the subsequent calendar year.

5. No amounts credited to Director's account may be assigned, transferred, encumbered, or made subject to any legal process for the payment of any claim against Director, Director's spouse or beneficiary. In no event shall Director, Director's spouse or beneficiary have the right to recover any fees credited to Director's account other than in accordance with this Agreement.

6. Nothing contained in this Agreement and no action taken pursuant to the provisions of this Agreement shall create or be construed to create a trust of any kind, or a fiduciary relationship between Company and the Director or any other person. To the extent that any person acquires a right to receive payments from Company under this Agreement, such right shall be no greater than the right of any unsecured general creditor of Company. Title to and beneficial ownership of any assets, whether cash or investments which Company may earmark to pay the deferred compensation hereunder, shall at all times remain assets of Company and neither the Director nor any other person shall, under this Agreement, have any property interest whatsoever in any specific assets of Company.

7. The existence of this Agreement shall not confer upon any Director any right to continue to serve as a Director for any period of time.

8. This Agreement may be terminated by Company upon 30 days written notice to the Director. Such termination shall be applicable only with respect to fees payable to Director on and after the first day of the calendar year following the date of termination. Funds previously deferred and credited (and income earned on such funds) will continue to be governed by the applicable year's director election form and Section 3 of this Agreement.

9. Director acknowledges that Director has been advised that Director may confer with and seek advice from a tax or financial advisor of Director's choice concerning this deferral. Director further acknowledges that Director has not received tax advice from Company nor has Director relied upon information provided by Company in electing to make this deferral.

IN WITNESS WHEREOF, this Agreement has been executed on the day and year written above.

NONEMPLOYEE DIRECTOR

COMPANY

\_\_\_\_\_  
Signature of Nonemployee Director

By \_\_\_\_\_  
Company \_\_\_\_\_  
Title \_\_\_\_\_

ENOVA CORPORATION  
1986 LONG-TERM INCENTIVE PLAN  
1997 RESTRICTED STOCK AWARD AGREEMENT

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THIS RESTRICTED STOCK AWARD AGREEMENT (the "Agreement") is entered into this \_\_\_\_ day of \_\_\_\_\_, 1997, by and between ENOVA CORPORATION, a California corporation ("Enova") and \_\_\_\_\_ ("Participant").

WHEREAS, the Boards of Directors of Enova and San Diego Gas & Electric Company ("SDG&E") ("the Boards") have adopted the Enova Corporation 1986 Long-Term Incentive Plan (the "Plan"), which provides for the granting to selected employees of Enova and its subsidiaries of awards of Common Stock of Enova Corporation ("Restricted Stock Awards");

WHEREAS, the grant of Restricted Stock Awards is intended as an incentive which will attract and retain highly competent persons as officers and key employees of Enova and its subsidiaries;

WHEREAS, Participant is a selected employee of Enova and/or one of its subsidiaries; and

WHEREAS, the Executive Compensation Committees of the Boards of Enova and SDG&E (the "Committees") have authorized, and the Boards have approved, the grant of a Restricted Stock Award to Participant pursuant to the terms of the Plan.

NOW, THEREFORE, in consideration of the foregoing and of the mutual covenants hereinafter set forth and other good and valuable consideration, the receipt of which is hereby acknowledged, the parties hereto agree as follows:

1. GRANT OF RESTRICTED STOCK AWARD

Enova hereby grants to Participant, on the terms, conditions and restrictions hereinafter set forth, and in accordance with the Plan which is incorporated herein, as a matter of separate inducement to achieve a certain goal set by the Boards and not in lieu of any salary or other compensation for Participant's services, a Restricted Stock Award consisting of \_\_\_\_\_ shares of the authorized but unissued shares of Enova Corporation Common Stock, (the "Shares").

2. RECEIPT AND TRANSFER OF SHARES

Participant hereby acquires the Shares, and Enova hereby transfers the Shares to Participant. Concurrently with the execution hereof, Enova has delivered to Participant, and Participant acknowledges receipt into escrow of, a certificate or certificates evidencing the Shares, duly issued to Participant by Enova Corporation. Concurrently with the execution hereof, Participant

- 1 -

acknowledges that the Secretary or Assistant Secretary of Enova, holds on behalf of Participant all certificates evidencing the Shares. Participant also acknowledges prior receipt of a prospectus for the Plan, a copy of the Plan, and the most recent Annual Report of Enova Corporation. Participant shall execute all such stock powers and other instruments of transfer in favor of Enova as are necessary at any time in the future to perform this contract.

3. SHAREHOLDER OF RECORD

Enova agrees that Participant shall be deemed a shareholder of record with respect to the Shares on the date first written above.

4. RESTRICTED TERM

The Restricted Term with respect to the Shares shall commence on the date first above written. The restrictions will be removed and the restricted term will expire on one quarter of such

restricted shares after the end of each of the years 1998, 1999, 2000 and 2001:

a. If, at the end of each of such year San Diego Gas & Electric Company has earned the CPUC authorized rate of return on rate base.

b. If, beginning in 1999 at the end of any quarter, San Diego Gas & Electric Company meets or exceeds its authorized rate of return for the twelve months then ending.

c. At the end of 2001, the remaining restricted shares not released previously may be released in the discretion of the Board dependent upon the impact on 1998 through 2001 earnings of industry and corporate restructuring during such period.

d. The Board of each Corporation, in response to industry or corporate restructuring, may elect to change the Plan design and performance goals to align the Plan with a new long term direction.

#### 5. VOTING AND OTHER RIGHTS

During the Restricted Term, Participant shall, except as otherwise provided herein, have all of the rights of a stockholder with respect to all of the Shares subject to the Restricted Term, including without limitation the right to vote such Shares and the right to receive all dividends or other distributions with respect to such Shares. In connection with the payment of such dividends or other distributions, there shall be deducted any taxes or other amounts required by any governmental authority to be withheld and paid over to such authority for the account of Participant.

#### 6. RESTRICTIONS ON INTER VIVOS TRANSFER

During the Restricted Term, the Shares subject to the Restricted Term shall not be sold, assigned, transferred, hypothecated or otherwise alienated, disposed of or encumbered except as

provided in the Plan. The certificate for such Shares shall bear the following legend, or any other similar legend as may be required by Enova:

"THE SHARES OF STOCK REPRESENTED BY THIS CERTIFICATE MAY NOT BE SOLD, ASSIGNED, TRANSFERRED, PLEDGED, HYPOTHECATED OR OTHERWISE ENCUMBERED OR DISPOSED OF EXCEPT AS PERMITTED BY ENOVA CORPORATION'S 1986 LONG-TERM INCENTIVE PLAN OR THE COMMITTEE WHICH ADMINISTERS THAT PLAN."

7. TERMINATION OF PARTICIPANT'S EMPLOYMENT

In the event Participant ceases to be employed by Enova and/or one of its subsidiaries at any time before the end of the Restricted Term for any reason, Participant shall deliver to Enova all certificates evidencing the Shares subject to the Restricted Term, accompanied by stock powers and other instruments of transfer duly executed by Participant to transfer such shares to Enova.

8. ELECTION TO RECOGNIZE INCOME

Check one:

a.  Participant elects, pursuant to the Internal Revenue Code as amended, and the comparable provisions of state tax law, to include in gross income in connection with the grant of this Restricted Stock Award, all amounts now recognizable.

b.  Participant shall not elect, pursuant to the Internal Revenue Code as amended, or comparable provisions of any state tax law, to include any amount in gross income in connection with the grant of this Restricted Stock Award.

9. WITHHOLDING AND REGISTRATION

a. Upon recognition of income as elected in paragraph 8 above, Participant shall, with respect to such Shares, make payment, in the form of cash or a cashier's check or in the manner stated in paragraph 9(b) below, to Enova in an amount sufficient to satisfy any taxes or other amounts Enova determines is required by any governmental authority to be withheld and paid over by Enova or any of its subsidiaries to such authority for the account of Participant (collectively, "Withholding Taxes"), or shall otherwise make arrangements satisfactory to Enova for the payment of such amounts through withholding or otherwise. For purposes of paragraph 8(a), such payment or arrangements shall be made by December 5, 1997. For purposes of paragraph 8(b), the date shall be 30 days after the restrictions are removed. Participant shall, if requested by Enova, make appropriate representations in a form satisfactory to Enova that such Shares will not be sold other than pursuant to an effective registration statement under the Securities Act of 1933, as amended, or an applicable exemption from the registration requirements of such Act.

b. Subject to the restrictions set forth in paragraph 9(c) and such rules as the Committee may from time to time adopt and upon approval by the Committee in its sole discretion,

Participant may elect to satisfy all or any portion of such Participant's tax withholding obligations set forth in paragraph 9(a) by electing (i) to have Enova withhold from delivery of any Shares otherwise deliverable to Participant in the manner set forth in paragraph 10 hereof, a portion of such Shares to satisfy Withholding Taxes or (ii) to deliver to Enova shares of Common Stock, no par value, of Enova, other than those delivered to Participant in the manner set forth in paragraph 10 hereof, to satisfy all or any portion of such Participant's Withholding Taxes.

The number of Shares withheld from delivery or such other shares delivered shall equal the number of shares the Committee, in its sole discretion, determines to have a fair market value equal to the amount of such Participant's Withholding Taxes required to be withheld or paid over by Enova or any of its subsidiaries and which Participant elected to be satisfied by withholding or delivery of shares.

c. Participant's election to satisfy all or any portion of Participants Withholding Taxes under paragraph 9(b) is subject to the following restrictions:

(i) such election must be made in writing on or before the date when the amount of Withholding Taxes is required to be determined (the "Tax Date");

(ii) such election shall be irrevocable;

(iii) such election shall be subject to the approval or disapproval of the Committee, in its sole discretion;

(iv) the fair market value of the Shares to be withheld or other shares of Common Stock to be delivered to Enova for the purposes of satisfying all or any portion of such Participant's Withholding Taxes shall be deemed to be the average of the highest and lowest selling prices of such stock as reported on the New York Stock Exchange Composite Transactions Tape on the Tax Date, or if such stock is not traded that day, then on the next preceding day on which such stock was traded; and

(v) if Participant is or becomes subject to Section 16(b) of the Securities Exchange Act of 1934, as amended (the "1934 Act"), such election must be made in compliance with Rule 16b-3(e) promulgated under said Section 16(b) or any successor regulation promulgated thereunder.

#### 10. DELIVERY OF SHARES

Upon expiration of the Restricted Term applicable to any shares as provided in the manner stated in paragraph 4 above and payment by the Participant as required in paragraph 9 above, the Secretary or Assistant Secretary of Enova shall deliver to Participant all certificates evidencing the Shares free of legend and no longer subject to the Restricted Term and all restrictions set forth herein with respect to such Shares shall terminate.

If at the end of 2001 the restrictions have not been removed from and the Restricted Term has not expired on any of the shares received by Participant under this Agreement, Participant shall

deliver to Enova all certificates evidencing such shares accompanied by stock powers and other instruments of transfer duly executed by Participant to transfer such shares to Enova.

11. EFFECTS ON PARTICIPANT'S CONTINUED EMPLOYMENT

Participant's right, if any, to continue to serve Enova and/or its subsidiaries as an officer or employee shall not be enlarged or otherwise affected by the grant to him or her of this Restricted Stock Award, nor shall such grant in any way restrict the right of Enova and/or any of its subsidiaries to terminate Participant's employment at any time.

12. FURTHER ACTION

Each party hereto agrees to perform any further acts and to execute and deliver any documents which may be reasonably necessary to carry out the provisions hereof.

13. PARTIES IN INTEREST AND GOVERNING LAW

This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective assigns and successors-in-interest, and shall be governed by and interpreted in accordance with the laws of the State of California.

14. ENTIRE AGREEMENT

This Agreement contains the entire agreement and understanding between the parties as to the subject matter hereof.

15. INVALID PROVISIONS

The invalidity or unenforceability of any particular provision hereto shall not affect the other provisions hereof, and this Agreement shall be construed in all respects as if such invalid or unenforceable provisions were omitted.

16. AMENDMENT

No amendment or modification hereof shall be valid unless it shall be in writing and signed by both parties hereto.

17. COUNTERPARTS

This Agreement may be executed in counterparts, each of which shall be deemed to be an original, and taken together shall constitute one and the same document.



EXECUTION COPY

LOAN AGREEMENT  
Between  
CITY OF CHULA VISTA  
And  
SAN DIEGO GAS & ELECTRIC COMPANY

Dated as of October 1, 1997

Relating to  
\$25,000,000  
City of Chula Vista  
Industrial Development Revenue Bonds  
(San Diego Gas & Electric Company)  
1997 Series A  
- cover page -

LOAN AGREEMENT

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LOAN AGREEMENT

THIS LOAN AGREEMENT, dated as of October 1, 1997, by and between the CITY OF CHULA VISTA, a municipal corporation and charter city duly organized and existing under the laws and Constitution of the State of California (the "City"), and SAN DIEGO GAS & ELECTRIC COMPANY, a corporation organized and existing under the laws of the State of California (the "Borrower"),

W I T N E S S E T H :

WHEREAS, the City is a municipal corporation and charter city, duly organized and existing under a freeholders' charter pursuant to which the City has the right and power to make and enforce all laws and regulations in accordance with and as more particularly provided in Sections 3, 5 and 7 of Article XI of the Constitution of the State of California and Section 200 of the Charter of the City (the "Charter"); and

WHEREAS, the City Council of the City, acting under and pursuant to the powers reserved to the City under Sections 3, 5 and 7 of Article XI of the Constitution and Section 200 of the Charter, has enacted Chapter 3.48 of the Chula Vista Municipal Code, pursuant to Ordinance No. 1970 adopted on February 9, 1982, as amended from time to time (the "Law"), establishing a program to provide financial assistance for the acquisition, construction and installation of facilities for industrial, commercial or public utility purposes; and

WHEREAS, the Borrower has duly applied to the City for financial assistance to refinance the costs of acquisition, construction and installation of certain facilities for the distribution of electric energy, as more fully described in Exhibit A hereto (the "Project"), by prepaying a loan (the "Prior Loan") made to the Borrower with the proceeds of The City of San Diego Industrial Development Revenue Bonds (San Diego Gas & Electric Company) 1987 Series A (the "Prior Bonds"), resulting in the refunding of the Prior Bonds; and

WHEREAS, the City after due investigation and deliberation has determined that the Project and the refinancing thereof, and the resulting refunding of the Prior Bonds, will directly benefit the citizens of the City by substantially promoting the public interests recited in the Law and has adopted its resolutions authorizing the provision or lending of financial assistance to the Borrower to refinance the costs of acquisition, construction and installation of the Project and to prepay the Prior Loan, and the issuance and sale of its bonds, including its Industrial Development Revenue Bonds (San Diego Gas & Electric Company) 1997 Series A (the "Bonds"), for such purposes; and

WHEREAS, the City proposes to assist in such refinancing upon the terms and conditions set forth herein;

NOW, THEREFORE, in consideration of the premises and the respective representations and covenants herein contained, the parties hereto agree as follows:

ARTICLE I  
DEFINITIONS

SECTION 1.1 DEFINITION OF TERMS Unless the context otherwise requires, the terms used in this Agreement shall have the meanings specified in Section 1.01 of the Indenture of Trust, of even date herewith relating to the Bonds (the "Indenture"), by and between the City and First Trust of California, National Association, as trustee (the "Trustee"), as originally executed or as it may from time to time be supplemented or amended as provided therein.

SECTION 1.2 NUMBER AND GENDER The singular form of any word used herein, including the terms defined in Section 1.01 of the Indenture, shall include the plural, and vice versa. The use herein of a word of any gender shall include all genders.

SECTION 1.3 ARTICLES, SECTIONS, ETC. Unless otherwise specified, references to Articles, Sections and other subdivisions of this Agreement are to the designated Articles, Sections and other subdivisions of this Agreement as originally executed. The words "hereof," "herein," "hereunder" and words of similar import refer to this Agreement as a whole. The headings or titles of the several articles and sections, and the table of contents appended to copies hereof, shall be solely for convenience of reference and shall not affect the meaning, construction or effect of the provisions hereof.

ARTICLE II  
REPRESENTATIONS

SECTION 2.1 REPRESENTATIONS OF THE CITY. The City makes the following representations as the basis for its undertakings herein contained:

(a) The City is a municipal corporation and charter city in the State of California. Under the provisions of the Law, the City has the power to enter into the transactions contemplated by this Agreement and to carry out its obligations hereunder. The Project constitutes a "project" as that term is defined in the Law. By proper action, the City has been duly authorized to execute, deliver and duly perform this Agreement and the Indenture.

(b) To refinance the cost of the Project, the City will issue the Bonds which will mature, bear interest and be subject to redemption as set forth in the Indenture.

(c) The Bonds will be issued under and secured by the Indenture, pursuant to which the City's interest in this Agreement (except certain rights of the City to give approvals and consents and to receive payment for expenses and indemnification and certain other payments) will be pledged to the Trustee as security for payment of the principal of, premium, if any, and interest on the Bonds.

(d) The City has not pledged and will not pledge its interest in this Agreement for any purpose other than to secure the Bonds under the Indenture.

(e) The City is not in default under any of the provisions of the laws of the State of California or the City's Charter which default would affect its existence or its powers referred to in subsection (a) of this Section 2.1.

(f) The City has found and determined and hereby finds and determines that all requirements of the Law with respect to the issuance of the Bonds and the execution of this Agreement and the Indenture have been complied with and that refinancing the Project by issuing the Bonds, refunding or replacing the Prior Bonds and entering into this Agreement and the Indenture will be in furtherance of the purposes of the Law.

(g) On May 21, 1996, the City Council of the City adopted Resolution No. 18302 authorizing the issuance and sale of the Bonds.

(h) On July 23, 1996, the City Council adopted Resolution No. 18384 authorizing the execution and delivery of a bond purchase agreement and official statement in connection with the sale of the Bonds.

SECTION 2.2 REPRESENTATIONS OF THE BORROWER. The Borrower makes the following representations as the basis for its undertakings herein contained:

(a) The Borrower is a corporation duly formed under the laws of the State of California, is in good standing in the State of California and has the power to enter into and has duly authorized, by proper corporate action, the execution and delivery of this Agreement and all other documents contemplated hereby to be executed by the Borrower.

(b) Neither the execution and delivery of this Agreement, the consummation of the transactions contemplated hereby, nor the fulfillment of or compliance with the terms and conditions hereof and thereof, conflicts with or results in a breach of any of the terms, conditions or provisions of the Borrower's Articles of Incorporation or By-laws or of any corporate actions or of any agreement or instrument to which the Borrower is now a party or by which it is bound, or constitutes a default (with due notice or the passage of time or both) under any of the foregoing, or results in the creation or imposition of any prohibited lien, charge or encumbrance whatsoever upon any of the property or assets of the Borrower under the terms of any instrument or agreement to which the Borrower is now a party or by which it is bound.

(c) The Project consists and will consist of those facilities described in Exhibit A hereto, and the Borrower shall make no changes to such portion of the Project or to the operation thereof which would affect the qualification of the Project as a "project" under the Law or impair the exemption from gross income of the interest on the Bonds for federal income tax purposes. In particular, the Borrower shall comply with all requirements of the San Diego Gas & Electric Company Engineering Certificate, dated the Issue Date (the "Engineering Certificate"), which is hereby incorporated by reference herein. The Project consists of facilities for the local furnishing of electric energy and gas as described in the Engineering Certificate.

The Borrower intends to utilize such portion of the Project as facilities for the local furnishing of electric energy and gas throughout the foreseeable future.

(d) The Borrower has and will have title to the Project sufficient to carry out the purposes of this Agreement.

(e) The economic useful life of the Project is as set forth in the Engineering Certificate.

(f) All certificates, approvals, permits and authorizations with respect to the construction of the Project of agencies of applicable local governmental agencies, the State of California and the federal government have been obtained; and pursuant to such certificates, approvals, permits and authorizations the Project has been constructed and is in operation.

#### ARTICLE III

##### ISSUANCE OF THE BONDS; APPLICATION OF PROCEEDS

##### SECTION 3.1 AGREEMENT TO ISSUE BONDS; APPLICATION OF

BOND PROCEEDS. To provide funds to enable the Borrower to refinance a portion of the cost of the Project by prepaying the Prior Loan, the City agrees that it will issue under the Indenture, sell and cause to be delivered to the purchasers thereof, the Bonds, bearing interest as provided and maturing on the date set forth in the Indenture. The City will thereupon apply the proceeds received from the sale of the Bonds as provided in Section 3.02 of the Indenture.

##### SECTION 3.2 INVESTMENT OF MONEYS IN FUNDS. Any moneys

in any fund held by the Trustee shall, at the written request of an Authorized Borrower Representative, be invested or reinvested by the Trustee as provided in the Indenture. Such investments shall be held by the Trustee and shall be deemed at all times a part of the fund from which such investments were made, and the interest accruing thereon and any profit or loss realized therefrom shall, except as otherwise provided in the Indenture, be credited or charged to such fund.

##### SECTION 3.3 AMENDMENT OF DESCRIPTION OF THE PROJECT.

In the event that the Borrower desires to amend or supplement the Project, as described in Exhibit A hereto, and the City approves of such amendment or supplement, the City will enter into, and will instruct the Trustee to consent to, such amendment or supplement upon receipt of:

(i) a certificate of an Authorized Borrower Representative describing in detail the proposed changes and stating that they will not have the effect of disqualifying any component of the Project as a facility that may be financed pursuant to the Law;

(ii) a copy of the proposed form of amended or supplemented Exhibit A hereto; and

(iii) an Opinion of Bond Counsel that such proposed changes will not affect the exclusion from gross income of interest on the Bonds for federal income tax purposes.

#### ARTICLE IV

##### LOAN TO BORROWER; REPAYMENT PROVISIONS

##### SECTION 4.1 LOAN TO BORROWER. The City and the

Borrower agree that the application of the proceeds of sale of the Bonds to refund and retire a portion of the Prior Bonds and the first mortgage bonds of the Borrower relating thereto will be deemed to be and treated for all purposes as a loan to the Borrower of an amount equal to the principal amount of the Bonds.

##### SECTION 4.2 REPAYMENT AND PAYMENT OF OTHER AMOUNTS PAYABLE.

(a) The Borrower covenants and agrees to pay to the Trustee as a Repayment Installment on the loan to the Borrower pursuant to Section 4.1 hereof, on each date provided in or pursuant to the Indenture for the payment of principal (whether at maturity or upon redemption or acceleration) of, premium, if any, and/or interest on the Bonds, until the principal of, premium, if any, and interest on the Bonds shall have been fully paid or provision for the payment thereof shall have been made in accordance with the Indenture, in immediately available funds, for deposit in the Bond Fund, a sum equal to the amount then payable as principal (whether at maturity or upon redemption or acceleration), premium, if any, and interest upon the Bonds as provided in the Indenture. Each payment required to be made pursuant to this Section 4.2(a) shall at all times be sufficient to pay the total amount of interest and principal (whether at maturity or upon redemption or acceleration) and premium, if any, then payable on the Bonds; provided that any amount held by the Trustee in the Bond Fund on any due date for a Repayment Installment hereunder shall be credited against the installment due on such date to the extent available for such purpose; and provided further that, subject to the provisions of this paragraph, if at any time the amounts held by the Trustee in the Bond Fund are sufficient to pay all of the principal of and interest and premium, if any, on the Bonds as such payments become due, the Borrower shall be relieved of any obligation to make any further payments under the provisions of this Section. Notwithstanding the foregoing, if on any date the amount held by the Trustee in the Bond Fund is insufficient to make any required payments of principal of (whether at maturity or upon redemption or acceleration) and interest and premium, if any, on the Bonds as such payments become due, the Borrower shall forthwith pay such deficiency as a Repayment Installment hereunder. The obligation of the Borrower to make any payment under this Section 4.2(a) with respect to the Bonds shall be deemed to have been satisfied to the extent of any corresponding payment by the Credit Provider under the Credit Facility, if any, for such Bonds.

(b) The Borrower also agrees to pay to the Trustee until the principal of, premium, if any, and interest on the Bonds shall have been fully paid or provision for the payment thereof shall have been made as required by the Indenture, (i) the annual fee of the Trustee for its ordinary services rendered as trustee, and its ordinary expenses incurred under the Indenture, as and when the same become due, (ii) the reasonable fees, charges and expenses of the Trustee, the Registrar and the reasonable fees of any paying agent on the Bonds as provided in the Indenture, as and when the same become due, (iii) the reasonable fees, charges and expenses of the Trustee for the necessary extraordinary services rendered by it and extraordinary expenses incurred by it under the Indenture, as and when the same become due. The Borrower shall also pay the cost of printing any Bonds required to be furnished by the City.

(c) The Borrower also agrees to pay, within 60 days after receipt of request for payment thereof, all expenses required to be paid by the Borrower under the terms of the bond purchase agreement executed by it in connection with the sale of the Bonds, and all reasonable expenses of the City related to the financing of the Project which are not otherwise required to be paid by the Borrower under the terms of this Agreement; provided that the City shall have obtained the prior written approval of the Authorized Borrower Representative for any expenditures other than those provided for herein or in said bond purchase agreement.

The Borrower also agrees to pay to the City within five days following the Issue Date an issuance fee in the amount of \$62,500.

(d) The Borrower hereby agrees to provide or cause to be provided in immediately available funds, for deposit into the Bond Purchase Fund maintained by the Tender Agent, all amounts necessary to purchase Bonds tendered for purchase in accordance with Sections 2.01(d) and 2.01(e) of the Indenture.

(e) In the event the Borrower should fail to make any of the payments required by subsections (a) through (d) of this Section, such payments shall continue as obligations of the Borrower until such amounts shall have been fully paid. The Borrower agrees to pay such amounts, together with interest thereon until paid, to the extent permitted by law, at the rate of one percent (1%) per annum over the rate borne by any Bonds in respect of which such payments are required to be made pursuant to said subsection (a), and one percent (1%) per annum over the average rate then borne by the Bonds as to all other payments. Interest on overdue payments required under subsection (a) or (d) above shall be paid to Bondholders as provided in the Indenture.

(f) Upon written request of the Trustee, the Borrower shall pay any Repayment Installment directly to the Paying Agent.

(g) Any unpaid obligation of the Borrower under subsections (b) through (e) of this Section 4.2 shall survive the payment and discharge of the Bonds and the termination of this Agreement.

SECTION 4.3 UNCONDITIONAL OBLIGATION. The obligations of the Borrower to make the payments required by Section 4.2 hereof and to perform and observe the

other agreements on its part contained herein shall be absolute and unconditional, irrespective of any defense or any rights of set-off, recoupment or counterclaim it might otherwise have against the City, and during the term of this Agreement, the Borrower shall pay absolutely net the payments to be made on account of the loan as prescribed in Section 4.2 and all other payments required hereunder, free of any deductions and without abatement, diminution or set-off.

Until such time as the principal of, premium, if any, and interest on the Bonds shall have been fully paid, or provision for the payment thereof shall have been made as required by the Indenture, the Borrower (i) will not suspend or discontinue any payments provided for in Section 4.2 hereof; (ii) will perform and observe all of its other covenants contained in this Agreement; and (iii) will not terminate this Agreement for any cause, including, without limitation, the occurrence of any act or circumstances that may constitute failure of consideration, destruction of or damage to the Project, commercial frustration of purpose, any change in the tax or other laws of the United States of America or of the State of California or any political subdivision of either of these, or any failure of the City or the Trustee to perform and observe any covenant, whether express or implied, or any duty, liability or obligation arising out of or connected with this Agreement or the Indenture, except to the extent permitted by this Agreement.

SECTION 4.4 ASSIGNMENT OF CITY'S RIGHTS. As security for the payment of the Bonds, the City will assign to the Trustee the City's rights, but not its obligations, under this Agreement, including the right to receive payments hereunder (except (i) the rights of the City to receive notices under this Agreement, (ii) the right of the City to receive certain payments, if any, with respect to fees, expenses and indemnification and certain other purposes under Sections 4.2(c), 4.2(e), 6.3, 8.2 and 8.3 hereof, and (iii) the right of the City to give approvals or consents pursuant to this Agreement) and the City hereby directs the Borrower to make the payments required hereunder (except such payments for fees, expenses and indemnification) directly to the Trustee. The Borrower hereby assents to such assignment and agrees to pay the Repayment Installments directly to the Trustee (subject to the provisions of Section 4.2(f)) without defense or set-off by reason of any dispute between the Borrower and the City or the Trustee.

SECTION 4.5 AMOUNTS REMAINING IN FUNDS. It is agreed by the parties hereto that after payment in full of (i) the Bonds, or after provision for such payment shall have been made as provided in the Indenture, (ii) the fees and expenses of the City in accordance with this Agreement, (iii) the fees, charges and expenses of the Trustee, the Registrar and Paying Agents in accordance with the Indenture and this Agreement and (iv) all other amounts required to be paid under this Agreement and the Indenture, any amounts remaining in any fund held by the Trustee under the Indenture shall belong, subject to the requirements of Section 6.06 of the Indenture, to the Borrower and be paid to the Borrower by the Trustee.

SECTION 4.6 CREDIT FACILITY. No initial Credit Facility shall be provided with respect to the Bonds. The Borrower may provide and subsequently terminate or remove a Credit Facility with respect to the Bonds pursuant to the provisions of Section 5.07 of the Indenture; provided, however, that, except in connection with the redemption of Bonds, the Borrower shall not intentionally cause the termination or substitution of any Credit Facility with

respect to Bonds during a Term Rate Period or a Variable Term Segment with respect to such Bonds. Not less than twenty-five days prior to the termination, removal, substitution or delivery of any Credit Facility with respect to the Bonds, the Borrower shall mail written notice of such termination, removal, substitution or delivery to the Trustee. Not less than fifteen days prior to the delivery of any substitute or new Credit Facility for the Bonds, the Borrower shall mail written notice of such substitution or delivery to each Rating Agency.

#### ARTICLE V

##### SPECIAL COVENANTS AND AGREEMENTS

###### SECTION 5.1 RIGHT OF ACCESS TO THE PROJECT. The

Borrower agrees that during the term of this Agreement the City, the Trustee and the duly authorized agents of either of them shall have the right at all reasonable times during normal business hours to enter upon the site of the Project described in Exhibit A hereto to examine and inspect such Project; provided, however, that this right is subject to federal and State of California laws and regulations applicable to such site. The rights of access hereby reserved to the City and the Trustee may be exercised only after such agent shall have executed release of liability (which release shall not limit any of the Borrower's obligations hereunder) and secrecy agreements if requested by the Borrower in the form then currently used by the Borrower, and nothing contained in this Section or in any other provision of this Agreement shall be construed to entitle the City or the Trustee to any information or inspection involving the confidential know-how of the Borrower.

###### SECTION 5.2 THE BORROWER'S MAINTENANCE OF ITS

EXISTENCE; ASSIGNMENTS. (a) The Borrower agrees that during the term of this Agreement it will maintain its corporate existence in good standing and will not dissolve or otherwise dispose of all or substantially all of its assets and will not consolidate with or merge into another corporation or permit one or more other corporations to consolidate or merge into it; provided, that the Borrower may, without violating the covenants contained in this Section, consolidate with or merge into another corporation, or permit one or more other corporations to consolidate with or merge into it, or sell or otherwise transfer to another corporation all or substantially all of its assets and thereafter dissolve, provided that (1) either (A) the Borrower is the surviving corporation or (B) the surviving, resulting or transferee corporation, as the case may be, (I) assumes and agrees in writing to pay and perform all of the obligations of the Borrower hereunder and (ii) qualifies to do business in the State of California; and (2) the Borrower shall deliver to the Trustee an Opinion of Bond Counsel to the effect that such consolidation, merger or transfer and dissolution does not in and of itself adversely affect the exclusion from gross income for federal income tax purposes of interest on the Bonds.

(b) With the prior written consent of the City (which consent shall not be unreasonably withheld), the rights and obligations of the Borrower under this Agreement may be assigned by the Borrower, in whole or in part, subject, however, to each of the following conditions:

(i) No assignment (other than pursuant to a merger, consolidation or combination described in Section 5.2(a)) shall relieve the Borrower from primary liability for any of its obligations hereunder, and in the event of any assignment not pursuant to Section 5.2(a), the Borrower shall continue to remain primarily liable for the payments specified in Section 4.2 hereof and for performance and observance of the other agreements on its part herein provided to be performed and observed by it.

(ii) Any assignment from the Borrower shall retain for the Borrower such rights and interests as will permit it to perform its obligations under this Agreement, and any assignee from the Borrower shall assume the obligations of the Borrower hereunder to the extent of the interest assigned.

(iii) The Borrower shall, within thirty days after delivery of such assignment, furnish or cause to be furnished to the City and the Trustee a true and complete copy of each such assignment together with an instrument of assumption.

(iv) The Borrower shall cause to be delivered to the City and the Trustee an Opinion of Bond Counsel that such assignment will not, in and of itself, result in the interest on the Bonds being determined to be includable in the gross income for federal income tax purposes of the owners thereof (other than a "substantial user" of the Project or a "related person" within the meaning of Section 147(a) of the Code).

SECTION 5.3 RECORDS AND FINANCIAL STATEMENTS OF BORROWER. The Borrower agrees (a) to keep and maintain full and accurate accounts and records of its operations in accordance with generally accepted accounting principles, (b) to permit the Trustee for itself or on behalf of the holders of the Bonds and its designated officers, employees, agents and representatives to have access to such accounts and records and to make examinations thereof at all reasonable times and (c) upon request of the Trustee, to provide the Trustee with the Borrower's most recent audited financial statements.

SECTION 5.4 MAINTENANCE AND REPAIR. The Borrower agrees that as long as it owns the Project it will (i) maintain, or cause to be maintained, the Project in as reasonably safe condition as its operations shall permit and (ii) maintain, or cause to be maintained, the Project in good repair and in good operating condition, ordinary wear and tear excepted, making from time to time all necessary repairs thereto and renewals and replacements thereof.

SECTION 5.5 QUALIFICATION IN CALIFORNIA. The Borrower agrees that throughout the term of this Agreement it, or any successor or assignee as permitted by Section 5.2, will be qualified to do business in the State of California.

SECTION 5.6 TAX EXEMPT STATUS OF BONDS. (a) It is the intention of the parties hereto that interest on the Bonds shall be and remain excluded from gross income for federal income tax purposes. To that end, the covenants and agreements of the City and the Borrower in this Section and in the Tax Certificate are for the benefit of the Trustee and each and every person who at any time will be a holder of the Bonds. Without limiting the generality

of the foregoing, the Borrower and the City agree that there shall be paid from time to time all amounts required to be rebated to the United States pursuant to Section 148(f) of the Code and any temporary, proposed or final Treasury Regulations as may be applicable to the Bonds from time to time. This covenant shall survive payment in full or defeasance of the Bonds. The Borrower specifically covenants to pay or cause to be paid for and on behalf of the City to the United States at the times and in the amounts determined under Section 6.06 of the Indenture the Rebate Requirement as described in the Tax Certificate. The City shall not be liable to make any such payment except from funds provided by the Borrower for such purpose.

(b) The City covenants and agrees that it has not taken and will not take any action which results in interest to be paid on the Bonds being included in gross income of the holders of the Bonds for federal income tax purposes, and the Borrower covenants and agrees that it has not taken or permitted to be taken and will not take or permit to be taken any action which will cause the interest on the Bonds to become includable in gross income for federal income tax purposes; provided that neither the Borrower nor the City shall have violated these covenants if interest on any of the Bonds becomes taxable to a person solely because such person is a "substantial user" of the Project or a "related person" within the meaning of Section 147(a) of the Code; and provided further that none of the covenants and agreements herein contained shall require either the Borrower or the City to enter an appearance or intervene in any administrative, legislative or judicial proceeding in connection with any changes in applicable laws, rules or regulations or in connection with any decisions of any court or administrative agency or other governmental body affecting the taxation of interest on the Bonds. The Borrower acknowledges having read Section 6.06 of the Indenture and agrees to perform all duties imposed on it by such Section, by this Section and by the Tax Certificate. Insofar as Section 6.06 of the Indenture and the Tax Certificate impose duties and responsibilities on the City or the Borrower, they are specifically incorporated herein by reference.

(c) Notwithstanding any provision of this Section 5.6 or Section 6.06 of the Indenture, if the Borrower shall provide to the City and the Trustee an Opinion of Bond Counsel to the effect that any specified action required under this Section 5.6 and Section 6.06 of the Indenture is no longer required or that some further or different action is required to maintain the exclusion from federal income tax of interest on the Bonds, the Borrower, the Trustee and the City may conclusively rely on such opinion in complying with the requirements of this Section, and the covenants set forth in this Section 5.6 shall be deemed to be modified to that extent.

SECTION 5.7 NOTICE OF RATE PERIODS. The Borrower shall designate and give timely written notice to the Trustee as required by the Indenture prior to any change in Rate Periods for the Bonds. In addition, if the Borrower shall elect to change Rate Periods in accordance with the Indenture and the Bonds under circumstances requiring the delivery of an Opinion of Bond Counsel, the Borrower shall deliver such opinion to the Trustee concurrently with the giving of notice with respect thereto, and no such change shall be effective without an Opinion of Bond Counsel to the effect that such change is authorized or permitted by the Indenture and the Law and will not adversely affect the Tax-Exempt status of the interest on the Bonds.

SECTION 5.8 REMARKETING OF THE BONDS.

(a) The Borrower agrees to perform all obligations and duties required of it by the Indenture with respect to the remarketing of the Bonds, and, to appoint as set forth below a Remarketing Agent and a Tender Agent meeting the qualifications and otherwise meeting the requirements set forth in this Section 5.8.

(b) Tender Agent.

(i) Appointment and Duties: In order to carry out the duties and obligations of the Tender Agent contained in the Indenture, the Borrower shall appoint a Tender Agent or Tender Agents in order to carry out such duties and obligations, subject to the conditions set forth below. Each Tender Agent shall designate to the Trustee its principal office and signify its acceptance of the duties and obligations imposed upon it under the Indenture by entering into a Tender Agreement with the Borrower and such other parties as shall be appropriate, which may be combined with a Remarketing Agreement into a single document, delivered to the City, the Trustee, the Borrower and the Remarketing Agent, under which the Tender Agent shall agree, particularly (but without limitation):

(A) to perform the duties and comply with the requirements imposed upon it by the Tender Agreement, the Indenture and this Agreement; and (B) to keep such books and records with respect to its activities as Tender Agent as shall be consistent with prudent industry practice and to make such books and records available for inspection by the City, the Trustee and the Borrower at all reasonable times.

(ii) Qualifications: The Tender Agent shall be a financial institution organized and doing business under the laws of the United States or of a state thereof, authorized under such laws to exercise corporate trust powers, having a combined capital and surplus of at least Fifty Million Dollars (\$50,000,000), and subject to supervision or examination by federal or state authority. If such financial institution publishes a report of condition at least annually, pursuant to law or to the requirements of any supervising or examining authority above referred to, then for the purposes of this Section the combined capital and surplus of such financial institution shall be deemed to be its combined capital and surplus as set forth in its most recent report of condition so published.

(c) Remarketing Agent. In order to carry out the duties and obligations contained in the Indenture, the Borrower, by an instrument in writing (which may be the Remarketing Agreement) signed by an Authorized Borrower Representative, shall select the Remarketing Agent for the Bonds subject to the conditions set forth below. The Remarketing Agent shall designate to the Trustee its principal office and signify its acceptance of the duties and obligations imposed upon it under the Indenture by a written instrument of acceptance (which may be the execution of a Remarketing Agreement) delivered to the City, the Trustee and the Borrower under which the Remarketing Agent shall agree, particularly (but without limitation): (i) to perform the duties and comply with the requirements imposed upon it by the Remarketing Agreement, the Indenture and this Agreement; and (ii) to keep such books and records with respect to its activities as Remarketing Agent as shall be consistent with prudent industry practice and to make such books and records available for inspection by the City, the Trustee and the Borrower at all reasonable times.

(d) Remarketing Agreement. In order to provide for the remarketing of the Bonds, the Borrower shall enter into a Remarketing Agreement with the Remarketing Agent and such other parties as shall be appropriate, which may be combined with a Tender Agreement into a single document. The Remarketing Agreement shall include the following: (i) a requirement that the Remarketing Agreement shall not be terminated by the Borrower without cause for a period of at least six months after the effective date thereof; and (ii) a statement to the effect that the Remarketing Agent is not acting in an agency capacity with respect to the Borrower in establishing interest rates and Rate Periods as described in Section 2.01 of the Indenture, but is acting as agent of the City pursuant to the Law with respect to such functions.

SECTION 5.9 NOTICES TO TRUSTEE AND CITY. The Borrower hereby agrees to provide the Trustee and the City with notice of any event of which it has knowledge which, with the passage of time or the giving of notice, would be an Event of Default, such notice to include a description of the nature of such event and what steps are being taken to remedy such Event of Default.

SECTION 5.10 CONTINUING DISCLOSURE. The Borrower hereby covenants and agrees, upon the adjustment of the Rate Period for the Bonds to a Term Rate Period pursuant to Section 2.01(c)(iv) of the Indenture and the remarketing of such Bonds in accordance with the Indenture, to comply with the continuing disclosure requirements for the Bonds as promulgated under Rule 15c2-12, as it may from time to time hereafter be amended or supplemented. Notwithstanding any other provision of this Agreement, failure of the Borrower to comply with the requirements of Rule 15c2-12 applicable to the Bonds, as it may from time to time hereafter be amended or supplemented, shall not be considered an Event of Default hereunder or under the Indenture; however, any Bondholder or beneficial owner of any Bonds may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the Borrower to comply with its obligations pursuant to this Section 5.10.

#### ARTICLE VI

##### EVENTS OF DEFAULT AND REMEDIES

SECTION 6.1 EVENTS OF DEFAULT. Any one of the following which occurs and continues shall constitute an Event of Default pursuant to this Agreement:

(a) failure by the Borrower to pay any amounts required to be paid under Section 4.2(a) or 4.2(d) hereof at the times required to avoid causing an Event of Default pursuant to the Indenture; or

(b) failure of the Borrower to observe and perform any covenant, condition or agreement on its part required to be observed or performed by this Agreement, other than making the payments referred to in (a) above, which continues for a period of 60 days after written notice, which notice shall specify such failure and request that it be remedied, given to the Borrower by the City or the Trustee, unless the

City and the Trustee shall agree in writing to an extension of such time; provided, however, that if the failure stated in the notice cannot be corrected within such period, the City and the Trustee will not unreasonably withhold their consent to an extension of such time if corrective action is instituted within such period and diligently pursued until the default is corrected; or

(c) an Act of Bankruptcy of the Borrower; or

(d) a default under any Credit Facility if the Credit Provider notifies the Trustee in writing that such default shall be treated as an Event of Default hereunder.

The provisions of subsection (b) of this Section are subject to the limitation that the Borrower shall not be deemed in default if and so long as the Borrower is unable to carry out its agreements hereunder by reason of strikes, lockouts or other industrial disturbances; acts of public enemies; orders of any kind of the government of the United States or of the State of California or any of their departments, agencies, or officials, or any civil or military authority; insurrections, riots, epidemics, landslides; lightning; earthquake; fire; hurricanes; storms; floods; washouts; droughts; arrests; restraint of government and people; civil disturbances; explosions; breakage or accident to machinery, transmission pipes or canals; partial or entire failure of utilities; or any other cause or event not reasonably within the control of the Borrower; it being agreed that the settlement of strikes, lockouts and other industrial disturbances shall be entirely within the discretion of the Borrower, and the Borrower shall not be required to make settlement of strikes, lockouts and other industrial disturbances by acceding to the demands of the opposing party or parties when such course is, in the judgment of the Borrower, unfavorable to the Borrower. This limitation shall not apply to any default under subsections (a), (c) or (d) of this Section.

SECTION 6.2 REMEDIES ON DEFAULT. Whenever any Event of Default shall have occurred and shall continue, the following remedies may be pursued:

(a) The Trustee may, and upon the written request of any Credit Provider or the holders of not less than 25% in aggregate principal amount of Bonds then outstanding, shall, by notice in writing delivered to the Borrower with copies of such notice being sent to the City and each Credit Provider, declare the unpaid balance of the loan payable under Section 4.2(a) of this Agreement and the interest accrued thereon to be immediately due and payable and such principal and interest shall thereupon become and be immediately due and payable. Upon any such acceleration, the Bonds shall be subject to mandatory redemption as provided in Section 4.01(b)(3) of the Indenture. After any such declaration of acceleration, the Trustee shall immediately take such actions as necessary to realize moneys under any Credit Facility.

(b) The Trustee shall have access to and the right to inspect, examine and make copies of the books and records and any and all accounts, data and federal income tax and other tax returns of the Borrower.

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(c) The City or the Trustee may take whatever action at law or in equity as may be necessary or desirable to collect the payments and other amounts then due and thereafter to become due or to enforce performance and observance of any obligation, agreement or covenant of the Borrower under this Agreement.

The provisions of clause (a) of the preceding paragraph, however, are subject to the condition that if, at any time after the loan shall have been so declared due and payable, and before any judgment or decree for the payment of the moneys due shall have been obtained or entered as hereinafter provided, there shall have been deposited with the Trustee a sum sufficient (together with any amounts held in the Bond Fund) to pay all the principal of the Bonds matured prior to such declaration and all matured installments of interest (if any) upon all the Bonds, with interest on such overdue installments of principal as provided herein, and the reasonable expenses of the Trustee, and any and all other defaults known to the Trustee (other than in the payment of principal of and interest on the Bonds due and payable solely by reason of such declaration) shall have been made good or cured to the satisfaction of the Trustee or provision deemed by the Trustee to be adequate shall have been made therefor, then, and in every such case, the holders of at least a majority in aggregate principal amount of the Bonds then outstanding, by written notice to the City and to the Trustee, may,

on behalf of the holders of all the Bonds, rescind and annul such declaration and its consequences and waive such default; provided that no such rescission and annulment shall extend to or shall affect any subsequent default, or shall impair or exhaust any right or power consequent thereon; and provided further that there shall not be rescinded or annulled any such declaration which follows an event described in Section 6.1(d) without the written consent of the Credit Provider.

In case the Trustee or the City shall have proceeded to enforce its rights under this Agreement and such proceedings shall have been discontinued or abandoned for any reason or shall have been determined adversely to the Trustee or the City, then, and in every such case, the Borrower, the Trustee and the City shall be restored respectively to their several positions and rights hereunder, and all rights, remedies and powers of the Borrower, the Trustee and the City shall continue as though no such action had been taken (provided, however, that any settlement of such proceedings duly entered into by the City, the Trustee or the Borrower shall not be disturbed by reason of this provision).

In case the Borrower shall fail forthwith to pay amounts due by reason of this Section 6.2 upon demand of the Trustee, the Trustee shall be entitled and empowered to institute any action or proceeding at law or in equity for the collection of the sums so due and unpaid, and may prosecute any such action or proceeding to judgment or final decree, and may enforce any such judgment or final decree against the Borrower and collect in the manner provided by law the moneys adjudged or decreed to be payable.

In case proceedings shall be pending for the bankruptcy or for the reorganization of the Borrower under the federal bankruptcy laws or any other applicable law, or in case a receiver or trustee shall have been appointed for the property of the Borrower or in the case of any other similar judicial proceedings relative to the Borrower, or the creditors or property of the Borrower, then the Trustee shall be entitled and empowered, by intervention in such proceedings or otherwise, to file and prove a claim or claims for the whole amount owing and

unpaid pursuant to this Agreement and, in case of any judicial proceedings, to file such proofs of claim and other papers or documents as may be necessary or advisable in order to have the claims of the Trustee allowed in such judicial proceedings relative to the Borrower, its creditors or its property, and to collect and receive any moneys or other property payable or deliverable on any such claims, and to distribute such amounts as provided in the Indenture after the deduction of its charges and expenses. Any receiver, assignee or trustee in bankruptcy or reorganization is hereby authorized to make such payments to the Trustee, and to pay to the Trustee any amount due it for compensation and expenses, including expenses and fees of counsel incurred by it up to the date of such distribution.

SECTION 6.3 AGREEMENT TO PAY ATTORNEYS' FEES AND EXPENSES. In the event the Borrower should default under any of the provisions of this Agreement and the City or the Trustee should employ attorneys or incur other expenses for the collection of the payments due under this Agreement or the enforcement of performance or observance of any obligation or agreement on the part of the Borrower herein contained, the Borrower agrees to pay to the City or the Trustee the reasonable fees of such attorneys and such other expenses so incurred by the City or the Trustee.

SECTION 6.4 NO REMEDY EXCLUSIVE. No remedy herein conferred upon or reserved to the City or the Trustee is intended to be exclusive of any other available remedy or remedies, but each and every such remedy shall be cumulative and shall be in addition to every other remedy given under this Agreement or now or hereafter existing at law or in equity or by statute. No delay or omission to exercise any right or power accruing upon any default shall impair any such right or power or shall be construed to be a waiver thereof, but any such right and power may be exercised from time to time and as often as may be deemed expedient. In order to entitle the City or the Trustee to exercise any remedy reserved to it in this Article, it shall not be necessary to give any notice, other than such notice as may be herein expressly required. Such rights and remedies as are given the City hereunder shall also extend to the Trustee, and the Trustee and the holders of the Bonds shall be deemed third party beneficiaries of all covenants and agreements herein contained.

SECTION 6.5 NO ADDITIONAL WAIVER IMPLIED BY ONE WAIVER. In the event any agreement or covenant contained in this Agreement should be breached by the Borrower and thereafter waived by the City or the Trustee, such waiver shall be limited to the particular breach so waived and shall not be deemed to waive any other breach hereunder.

#### ARTICLE VII PREPAYMENT

SECTION 7.1 REDEMPTION OF BONDS WITH PREPAYMENT MONEYS. By virtue of the assignment of certain of the rights of the City under this Agreement to the Trustee as is provided in Section 4.4 hereof, the Borrower agrees to and shall pay directly to the Trustee any amount permitted or required to be paid by it under this Article VII. The Trustee shall use the moneys so paid to it by the Borrower to effect redemption of the Bonds in

accordance with Article IV of the Indenture on the date specified for such redemption pursuant to Section 7.5 hereof.

SECTION 7.2 OPTIONS TO PREPAY INSTALLMENTS. The Borrower shall have the option to prepay the amounts payable under Section 4.2 hereof, in whole or in part, by paying to the Trustee, for deposit in the Bond Fund, the amount set forth in Section 7.4 hereof, under the circumstances set forth in Section 4.01(a) of the Indenture; provided, however, that if any event specified in Section 4.01(a)(1)(A) through (D) of the Indenture gives rise to the Borrower's exercise of its option to prepay such amounts payable hereunder, the amount of such loan payment prepaid shall not exceed the original cost of the portion of the Project affected by such event.

SECTION 7.3 MANDATORY PREPAYMENT. (a) The Borrower shall have and hereby accepts the obligation to prepay Repayment Installments to the extent mandatory redemption of the Bonds is required pursuant to Section 4.01(b) of the Indenture. The Borrower shall satisfy its obligation hereunder by prepaying such Repayment Installments within one hundred eighty (180) days after the occurrence of any event set forth in paragraphs (1) through (3) of said Section 4.01(b) giving rise to such required prepayment, and immediately upon the occurrence of any event set forth in paragraph (3) thereof giving rise to such required prepayment. The amount payable by the Borrower in the event of a prepayment required by this Section shall be determined as set forth in Section 7.4 and shall be deposited in the Bond Fund.

SECTION 7.4 AMOUNT OF PREPAYMENT. In the case of a prepayment of the entire amount due hereunder pursuant to Section 7.2 or 7.3 hereof, the amount to be paid shall be a sum sufficient, together with other funds and the yield on any securities deposited with the Trustee and available for such purpose, to pay (1) the principal of all Bonds outstanding on the redemption date specified in the notice of redemption, plus interest accrued and to accrue to the payment or redemption date of the Bonds, plus premium, if any, pursuant to the Indenture, (2) all reasonable and necessary fees and expenses of the City, the Trustee, the Registrar, the Tender Agent and any Paying Agent accrued and to accrue through final payment of the Bonds, and (3) all other liabilities of the Borrower accrued and to accrue under this Agreement.

In the case of partial prepayment of the Repayment Installments, the amount payable shall be a sum sufficient, together with other funds deposited with the Trustee and available for such purpose, to pay the principal amount of and premium, if any, and accrued interest on the Bonds to be redeemed, as provided in the Indenture, and to pay expenses of redemption of such Bonds.

SECTION 7.5 NOTICE OF PREPAYMENT. The Borrower shall give forty-five days' prior written notice to the City and the Trustee specifying the date upon which any prepayment pursuant to this Article VII will be made. If, in the case of a mandatory prepayment pursuant to Section 7.3 hereof, the Borrower fails to give such notice of a prepayment required by this Section 7.5, such notice may be given by the City or by any holder or holders of ten percent (10%) or more in aggregate principal amount of the Bonds Outstanding, and shall be given by the Trustee, but solely at the times and under the

circumstances provided in Section 4.01(b) of the Indenture. The City and the Trustee, at the request of the Borrower or any such Bondholder or Bondholders, shall forthwith take all steps necessary under the applicable provisions of the Indenture (except that the City shall not be required to make payment of any money required for such redemption) to effect redemption of all or part of the then outstanding Bonds, as the case may be, on the earliest practicable date thereafter on which such redemption may be made under applicable provisions of the Indenture.

Notwithstanding anything to the contrary in this Agreement, each notice contemplated in this Section 7.5 that is given with respect to an optional prepayment pursuant to Section 7.2 hereof may state that it is subject to and conditional upon receipt by the Trustee on or prior to the proposed prepayment date of amounts sufficient to effect such prepayment and, if a notice so states, such notice shall be of no force and effect and the prepayment need not be made and the Repayment Installments will not become due and payable on the proposed prepayment date unless such amounts are so received on or prior to the proposed prepayment date.

#### ARTICLE VIII

##### NON-LIABILITY OF CITY; EXPENSES; INDEMNIFICATION

SECTION 8.1 NON-LIABILITY OF CITY. The City shall not be obligated to pay the principal of, or premium, if any, or interest on the Bonds, or to discharge any other financial liability (including but not limited to financial liability under Section 5.6 hereof) in connection herewith, except from Revenues. The Borrower hereby acknowledges that the City's sole source of moneys to repay the Bonds will be provided by the payments made by the Borrower pursuant to this Agreement (excluding payments to the City or the Trustee pursuant to Section 4.2(b), 4.2(c), 4.2(e), 5.6, 6.3, 8.2 and 8.3 of this Agreement), together with other Revenues, including investment income on certain funds and accounts held by the Trustee under the Indenture, and hereby agrees that if the payments to be made hereunder shall ever prove insufficient to pay all principal of, and premium, if any, and interest on the Bonds as the same shall become due (whether by maturity, redemption, acceleration or otherwise), then upon notice from the Trustee, the Borrower shall pay such amounts as are required from time to time to prevent any deficiency or default in the payment of such principal, premium or interest, including, but not limited to, any deficiency caused by acts, omissions, nonfeasance or malfeasance on the part of the Trustee, the Borrower, the City or any third party.

SECTION 8.2 EXPENSES. The Borrower covenants and agrees to pay within fifteen (15) days after billing therefor and to indemnify the City and the Trustee against all costs and charges, including fees and disbursements of attorneys, accountants, consultants, including financial consultants, engineers and other experts incurred, in the absence of willful misconduct, in connection with this Agreement, the Bonds or the Indenture. The City shall notify the Borrower in writing prior to engaging any professional or expert for which the City plans to bill the Borrower.

SECTION 8.3 INDEMNIFICATION. The Borrower releases

the City and the Trustee from, and covenants and agrees that neither the City nor the Trustee shall be liable for, and covenants and agrees, to the extent permitted by law, to indemnify, defend and hold harmless the City and the Trustee and their officers, employees and agents from and against, any and all losses, claims, damages, liabilities or expenses, of every conceivable kind, character and nature whatsoever arising out of, resulting from or in any way connected with (1) the Project, or the conditions, occupancy, use, possession, conduct or management of, or work done in or about, or from the planning, design, acquisition, installation or construction of the Project or any part thereof; (2) the issuance of any Bonds or any certifications, covenants or representations made in connection therewith and the carrying out of any of the transactions contemplated by the Bonds, the Indenture and this Agreement; (3) the Trustee's acceptance or administration of the trusts under the Indenture, or the exercise or performance of any of its powers or duties under the Indenture or this Agreement; or (4) any untrue statement or alleged untrue statement of any material fact or omission or alleged omission to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading, in any official statement or other offering circular utilized by the City or any underwriter or placement agent in connection with the sale of any Bonds; provided that such indemnity shall not be required for damages that result from negligence or willful misconduct on the part of the party seeking such indemnity. The indemnity of the Trustee required by this Section shall be only to the extent that any loss sustained by the Trustee exceeds the net proceeds the Trustee receives from any insurance carried with respect to the loss sustained. The Borrower further covenants and agrees, to the extent permitted by law, to pay or to reimburse the City and the Trustee and their officers, employees and agents for any and all reasonable costs, including but not limited to attorneys fees, liabilities or expenses incurred in connection with investigating, defending against or otherwise in connection with any such losses, claims, damages, liabilities, expenses or actions, except to the extent that the same arise out of the negligence or willful misconduct of the party claiming such payment or reimbursement. The provisions of this Section shall survive the retirement of the Bonds or resignation or removal of the Trustee.

ARTICLE IX  
MISCELLANEOUS

SECTION 9.1 NOTICES. All notices, certificates or

other communications shall be deemed sufficiently given on the second day following the day on which the same have been mailed by first class mail, postage prepaid, addressed to the City, the Borrower or the Trustee, as the case may be, as set forth in the Indenture. A duplicate copy of each notice, certificate or other communication given hereunder by either the City or the Borrower to the other shall also be given to the Trustee. The City, the Borrower and the Trustee may, by notice given hereunder, designate any different addresses to which subsequent notices, certificates or other communications shall be sent.

SECTION 9.2 SEVERABILITY. If any provision of this

Agreement shall be held or deemed to be, or shall in fact be, illegal, inoperative or unenforceable, the same shall

not affect any other provision or provisions herein contained or render the same invalid, inoperative, or unenforceable to any extent whatever.

SECTION 9.3 EXECUTION OF COUNTERPARTS. This Agreement may be simultaneously executed in several counterparts, each of which shall be an original and all of which shall constitute but one and the same instrument; provided, however, that for purposes of perfecting a security interest in this Agreement under Article 9 of the California Uniform Commercial Code, only the counterpart delivered, pledged, and assigned to the Trustee shall be deemed the original.

SECTION 9.4 AMENDMENTS, CHANGES AND MODIFICATIONS. Except as otherwise provided in this Agreement or the Indenture, subsequent to the initial issuance of Bonds and prior to their payment in full, or provision for such payment having been made as provided in the Indenture, this Agreement may not be effectively amended, changed, modified, altered or terminated without the written consent of the Trustee.

SECTION 9.5 GOVERNING LAW. This Agreement shall be governed exclusively by and construed in accordance with the applicable laws of the State of California.

SECTION 9.6 AUTHORIZED BORROWER REPRESENTATIVE. Whenever under the provisions of this Agreement the approval of the Borrower is required or the City or the Trustee is required to take some action at the request of the Borrower, such approval or such request shall be given on behalf of the Borrower by an Authorized Borrower Representative, and the City and the Trustee shall be authorized to act on any such approval or request and neither party hereto shall have any complaint against the other or against the Trustee as a result of any such action taken.

SECTION 9.7 TERM OF THE AGREEMENT. This Agreement shall be in full force and effect from the date hereof and shall continue in effect as long as any of the Bonds are outstanding or the Trustee holds any moneys under the Indenture, whichever is later; provided, however, that the rights of the Trustee and the City under Section 8.2 and 8.3 hereof shall survive the termination of this Agreement, the retirement of the Bonds and the removal or resignation of the Trustee. All representations and certifications by the Borrower as to all matters affecting the Tax-Exempt status of the Bonds shall survive the termination of this Agreement.

SECTION 9.8 BINDING EFFECT. This Agreement shall inure to the benefit of and shall be binding upon the City, the Borrower, the Trustee and their respective successors and assigns; subject, however, to the limitations contained in Section 5.2 hereof.

IN WITNESS WHEREOF, the City of Chula Vista has caused this Agreement to be executed in its name and its seal to be hereunto affixed and attested by its duly authorized officers, and San Diego Gas & Electric Company has caused this Agreement to be executed in its name and its seal to be hereunto affixed by its duly authorized officers, all as of the date first above written.

CITY OF CHULA VISTA

By \_\_\_\_\_  
Mayor

[SEAL]  
Attest:

\_\_\_\_\_  
City Clerk

APPROVED AS TO FORM:

JOHN M. KAHENY  
CITY ATTORNEY

By \_\_\_\_\_  
Deputy City Attorney

SAN DIEGO GAS & ELECTRIC COMPANY

Vice President and Controller  
[SEAL]  
Attest:

By \_\_\_\_\_

\_\_\_\_\_  
Assistant Secretary

EXHIBIT A

Description of the Project

Local Electric Facilities

Acquisition and construction of additions and improvements to the Borrower's electric distribution facilities (12 KV and under) and related substations, and customer service connections located within the Borrower's electric retail service area, required by the Borrower to provide for the transfer and distribution of electric energy to its customers located therein, including all necessary poles, foundations, cable, conduit, transformers, switches, controls, meters, substations, land and land rights and other like facilities and equipment, as well as necessary other equipment required for the proper installation, protection, maintenance, control and operation of the foregoing local electric distribution facilities. These facilities will be required to meet the needs of new customers, maintain and improve system capabilities, and make overhead to underground conversions.

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An extra section break has been inserted above this paragraph. Do not delete this section break if you plan to add text after the Table of Contents/Authorities. Deleting this break will cause Table of Contents/Authorities headers and footers to appear on any pages following the Table of Contents/Authorities.

Between

SAN DIEGO GAS & ELECTRIC COMPANY, a  
California corporation with its  
principal office of business in San  
Diego, California ("SDG&E")

- and -

HUSKY OIL OPERATIONS LTD., an Alberta  
corporation with its principal place of  
business in Calgary, Alberta ("H00L")  
and HUSKY GAS MARKETING INC., a Delaware  
corporation with its principal place of  
business in Calgary, Alberta ("HGMI")  
(collectively, "Seller")

Whereas:

1. SDG&E and H00L are parties to a Natural Gas Purchase Agreement made as of March 12, 1991 as amended by an Amending Agreement made effective as of November 1, 1994 and a Second Amending Agreement made effective as of January 1, 1997 ("Agreement"); and
2. the parties wish to amend the Agreement in the manner hereinafter set forth and to include HGMI as a party to the Agreement.

Now therefore in consideration of the premises and the mutual covenants herein contained, the parties agree as follows:

1. The terms and expressions which are defined in the Agreement shall have the same meanings where used in this Third Amending Agreement.
2. Section 1.1 is amended to add the following as clauses to Section 1.1:
  - (a-1) "Assigned ANG Transportation" means, initially, the firm transportation service described in clause 1.1(ii)(1), subject to any reduction which occurs from time to time when Seller assigns all or

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any portion of such service to SDG&E pursuant to any term of this Agreement;

- (a-2) "Assigned PGT Transportation" means, initially, the firm transportation service described in clause 1.1(ii)(2), subject to any reduction which occurs from time to time when Seller assigns all or any portion of service to SDG&E pursuant to any term of this Agreement;
- (a-3) "Assigned PG&E Transportation" means, initially, the transportation service described in clause 1.1(ii)(3), subject to any reduction which occurs from time to time when Seller assigns all or any portion of such service to SDG&E pursuant to any term of this Agreement;
- (a-4) "Assignment Transporters" means, collectively, ANG, PGT and PG&E and "Assignment Transporter" means any one of them, as the context requires;
- (k-1) "Demand Charges" means amounts payable from time to time by a shipper to a pipeline entity pursuant to contract or as may be mandated to be paid by any regulatory body or agency or by legislation or regulations, to reserve and maintain the right to transport quantities or volumes of gas on a firm basis for an agreed-to period of time on a pipeline

and which are payable irrespective of actual quantities or volumes shipped including, without limitation, any amounts chargeable to a shipper's account as costs, charges, surcharges, or levies for that firm service entitlement;

- (y-1) "Netback Price" means the Contract Price less Seller's Unit Transportation Costs;
- (ee-1) "Reassignment Date" means the earlier of (i) the date that the temporary assignments referred to in the definition of Seller's Transportation have terminated and Seller's Transportation has reverted to SDG&E, and (ii) the date that all of Seller's Transportation has been reassigned by Seller to SDG&E pursuant to this Agreement.

3. Section 1.1 is further amended as follows:

- (a) Subsection 1.1(j) is amended to (1) delete the references to "Mountain Standard Time" and "Mountain Daylight Time" and to replace those references with "Pacific Standard Time" and "Pacific

Daylight Time", respectively, (2) delete the reference to "NOVA" and to replace reference with "PG&E", and (3) delete each reference to "8:00 o'clock a.m." and to replace those references with "12:00 midnight".

- (b) Subsection 1.1(k) is deleted and replaced with the following:

"Delivery Point" shall mean the interconnection of the facilities of PG&E and SoCal on the upstream side of Wheeler Ridge or such other point as is mutually agreed to by the parties pursuant to Section 8.3;

- (c) Subsection 1.1(v) is deleted and replaced with the following:

"Maximum Daily Quantity" or "MDQ" shall mean (prior to the Authorization Date) the lesser of:

- (1) ABC Heat Value Equivalent

$$\frac{\text{ABC Heat Value Equivalent}}{(1 + \text{ANG Fuel\%}) \times (1 + \text{PGT Fuel\%}) \times (1 + \text{PG\&E Fuel\%})}$$

and

- (2) the firm delivery capacity available under the Assigned PG&E Transportation on that Day reduced by PG&E's line loss percentage in effect for that Day pursuant to PG&E's tariff and increased or reduced to reflect any reduction or increase respectively in PG&E's fuel gas ratio for that day (pursuant to PG&E's tariff) below or above 1.11%.

and

"Maximum Daily Quantity" or "MDQ" shall mean (following the Authorization Date) the lesser of:

- (1) ABC Heat Value Equivalent

$$\frac{\text{ABC Heat Value Equivalent}}{(1 + \text{ANG Fuel\%}) \times (1 + \text{PGT Fuel\%}) \times (1)}$$

and

- (2) the firm delivery capacity available under the Assigned PG&E Transportation on that Day.

Where:

"ABC Heat Value Equivalent" means, for each Day, the Heating Value of 619.8 103m3 of gas determined at the interconnection of the NOVA and ANG systems at the Alberta-British Columbia border calculated using NOVA's weighted average heating value for all gas delivered to that point on that Day (expressed in MMBtus using the conversions in Section 21.3).

"ANG Fuel %" means, for each Day, the fuel gas ratio in effect for that Day pursuant to ANG's tariff expressed as a decimal number (i.e., an ANG fuel ratio of 1.6% is converted to ".016" before being used in the denominator of the formula in paragraph 1.1(v)(1)).

"PGT Fuel %" means, for each Day, the fuel gas ratio in effect for that Day pursuant to PGT's tariff expressed as a decimal number (i.e., a PGT fuel ratio of 3% is converted to ".03" before being used in the denominator of the formula in paragraph 1.1(v)(1)).

"PG&E Fuel %" means, for each Day, the fuel gas ratio in effect for that Day pursuant to PG&E's tariff expressed as a decimal number (i.e., a PG&E fuel ratio of 1.11% is converted to ".0111" before being used in the denominator of the formula in paragraph 1.1(v)(1)).

"Authorization Date" means the date that the amendment dated December 10, 1996 between PG&E and SDG&E (which amends SDG&E's Firm Transportation Service Agreement dated December 31, 1991, as amended March 18, 1994) becomes effective following the receipt of all required approvals from the CPUC (such amendment being more particularly described in PG&E's Advice 2003-G dated January 31, 1997 to the CPUC).

- (d) Subsection 1.1(aa) is amended to delete the words "the MDQ into the NOVA system and deliver the MDQ to the Delivery Point" and to replace those words with the following:

into the NOVA system the volume of gas required for NOVA to deliver 619.8 103m3 of gas each Day to the inter-connection of the NOVA and ANG systems at the Alberta-British Columbia border, such volume to be proportionately reduced by each decrease in the MDQ pursuant to this Agreement;

- (e) Subsection 1.1(gg) is amended to delete the reference to "SDG&E's Transporters" from the fourth line and to replace that term with "ANG, PGT and PG&E".

- (f) Subsection 1.1(ii) is deleted and replaced with the following:

"Seller's Transportation" means, collectively:

- (1) ANG FS-1 transportation service for firm delivery capacity at Kingsgate, British Columbia of 610 103m<sup>3</sup> per day;
- (2) PGT T-3 transportation service for firm delivery capacity at Malin, Oregon of 21,323 MMBtus per day; and
- (3) PG&E Line 401 transportation service for firm delivery capacity at Kern River Station of 21,089 MMBtus per day,

which has been temporarily assigned by SDG&E to Seller for the period from November 1, 1997 to August 1, 2003, subject to earlier reassignment (in whole or in part) by Seller to SDG&E from time to time pursuant to the terms of this Agreement;

- (g) Subsection 1.1(jj) is deleted and replaced with the following:

"Seller" means, collectively, HOOL and HGMI except when the context requires that "Seller" refer to only one of HOOL and HGMI;

- (h) Subsection 1.1(kk) is deleted and replaced with the following:

"Seller's Unit Transportation Costs" has the meaning ascribed to this term in Section 6.1;

- (i) Subsection 1.1(11) is deleted and replaced with the following:

"Seller's Regulatory Authorities" means each federal, provincial, state and local government agency or other authority in Canada and in the United States, which has jurisdiction over the sale and removal from Alberta, the export from Canada, the import into the United States, and transportation on Seller's Transportation, of gas to be sold and purchased hereunder including, without limitation, the Alberta Energy and Utilities Board, the National Energy Board of Canada, the Alberta and federal Governors-in-Council, the Office of Fossil Energy of the United States Department of Energy, the Federal Energy Regulatory Commission and the California Public Utilities Commission.

4. Section 1.3 is amended to delete the reference to "Mountain Standard Time ("MST")" and to replace that reference with "Pacific Standard Time ("PST")".
5. Article II is amended to delete Sections 2.1-2.7 inclusive, to replace those sections with the following Sections 2.1-2.5, and to re-title the Article "Seller's Transportation":

#### 2.1 TRANSPORTATION MAINTENANCE OBLIGATIONS

Seller covenants, represents and warrants to SDG&E that:

- (a) Seller shall use Seller's Transportation to deliver gas to SDG&E in accordance with Seller's obligations under this Agreement;
- (b) until the Reassignment Date and subject to SDG&E's performance of its obligations under Section 2.2, Seller shall maintain the Seller's Transportation in good standing including, without limitation, Seller shall be responsible for and timely pay to the Assignment Transporters all amounts which are due or become due under the Seller's Transportation from time to time and perform all of the other obligations of the shipper relating to that transportation service;
- (c) Seller shall promptly reassign Seller's Transportation to SDG&E when required pursuant to this Agreement;
- (d) Seller shall not amend, encumber, assign, broker, terminate, allow to terminate or expire, surrender, release, waive non-performance under, or in any other way modify or alienate its interest in any of Seller's Transportation except as first approved in writing by SDG&E;
- (e) Seller shall promptly provide SDG&E with copies of all notices and other communications of any kind whatsoever given to any Assignment Transporter by Seller or received by Seller from any Assignment Transporter including, without limitation, invoices, non-payment notices, and other reports or other information provided by any of the Assigned Transporters and required or reasonably requested by SDG&E from time to time but excluding other day-to-day nomination notices and nomination confirmations and the PG&E 120 daily Report (Scheduled Transactions) (and any replacements or substitutions for that Report) except when specifically requested by SDG&E from time to time;

- (f) Seller shall keep SDG&E timely informed of all material matters relating to each of Seller's Transportation agreements; and
- (g) SDG&E shall have the right, from time to time, to review Seller's records which pertain to the administration and operation of Seller's Transportation.

For the purposes of certainty, it is understood that Seller's Transportation contains the specific firm capacity rights described in paragraphs 1.1(ii)(1)-(3) (in the definition of Seller's Transportation) and Seller's firm capacity rights on each of the Assignment Transporters pursuant to the Seller's Transportation shall not be increased or reduced in the event SDG&E either takes additional capacity on any Assignment Transporter or releases or otherwise disposes of any of its other existing firm service capacity on any of the Assignment Transporters.

## 2.2 PIPELINE FINANCIAL ASSURANCES

SDG&E shall maintain in effect, with the Assignment Transporters, all financial assurances and arrangements ("SDG&E Assurances") which SDG&E currently has in place with each of the Assignment Transporters (to the extent each Assignment Transporter continues to require the continuation of the SDG&E assurances). Seller shall be responsible for timely providing and maintaining, at its sole expense, any financial assurances and arrangements (including letters of credit) which are required by any of the Assignment Transporters in addition to the SDG&E assurances but only if those additional assurances would not be required to be provided by SDG&E if SDG&E had remained as the sole shipper of record under the applicable Seller's Transportation. If additional financial assurances are requested of Seller by any Assignment Transporter, SDG&E shall provide those additional financial assurances if SDG&E would have been required to provide those additional assurances had it remained the sole shipper of record under Seller's Transportation.

## 2.3 TRANSPORTATION INDEMNITY

- (a) Seller agrees to and shall at all times indemnify and save harmless SDG&E, and SDG&E's directors, officers, employees and agents (collectively the "SDG&E Indemnitees") from and against any and all:
  - (i) claims, demands, liabilities, actions and prosecutions of any nature or kind whatsoever which may be asserted, made or brought against the SDG&E Indemnitees, or any of them; and
  - (ii) losses, damages, and expenses of any nature or kind whatsoever which may be incurred, suffered or sustained by the SDG&E Indemnitees, or any of them, to the extent directly or indirectly resulting from, contributed by or attributable to any breach by Seller of any of its obligations under this Article.
- (b) For purposes of certainty, it is agreed that the parties comprising Seller shall be jointly and severally liable for the performance of all obligations in respect of each of Seller's Transportation agreements and the indemnification in subsection 2.3(a) notwithstanding that only one party comprising Seller is a party to each of Seller's Transportation agreements.
- (c) SDG&E agrees to and shall at all times indemnify and save harmless Seller, and Seller's directors, officers, employees and agents (collectively, the "Seller's Indemnitees") from and against any and all:
  - (i) claims, demands, liabilities, actions and prosecutions of any nature or kind whatsoever which may be asserted, made or brought against the Seller's Indemnitees, or any of them; and

(ii) costs, losses, damages, and expenses of any nature or kind whatsoever which may be incurred, suffered or sustained by the Seller's Indemnitees, or any of them,

to the extent directly or indirectly resulting from, contributed by or attributable to any breach by SDG&E of any of its obligations under this Article.

#### 2.4 TRANSPORTATION DEFAULT

(a) In the event Seller defaults in any of its obligations under this Article, SDG&E shall have the right (but not the obligation) to require that Seller reassign Seller's Transportation to SDG&E and take all other steps as are reasonably required to terminate the temporary assignments (described in the definition of Seller's

Transportation) in order for SDG&E to be recognized by the Assignment Transporters as the sole shipper of record in respect of Seller's Transportation. Upon receipt of a notice from SDG&E identifying Seller's default and requiring the return of all of Seller's Transportation, Seller shall promptly take all steps required to cause the return of Seller's Transportation to SDG&E. For purposes of certainty, SDG&E shall be entitled to require the return of all of Seller's Transportation even though Seller's default may pertain to less than all of the Assignment Transporters.

- (b) Effective upon the return of Seller's Transportation to SDG&E, Seller and SDG&E shall, from and after that date, continue to sell and purchase gas for the remainder of the term in Section 3.1 (subject to any other rights or remedies available to SDG&E arising from Seller's non-performance of any of its obligations under this Article) upon the terms of the original Natural Gas Purchase Agreement made as of March 12, 1991 as amended by the Amending Agreement made effective as of November 1, 1994 and the Second Amending Agreement made effective as of January 1, 1997 ("original arrangements"). To the extent any dispute arises in respect of any matter when returning to the original arrangements, either party shall be entitled to refer the matter to a single arbitrator and the decision of the arbitrator shall be binding upon the parties. The arbitration shall be conducted pursuant to the provisions of Section 11(d) of Appendix A to the original arrangements which shall apply, mutatis mutandis, to any arbitration conducted pursuant to this provision. The parties shall use all reasonable efforts to continue performing their respective obligations under this Agreement during any such arbitration proceedings and to make all required adjustments following the receipt of the arbitrator's decision retroactive to the date that Seller's Transportation was returned to SDG&E.
- (c) In the event of a default by Seller in any payment obligation pertaining to any of Seller's Transportation, SDG&E shall be entitled (but not obligated) to make any overdue payment to maintain Seller's Transportation in good standing (without limiting its rights under this Article) and to set off any such payment against any amount then or thereafter payable by SDG&E to Seller under this Agreement.

## 2.5 EARLY TRANSPORTATION REVERSION

(a) In the event that this Agreement terminates prior to August 1, 2003, Seller shall promptly reassign Seller's Transportation to SDG&E and take all other steps as are reasonably required to terminate the temporary assignments (referred to in the definition of Seller's Transportation) in order that SDG&E is recognized by the Assignment Transporters as the sole shipper of record.

6. Subsection 3.1(b) is amended to delete "and (d)" from the first line of that subsection. In addition, subsections 3.1(c) and (d) are deleted and replaced with the following:

(c) If Seller is unable to obtain the long term import authorization (referred to in subsection 12.1(c)) by September 1, 1998, then and promptly following that date, Seller shall take all necessary steps to re-assign the Seller's Transportation to SDG&E effective as of November 1, 1998 and to otherwise ensure that, as of November 1, 1998, SDG&E is recognized by the Assignment Transporters as the sole shipper of record in respect of Seller's Transportation. Without limiting the generality of the foregoing, Seller shall take all steps as are reasonably required to terminate the temporary assignments (described in the definition of Seller's Transportation). All such action shall be taken in a timely manner, taking into account the advance notice requirements of each of the Assignment Transporters, to ensure that SDG&E will be able to place nominations with the Assignment Transporters for November 1, 1998. Effective upon the return of Seller's Transportation to SDG&E, Seller and SDG&E shall, from and after that date, continue to sell and purchase gas for the remainder of the term set out in Section 3.1 (subject to any other rights or remedies available to SDG&E arising from Seller's non-performance of any of its obligations) upon the terms of the original arrangements (as that term is defined in subsection 2.4(b)). For the purposes of effecting such purchases and sales from and after November 1, 1998:

(i) Seller shall continue to use its long term removal permit originally obtained by Seller for the purposes of this Agreement (prior to the Commencement of Firm Deliveries) to remove gas from Alberta for delivery to SDG&E; and

- (ii) SDG&E shall continue to use the long term export licence originally obtained by the parties (on a joint basis) and the long term import authorization originally obtained by SDG&E, in each case for the purposes of this Agreement (prior to the Commencement of Firm Deliveries).

7. Article III is amended to add the following as Sections 3.4, 3.5 and 3.6:

3.4 The parties entered into the Third Amending Agreement (dated as November 1, 1997) to this Agreement ("Third Amendment") with the understanding that the assignment of the Seller's Transportation to Seller and the management and use of that transportation service by Seller will enable Seller to share increased revenues and other benefits (over and above those that Seller would have obtained had the Seller's Transportation remained with SDG&E and the parties performed their obligations and obtained the benefits provided for under the original arrangements, as defined in subsection 2.4(b)). If at any time SDG&E determines, acting reasonably, that Seller is failing to perform in accordance with its obligations hereunder including, without limitation, its obligation to mitigate demand charges payable to the Assignment Transporters, or any of them, for unutilized transportation capacity, then SDG&E shall be entitled to forward a notice ("Election") to Seller electing to terminate the Third Amendment. Upon receipt of the Election, Seller shall take all necessary steps to re-assign the Seller's Transportation to SDG&E and otherwise ensure that, as of the first day of the third month following the month that Seller receives the Election, SDG&E is recognized by the Assignment Transporters as the sole shipper of record in respect of the Seller's Transportation. Without limiting the generality of the foregoing, Seller shall take all steps as are reasonably required to terminate the temporary assignments (described in the definition of Seller's Transportation). All such actions shall be taken in a timely manner, taking into account the advance notice requirements of each of the Assignment Transporters to ensure that SDG&E will be able to place nominations with the Assignment Transporters on the first day of the aforementioned third month (following the month that Seller receives the Election). Effective upon the return of the Seller's Transportation to SDG&E, Seller and SDG&E shall, from and after that date, continue to sell and purchase gas for the remainder of the term set out in Section 3.1 upon the terms of the original arrangements (and the Third Amendment shall thereafter cease to have any force or effect).

3.5 If at any time Seller determines, acting reasonably, either that:

- (a) it has not been able to generate sufficient increased revenues and other benefits as a result of managing and using Seller's Transportation (in accordance with the understanding as expressed in the first sentence of Section 3.4); or
- (b) SDG&E has repeatedly failed to act in a reasonable manner when considering whether to accept Opportunities presented by Seller to SDG&E under Section 4.4 (excluding from that determination any Opportunities rejected by SDG&E for any of the four reasons cited in subsection 4.4(c)),

then Seller shall be entitled to forward a notice ("Assignment Notice") to SDG&E electing to terminate the Third Amendment effective as of the first day of the third month following the month that SDG&E receives the Assignment Notice. Upon SDG&E's receipt of the Assignment Notice, Seller shall take all necessary steps to reassign the Seller's Transportation to SDG&E and otherwise ensure that, as of the first day of the third month following the month that SDG&E receives the Assignment Notice, SDG&E is recognized by the Assignment Transporters as the sole shipper of record in respect of the Seller's Transportation. The last three sentences of Section 3.4 shall apply, mutatis mutandis, to this provision.

3.6 To the extent any dispute arises in respect of any matter when returning to the original arrangements (pursuant to subsection 3.1(c), Section 3.4 or Section 3.5), either party shall be entitled to refer the matter to a single arbitrator and the decision of the arbitrator shall be binding upon the parties. The arbitration shall be conducted pursuant to the provisions of Section 11(d) of Appendix A to the original arrangements which shall apply, mutatis mutandis, to any arbitration conducted pursuant to this provision. The parties shall use all commercially reasonable efforts to continue performing their respective obligations under this Agreement during any such arbitration proceedings and to make all required adjustments following the receipt of the arbitrator's decision retroactive to the date that Seller's Transportation was returned to SDG&E.

8. Section 4.2(a) is amended to delete the words "less an amount equal to any `elected capacity' pursuant to subsection 4.4(b) for such Months."

9. Clause 4.2(b)(1) is deleted and replaced with the following:

(i) the Netback Price less

10. The last sentence of subsection 4.2(b) is amended to delete "the weighted average heat content of all gas received in such Month by SDG&E at the Delivery Point" and to replace those words with the following:

NOVA's weighted average heating value for the Month for all gas delivered by NOVA for the Month at the interconnection of the NOVA and ANG systems at the Alberta-British Columbia border

11. Subsection 4.2(d) is amended to delete the reference to "paragraphs 4.2(a)(i) and (ii)" and to replace that reference with "subsections 4.2(a) and (b)".

12. Subsection 4.2(e) is amended to add the following additional sentences:

If Seller elects to reduce the MDQ pursuant to this subsection, Seller shall have the one time option of reassigning to SDG&E a proportionate share of Seller's Transportation, such proportionate share to be equal to the proportionate reduction in the MDQ elected by Seller. Seller's election to assign such share of Seller's Transportation must be specified in the aforesaid notice to SDG&E (in which Seller elects to reduce the MDQ). For purposes of certainty, any election to reassign transportation service to SDG&E must include a proportionate share of Seller's capacity on all three of the Assignment Transporters. If Seller does not elect to reassign such share of Seller's Transportation to SDG&E (when Seller has elected to reduce the MDQ), then SDG&E shall have the option to require that Seller assign such proportionate share of Seller's Transportation to SDG&E. SDG&E's option must be exercised within 60 days of receipt of Seller's notice electing to reduce the MDQ. In the event SDG&E elects to obtain that transportation service, Seller shall promptly take all steps required to cause the return of that proportionate share of Seller's Transportation to SDG&E. If Seller does not elect to reassign, and SDG&E does not elect to acquire, such proportionate share of Seller's Transportation, Seller shall assume all Demand Charge obligations and other liabilities in respect of that transportation service for the remainder of the term of this Agreement and SDG&E's obligation under Section 4.3 shall be reduced accordingly.

13. Subsection 4.2(f) is deleted.

14. Section 4.3 is deleted and replaced with the following:

#### 4.3 TRANSPORTATION ADJUSTMENT PAYMENT

Each month, SDG&E shall pay to Seller the amount of the Transportation Adjustment Payment ("TAP") for the prior Month calculated as follows:

TAP = Unutilized ANG Service + Unutilized PGT Service + Unutilized PG&E Service

Where:

"Unutilized ANG Service" for a Month means the monthly Demand Charge payable in respect of the Assigned ANG Transportation for that Month (converted to United States dollars pursuant to Section 21.2) ("ANG Toll") less the portion of the ANG Toll which is attributable to:

(a) the sum of

(i) the aggregate quantity of gas (expressed in MMBtus) transported for or sold to a third party by Seller using all or a portion of the Assigned ANG Transportation during that Month,

plus

(ii) the aggregate quantity of fuel gas which is transported using the Assigned ANG Transportation and which is attributable to such third party volumes and sales,

such portion of the ANG Toll to be determined on a 100% load factor basis;

(b) the sum of:

(i) the aggregate quantity of gas (expressed in MMBtus) diverted for that Month under Section 4.4, plus the aggregate quantity of gas (expressed in MMBtus) not delivered by Seller (when nominated by SDG&E) other than due to force majeure,

plus

- (ii) the aggregate quantity of fuel gas which would have been transported using the Assigned ANG Transportation if such aggregate withheld and undelivered quantities had been delivered to SDG&E during the Month,

such portion of the ANG Toll to be determined on a 100% load factor basis; and

(c) the sum of:

- (i) the aggregate quantity of gas (expressed in MMBtus) which is delivered by Seller to SDG&E for the Month,

plus

- (ii) the aggregate quantity of fuel gas which is transported using the Assigned ANG Transportation and which is attributable to gas delivered to SDG&E.

"Unutilized PGT Service" for a Month means the monthly Demand Charge payable in respect of the Assigned PGT Transportation for that Month ("PGT Toll") less the portion of the PGT Toll which is attributable to:

(a) the sum of:

- (i) the aggregate quantity of gas (expressed in MMBtus) transported for or sold by Seller to a third party by Seller using all or a portion of the Assigned PGT Transportation during that Month,

plus

- (ii) the aggregate quantity of fuel gas which is transported using the Assigned PGT Transportation and which is attributable to such third party volumes and sales,

such portion of the PGT Toll to be determined on a 100% load factor basis;

(b) the sum of:

- (i) the aggregate quantity of gas (expressed in MMBtus) diverted for that Month under Section 4.4, plus the aggregate quantity of gas (expressed in MMBtus) not delivered by Seller (when nominated by SDG&E) other than due to force majeure,

plus

- (ii) the aggregate quantity of fuel gas which would have been transported using the Assigned PGT Transportation if such aggregate withheld and undelivered quantities had been delivered to SDG&E during the Month,

such portion of the PGT Toll to be determined on a 100% load factor basis; and

- (c) the sum of:

- (i) the aggregate quantity of gas (expressed in MMBtus) which is delivered by Seller to SDG&E for the Month,

plus

- (ii) the aggregate quantity of fuel gas which is transported using the Assigned PGT Transportation and which is attributable to gas delivered to SDG&E.

"Unutilized PG&E Service" for a Month means the monthly Demand Charge payable in respect of the Assigned PG&E Transportation for that Month ("PG&E Toll") less the portion of the PG&E Toll which is attributable to:

- (a) the sum of:

- (i) the aggregate quantity of gas (expressed in MMBtus) transported for or sold by Seller to a third party by Seller using all or a portion of the Assigned PG&E Transportation during that Month,

plus

- (ii) the aggregate quantity of fuel gas which is transported using the Assigned PG&E Transportation and which is attributable to such third party volumes and sales,

such portion of the PG&E Toll to be determined on a 100% load factor basis;

(b) the sum of:

- (i) the aggregate quantity of gas (expressed in MMBtus) diverted for that Month under Section 4.4, plus the aggregate quantity of gas (expressed in MMBtus) not delivered by Seller (when nominated by SDG&E) other than due to force majeure,

plus

- (ii) the aggregate quantity of fuel gas which would have been transported using the Assigned PG&E Transportation if such aggregate withheld and undelivered quantities had been delivered to SDG&E during the Month,

such portion of the PG&E Toll to be determined on a 100% load factor basis; and

(c) the sum of:

- (i) the aggregate quantity of gas (expressed in MMBtus) which is delivered by Seller to SDG&E for the Month,

plus

- (ii) the aggregate quantity of fuel gas which is transported using the Assigned PG&E Transportation and which is attributable to gas delivered to SDG&E.

For purposes of certainty, if the parties agree at any time and from time to time to deliver and receive gas at an alternate delivery point pursuant to Section 8.3, all such gas deliveries (including associated fuel gas volumes) shall be included within paragraph (c) in each of the definitions of "Unutilized ANG Service", "Unutilized PGT Service" and "Unutilized PG&E Service" notwithstanding that some portion of Seller's Transportation may not have been required to

deliver those gas quantities to SDG&E. In addition, SDG&E's obligation to Seller under this Section is subject to further reduction pursuant to subsection 4.2(e) and Section 4.4.

15. Section 4.4 is deleted and replaced with the following:

#### 4.4 SALES/TRANSPORTATION OPTIMIZATION

(a) If, from time to time:

(i) either party becomes aware of a potential or actual opportunity (including opportunities developed by that party or anticipated to be developable by that party or the parties) which could be served or otherwise taken advantage of using the assets which are subject to this Agreement (including, without limitation, Seller's firm gas supply, Seller's Transportation, SDG&E's SoCal transportation service and Seller's NOVA firm service) ("Opportunity"); and

(ii) the Opportunity could reasonably be expected to increase revenues or create other benefits for the parties (after taking into account the sharing arrangements in subsection 4.4(d)) in excess of the revenues and benefits which would otherwise accrue to each of the parties if the parties simply continued to perform their respective commitments under this Agreement,

then that party shall timely notify the other party of the Opportunity, which notice shall contain reasonably detailed particulars of the Opportunity including, without limitation, the term of the arrangement, the adverse effect on the rights and other benefits of each party under this Agreement, any additional obligations associated with the Opportunity, and the anticipated benefits which would be expected to accrue from the Opportunity. Opportunities could include, but are not limited to, the delivery of gas to alternate delivery points whether to SDG&E or a third party, third party gas purchase and sale arrangements (including, without limitation, peaking sales), exchanges, swaps, the brokering of pipeline capacity (including, without limitation, temporary assignments), buy/sell arrangements, combinations of any of the foregoing or other opportunities.

(b) If:

(i) each party identifies an Opportunity, all or any portion of which would be in effect during the same period of time; and

(ii) both such Opportunities cannot be accommodated at the same time using the assets which are subject to this Agreement,

then the parties will only consider implementing the Opportunity which is anticipated to provide the greater level of benefits (after taking into account subsection 4.4(d)).

(c) The parties must jointly agree to accept any Opportunity which would alter any of a party's rights, benefits and obligations under this Agreement. A party's approval to any Opportunity may be arbitrarily withheld if (1) that party has reasonable cause for believing that the Opportunity will not provide sufficient benefits when compared to the efforts and costs required to implement the Opportunity, (2) that party reasonably believes that, during the particular time period that the Opportunity will be in effect, it will be important for that party to either retain all of its rights and benefits under this Agreement or not increase its level of obligations (as may be required to effectuate the Opportunity), (3) in respect of quantities of gas which are proposed to be diverted from SDG&E (for the purposes of an Opportunity) for a period of one Month or longer, SDG&E does not receive notice of the Opportunity together with all required particulars at least 72 hours prior to the first Day that gas is to be diverted from SDG&E hereunder (if the Opportunity is agreed to by the parties), or (4) in respect of quantities of gas which are proposed to be diverted from SDG&E (for the purposes of an Opportunity) for a period of less than one Month, SDG&E does not receive notice of the Opportunity together with all required particulars by not later than 0930 hours Pacific time on the second day preceding the first Day that gas is to be diverted from SDG&E hereunder (if the Opportunity is agreed to by the parties).

(d) All net incremental benefits derived from implementing an Opportunity shall be shared as follows:

Seller - 70%

SDG&E - 30%

Net incremental benefit shall be the residual revenue or other benefit remaining from the implementation of an Opportunity after each party is reimbursed for its reasonable, third party out-of-pocket costs incurred to implement the Opportunity. Under no circumstances whatsoever shall any Non-Delivery Adjustment Payments (payable by Seller pursuant to subsection 4.4(e)) reduce the amount of the net incremental benefits which are to be determined for each Opportunity and shared as provided herein. All Non-Delivery Adjustment Payments are to be borne solely by Seller without reducing SDG&E's benefits under this Section.

- (e) If an accepted Opportunity results in SDG&E's right to nominate for the MDQ being reduced, then and for the term of the Opportunity, the MDQ under this Agreement shall be deemed to be reduced accordingly. In addition, during each Month of any accepted Opportunity that the Replacement Price exceeds the Reference Price, Seller shall pay to SDG&E, in respect of each MMBtu of gas purchased by SDG&E to replace some or all of the quantities of gas diverted to an Opportunity ("Replacement Gas Quantity") an amount ("Non-Delivery Adjustment Payment") calculated as follows:

$$\text{Replacement Gas Quantity (total for the Month)} \times (\text{Replacement Price} - \text{Reference Price})$$

Where:

"Replacement Price" equals the weighted average price per MMBtu paid by SDG&E for the Replacement Gas Quantity for that Month at the California border into SoCal's System.

SDG&E shall not unreasonably refuse any request from Seller to terminate any Opportunity if such termination can occur without penalty or other cost to SDG&E.

- (f) If any accepted Opportunity involves deliveries at an alternate delivery point such that all or any portion of the Assigned ANG Transportation, Assigned PGT Transportation or Assigned PG&E Transportation is not expected to be utilized during the term of the Opportunity for the purposes of implementing or fulfilling the Opportunity, SDG&E shall have no obligation under Section 4.3 in respect of the entire transportation service of the applicable Assignment Transporter (to the extent of the Opportunity volume)

and Seller shall be responsible for all Demand Charges attributable to that stranded transportation service (to the extent of the Opportunity volume).

(g) During those periods when SDG&E is not nominating for the MDQ, SDG&E shall have the right (without relieving Seller of its obligations under the last paragraph of Section 4.3) to temporarily assign or broker the capacity under Seller's Transportation which is attributable to the quantities not then being nominated by SDG&E, for the purpose of mitigating SDG&E's obligations under Section 4.3. Seller shall use all commercially reasonable efforts to assist SDG&E in locating opportunities to mitigate unutilized transportation capacity under Seller's Transportation. Seller shall timely implement any such mitigation arrangements made by SDG&E. If, during any Contract Year, SDG&E receives aggregate revenues from such mitigation arrangements which exceed its aggregate payments to Seller under Section 4.3 for that Contract Year, the difference shall be shared by the parties in accordance with subsection 4.4(d).

(h) If Seller receives any payment from a third party which is attributable to any arrangements made by SDG&E pursuant to subsection 4.4(g), Seller shall immediately pay those amounts to SDG&E (subject to Seller's right, if any, to receive a portion of aggregate mitigation revenues pursuant to the last sentence of subsection 4.4(g)).

16. Article IV is amended to add the following as Section 4.5:

#### 4.5 Pipeline Utilization

(a) The parties acknowledge that:

(i) either or both of the Sellers or any of their Affiliates may now hold and may hereafter acquire firm, interruptible or other transportation service rights on all or any of the systems of the Assignment Transporters (whether held directly by or indirectly for the benefit of either of the Sellers or their Affiliates and regardless of when those rights were acquired) ("Other Transportation"); and

- (ii) SDG&E has obligations under this Agreement to make Transportation Adjustment Payments under certain circumstances when Seller's Transportation is not being used.

Seller agrees to use all commercially reasonable efforts to ensure that the Seller's Transportation is fully utilized at all times in order that SDG&E is able to avoid making Transportation Adjustment Payments in respect of unutilized Seller's Transportation. In the event of a curtailment of firm pipeline service by any of the Assignment Transporters, then Seller shall allocate its remaining capacity on the Assignment Transporters between the Seller's Transportation and the Other Transportation on the basis of the respective maximum daily capacities of firm service normally available to Seller under those transportation service arrangements. For the purposes of this Section, "Affiliate" means, in respect of a person, any other person that, directly or indirectly, controls, is controlled by or under common control with the first mentioned person, and for the purposes of this definition "control" means the possession, directly or indirectly, by a person or a group of persons acting in concert of the power to direct or cause the direction of the management and policies of the person, whether through the ownership of voting securities or otherwise.

- (b) During those periods when Seller is unable (or expects to be unable) to deliver all or any portion of the quantity of gas nominated by SDG&E due to a force majeure event affecting Seller's performance under this Agreement, then Seller shall promptly inform SDG&E of the delivery shortfall (or expected delivery shortfall) and use all commercially reasonable efforts to locate and to obtain substitute gas supplies (to avoid a delivery shortfall) at the lowest possible prices reasonably obtainable under the circumstances. Once Seller has located such substitute gas supplies, Seller shall promptly contact SDG&E (with all relevant particulars pertaining to the substitute supplies) to determine whether those supplies should be acquired for delivery to SDG&E. Without detracting from Seller's obligations (under the preceding sentence), SDG&E shall have the right (but not the obligation) to arrange for substitute gas supplies (to avoid any delivery shortfall). Seller shall use the Seller's Transportation to transport to SDG&E all such substitute gas supplies.

17. Article V is amended to delete Section 5.1.

18. (a) The formula for the calculation of "Contract Price" in the fourth line of Section 6.1 is deleted and replaced with the following:

Contract Price = Reference Price

- (b) The definition "SDG&E's Unit Transportation Cost" is deleted from Section 6.1 and replaced with the following:

Seller's Unit Transportation Cost = in respect of any Month, Seller's unit cost (expressed in \$U.S./MMBtu), being the sum of all Seller's Transportation fixed and variable charges and surcharges, net of any credits, that apply to the firm transportation of gas hereunder in such Month from the interconnection of the NOVA and ANG systems at the Alberta-British Columbia border to the Delivery Point, including any non-tariff costs such as shipper provided fuel and line loss. This unit cost will be the 100% load factor rate calculated based upon an assumed full utilization of transportation capacity, held on Seller's Transportation equal to the MDQ regardless of whether Seller delivered and SDG&E received less than the MDQ.

- (c) The last paragraph of Section 6.1 is amended to delete the term "SDG&E's" and to replace that term with the word "Seller's".

19. Section 6.3 is amended to (1) replace the "; or" at the end of subsection 6.3(a) with a period, and (2) delete subsection 6.3(b).

20. Section 7.1 is deleted and replaced with the following: Commencing with the Month immediately following the Month in which the Commencement of Firm Deliveries occurs, SDG&E shall, on or before the 10th day of each Month, notify Seller of the Reference Price and the Base Price for the preceding Month and Seller shall, on or before the 15th Business Day of such Month, render to SDG&E a statement in U.S. dollars showing on a line basis:

- (a) Seller's best reasonable estimate of the quantity of gas delivered to SDG&E at the Delivery Point during the preceding Month under this Agreement, the Heating Value thereof, and the gross amount payable in respect thereof;
- (b) the amount of any Transportation Adjustment Payment in respect of the preceding Month (including a detailed breakdown of the

Unutilized ANG Service, Unutilized PGT Service and Unutilized PG&E Service calculations for the Month);

- (c) the amount of any Deficiency Volume, GIC Payment and NOVA Adjustment (under Section 4.2) in respect of the preceding Month;
- (d) the amounts of any Non-Delivery Adjustment Payment (under Section 4.4) in respect of the preceding Month;
- (e) the amount of any credits or other adjustments determined in accordance with the terms of this Agreement; and
- (f) the net amount payable hereunder.

Included with each statement, Seller shall separately provide details of the appropriate conversions, calculations applied to prepare the statement, and any other information reasonably requested by SDG&E. SDG&E shall make payment of the net amount on or before the 25th day of the calendar month in which the invoice is received. In the event the 25th day of the month is a Saturday or another day which is not a Business Day (other than a Sunday or Monday), SDG&E shall make payment to Seller on or before the last Business Day immediately before the 25th day of the billing month. When the 25th day of the month is a Sunday or a Monday (which is not a Business Day) SDG&E shall make payment on or before the first Business Day immediately following the 25th day of the billing month. If presentation of the invoice to SDG&E is delayed after the 15th day of the billing month, then the time for payment shall be extended accordingly unless SDG&E is responsible for the delay. Such payment shall be made by wire transfer as set out below under "Bank Instructions". Any adjustments necessary to reflect actual deliveries shall be made in the Month's invoice following the receipt of information which reflects actual deliveries. Unpaid amounts shall accrue interest at a rate and in the manner described in Section 7.4.

Banking Instructions:

Route through Fedwire to: Bank of America NT & SA  
One World Trade Center  
10th Floor  
New York, New York 10048-1191  
ABA 026009593

To: Canadian Imperial Bank of Commerce  
Toronto, Ontario  
Account #655026157  
Swift Address: BOFAUS3N  
Chips Member ID: 015035

Further Credit to: Canadian Imperial Bank of Commerce  
309 - 8th Avenue S.W.  
Calgary, Alberta  
Transit #0010-0009

Account Of: Husky Gas Marketing Inc.  
#03-46217

21. Section 7.2 is amended to delete the phrase "any SDG&E Transportation Adjustment and".
22. Section 8.3 is deleted and replaced with the following:  
At any time and from time to time at the request of either party, the parties shall meet or otherwise discuss the possibility of establishing one or more alternate delivery points for gas deliveries and receipts under this Agreement. Such proposed alternate delivery points must be locations at which SDG&E has the ability to receive gas and Seller has the ability to deliver gas using Seller's Transportation (in each case taking into account the quantities proposed to be delivered and received at those alternate points), provided that neither party shall have any obligation to agree to an alternate delivery point or points at any time, such decision to be in its sole discretion.
23. Section 11.1 is amended to delete the reference to "GJ's" and to replace that reference with "MMBtus".
24. Section 11.2 is amended to delete the reference to "transporters" in the second line and to replace that reference with "receiving transporter".
25. Subsection 12.1(c) is deleted and replaced with the following:

"Seller has obtained all approvals which may be required by Seller's Regulatory Authorities, provided that Seller has only obtained a 2 year import authorization from the United States Department of Energy (expiring on April 30, 1999). Seller shall use all commercially reasonable

efforts to promptly obtain a long-term import authorization for the MDQ expiring August 1, 2003."

26. Section 12.2 is amended to delete the words "other than SDG&E's Regulatory Authorities as contemplated in Section 2.2".

27. Section 14.2 is amended to add the following as a final paragraph to the Section:

In the event SDG&E elects, at any time, to reduce the MDQ pursuant to subsection 14.2(a), Seller shall reassign to SDG&E a proportionate share of Seller's Transportation, such proportionate share to be equal to the proportionate reduction in the MDQ elected by SDG&E. If SDG&E makes that election, Seller shall reassign such proportionate share of the Seller's Transportation to SDG&E and take all other steps as are reasonably required in order for SDG&E to be recognized by the Assignment Transporters as the sole shipper in respect of the assigned portion of the Seller's Transportation, effective on the date that the MDQ reduction takes effect.

28. Section 14.3 is amended to delete subsection 14.3(b).

29. Section 15.1 is amended as follows:

- (a) to replace the colon following the phrase "mechanical breakdowns" in the 12th line with a comma.
- (b) to delete the phrase "NOVA's facilities" from the 14th line and to replace that phrase with "any of NOVA's, ANG's, PGT's and PG&E's facilities".
- (c) to delete the reference to "Transporters'" from the 16th line and to replace that word with "or SoCal's".

30. Article XIX is amended to add the following in Section 19.2:

#### 19.2 COMMUNICATIONS AND DEALINGS

Notwithstanding that H00L and HGMI are parties to this Agreement or that HGMI is the sole shipper of record for the Assigned PGT Transportation and the Assigned PG&E Transportation, SDG&E shall be entitled at all times to deal solely with H00L in respect of any and all matters which in any way pertain to this Agreement including, without limitation, the Assigned PGT Transportation and the Assigned PG&E

Transportation as if HOOL was the only party to this Agreement as "Seller" and was the shipper of record for the Assigned PGT Transportation and the Assigned PG&E Transportation. HGMI waives any and all right to deal with SDG&E in respect of any matter and agrees that any and all notices, conversations, negotiations and other communications of any kind whatsoever between SDG&E and HOOL shall be binding upon and enforceable against HGMI as if HGMI had been involved together with HOOL in those communications. Without limiting the generality of the foregoing:

- (a) any amendment to this Agreement executed by HOOL or any waiver provided by HOOL shall bind HGMI whether or not executed by, known of or consented to by HGMI;
- (b) any notice of any kind whatsoever served on HOOL under this Agreement (including, without limitation, a default notice) shall be binding upon HGMI; and
- (c) SDG&E shall be entitled to disregard any notices or other communications received from HGMI.

If, at any time, SDG&E deals with HGMI, SDG&E shall not be under any obligation to continue dealing with HGMI, whether in respect of the same or any other matter. Any course of conduct by SDG&E in this regard shall not in any way modify SDG&E's right to deal solely with HOOL, it being understood that HOOL requested HGMI's inclusion as a party to this Agreement for purposes relevant only to HOOL and HGMI, and SDG&E is prepared to accept HGMI as a party to accommodate that request so long as SDG&E is only obligated to deal with HOOL in respect of any matter pertaining to this Agreement.

- 31. Section 20.1 is amended to delete the phrase "SDG&E's Transporters" in the 9th line and to replace that phrase with "SoCal".
- 32. Section 20.3 is amended to add "(including charges under Seller's Transportation)" after the reference to "fixed transportation charges" in the second line.
- 33. Article XXII is amended to include the following as an additional Section:
  - 22.10. Joint and Several Liability. HOOL and HGMI are jointly and severally liable for the performance of Seller's obligations under this Agreement (including, without limitation, all liabilities and

responsibilities relating to each of the Assigned Transportation agreements notwithstanding that both of them are not parties to each of those agreements). SDG&E shall be entitled, at its option, to pursue any of its rights and remedies under this Agreement against either or both of H00L and HGMI and neither H00L nor HGMI shall be entitled to defend against any SDG&E claim on the basis that the other is responsible for the breach, failure or nonperformance upon which SDG&E's claim is based.

34. This Third Amending Agreement is effective as of November 1, 1997.
35. By its execution of this Agreement, HGMI agrees to become a party to the Agreement as "Seller" jointly with H00L and each of SDG&E and H00L accept HGMI as a party to the Agreement in that capacity effective November 1, 1997.
36. As between the parties hereto, Seller shall be responsible for complying with all filing and other reporting requirements of Seller's Regulatory Authorities in respect of this Third Amending Agreement.
37. This Third Amending Agreement was prepared with each of the parties having access to its own counsel and the parties waive any claim they may have now or in the future based on this Third Amending Agreement not having been prepared jointly by the parties or by any party to the exclusion of one or more of the other parties.
38. This Third Amending Agreement may be executed in any number of counterparts, each of which when so executed shall be deemed to be an originally executed copy, and it shall not be necessary to make proof of the Third Amending Agreement to produce all of such counterparts.
39. Each party represents and warrants that the officer or officers signing this Third Amending Agreement on its behalf is authorized to do so.
40. SDG&E and H00L each restate as being true and correct as of the date of this Third Amending Agreement each of the representations and warranties made by them and set forth in Article XII of the Agreement.
41. This Third Amending Agreement shall be governed by and construed in accordance with the laws of the Province of Alberta excluding however any conflict of laws rule that would apply the laws of another jurisdiction. The parties hereby attorn to the jurisdiction of the Courts of Alberta at Calgary which shall have exclusive jurisdiction in respect of all disputes and other

matters relating to this Third Amending Agreement with the exception of those disputes and other matters referable to arbitration under this Third Amending Agreement.

In Witness Whereof this Third Amending Agreement is executed in multiple originals effective as of the date first above written.

SAN DIEGO GAS & ELECTRIC  
COMPANY

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

HUSKY OIL OPERATIONS LTD.

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

HUSKY GAS MARKETING INC.

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

THIS AMENDING AGREEMENT made effective as of January 1, 1997.  
BETWEEN:

SAN DIEGO GAS & ELECTRIC COMPANY, an Enova Company, a California corporation with its principal place of business in San Diego, California ("SDG&E")

- and -

HUSKY OIL OPERATIONS LTD., an Alberta corporation, with its principal place of business in Calgary, Alberta ("Seller")

WHEREAS SDG&E and Seller are parties to a Natural Gas Purchase Agreement made as of March 12, 1991, and amended as of November 1, 1994 (the "Gas Purchase Agreement"); and

WHEREAS the parties wish to amend the Gas Purchase Agreement in the manner hereinafter set forth.

NOW, THEREFORE, in consideration of the premises and the mutual covenants herein contained, the parties agree as follows:

1. Section 22.6 of the Gas Purchase Agreement is deleted and replaced with the following:

"Section 22.6 Governing Law

This Agreement shall be governed by and construed according to the laws of the Province of Alberta excluding however any conflict of laws rule that would apply the law of another jurisdiction. The parties hereby attorn to the jurisdiction of the Courts of Alberta at Calgary which shall have exclusive jurisdiction in respect of all disputes and other matters relating to this Agreement with the exception of those disputes and other matters referable to arbitration under this Agreement."

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2. Sections 11.0(a), (c) and (f) of Appendix A to the Gas Purchase Agreement are deleted and replaced with:

(a) Subject to any other provisions of this Appendix:

- (i) if in the reasonable opinion of either party any published index or price, or any rate or tariff or other provision of the Gas Purchase Agreement, including this Appendix, which is required to determine the Base Price:

(A) ceases to be available or ascertainable; or

(B) assumes a measure or value that is wholly inconsistent with the measure or value represented by the component in December, 1994; or

- (ii) if in the reasonable opinion of either party the Base Price no longer represents a price which is competitive with SDG&E's alternative southwest gas supplies

(any of the circumstances described in (i) or (ii) shall, subject to section 11.0 (b), be referred to as a "Pricing Event"),

then that party shall have the right by notice in writing ("Pricing Event Notice"), which can be given to the other party ("Recipient") at any time following the occurrence of the Pricing Event, to require the other party to meet, within thirty (30) days of the Recipient's receipt of the

Pricing Event Notice, to attempt in good faith to negotiate a replacement index, price, rate, tariff or mechanism in order that the Base Price will be:

(iii) competitive with the cost of SDG&E's alternative southwest gas supplies; and

(iv) insofar as possible, consistent with the pricing structure as set out in this Appendix;

((iii) and (iv) herein shall be referred to as the "Standard").

If the Recipient disputes the occurrence of a Pricing Event, the parties shall nevertheless meet within thirty (30) days of the Recipient's receipt of the Pricing Event Notice. For the then remaining portion of the ninety (90) day period following the Recipient's receipt of the Pricing Event Notice ("Determination Period"), the parties shall meet regularly to review and discuss the relevant issues and events in a good faith effort to agree upon whether or not a Pricing Event has occurred. During the Determination Period, neither party shall commence any legal

proceedings of any kind whatsoever which pertain in any way to the Pricing Event Notice or the alleged occurrence of a Pricing Event. If during the Determination Period the parties determine that a Pricing Event has not occurred, the Pricing Event Notice shall be deemed not to have been issued. If during the Determination Period the parties determine that a Pricing Event has occurred ("Consensus"), then the parties shall meet, within ten (10) days of the Consensus, in a good faith attempt to negotiate a replacement index, price, rate, tariff or mechanism consistent with this section 11.

- (c) If the parties are unable to negotiate a replacement index, price, rate, tariff or mechanism within ninety (90) days following the Recipient's receipt of the Pricing Event Notice, the parties shall proceed to arbitration pursuant to the following provisions of this section. However, if a Consensus has occurred, the parties shall not proceed to arbitration until thirty (30) days following the date of the Consensus (during which period the parties shall meet regularly in a good faith attempt to negotiate a replacement index, price, rate, tariff or mechanism as stipulated in section 11(a)).
- (f) Upon a replacement index, price, rate, tariff, mechanism or Base Price being determined by negotiation or arbitration, the Base Price, the Reference Price and Contract Price shall be adjusted to reflect the difference, if any, for:
  - (i) each Day, during the Month in which the Recipient received the Pricing Event Notice ("Receipt Month"), that the Pricing Event occurred or was in effect,
  - (ii) each Day, during the 3 Month period immediately preceding the Receipt Month, that the Pricing Event occurred or was in effect, and
  - (iii) each Month following the Receipt Month, and any payment adjustment will be recovered in the first payment period immediately following that determination and shall include interest accrued as if the adjustment was a Disputed Amount (determined to be owing) under Article 7 of the Gas Purchase Agreement.

3. None of the amendments made to the Gas Purchase Agreement in this Amending Agreement are intended to either support or detract from any argument or position respecting the authority or proper jurisdiction of either an arbitrator or a court to determine the issue (if the parties are unable to agree) of whether or not a Pricing Event has occurred.

4. This Amending Agreement was prepared with each of the parties having access to its own counsel and the parties waive any claim they may have now or in the future

based on this Amending Agreement not having been prepared jointly by the parties or by either to the exclusion of the other.

5. This Amending Agreement may be executed in any number of counterparts, each of which when so executed shall be deemed to be an originally executed copy, and it shall not be necessary in making proof of the Amending Agreement to produce all of such counterparts.

6. Each party represents and warrants that the officer or officers signing this Amending Agreement on its behalf is authorized to do so.

7. This Amending Agreement shall be governed by and construed according to the laws of the Province of Alberta excluding however any conflict of laws rule that would apply to the law of another jurisdiction. The parties hereby attorn to the jurisdiction of the Courts of Alberta at Calgary which shall have exclusive jurisdiction in respect of all disputes and other matters relating to this Amending Agreement with the exception of those disputes and other matters referable to arbitration under the Gas Purchase Agreement.

IN WITNESS WHEREOF this Amending Agreement is executed in multiple originals effective as of the date and year first above written.

SAN DIEGO GAS &  
ELECTRIC COMPANY

HUSKY OIL OPERATIONS LTD.

By: \_\_\_\_\_ By: \_\_\_\_\_

Name: \_\_\_\_\_ Name: \_\_\_\_\_

Title: \_\_\_\_\_ Title: \_\_\_\_\_

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

AMENDING AGREEMENT

THIS AMENDING AGREEMENT made effective as of November 1, 1994.

BETWEEN:

SAN DIEGO GAS & ELECTRIC COMPANY, a California  
corporation with its principal place of business in San  
Diego, California ("SDG&E")

OF THE FIRST PART

- and -

HUSKY OIL OPERATIONS LTD., an Alberta corporation, with  
its principal place of business in Calgary, Alberta ("Seller")

OF THE SECOND PART

WHEREAS SDG&E and Seller are parties to a Natural Gas  
Purchase Agreement made as of March 12, 1991 (the "Gas Purchase  
Agreement"); and

WHEREAS the parties wish to amend the Gas Purchase  
Agreement in the manner hereinafter set forth.

NOW, THEREFORE, in consideration of the premises and the  
mutual covenants herein contained, the parties agree as follows:

1. The terms and expressions which are defined in the Gas  
Purchase Agreement shall have the same meanings where used in this  
Amending Agreement except where the context otherwise requires.

2. Subsection 1.1 is amended as follows:

(a) Subsection 1.1(z) is deleted and replaced with the  
following:

"(z) "NOVA" means NOVA Gas Transmission Ltd."

(b) Subsection 1.1(ii) is deleted and replaced with the  
following:

"(ii) "SDG&E's Transporters" means those transporters  
operating pipeline facilities which are used to transport  
gas from the Delivery Point to the interconnection of the  
facilities of PG&E with SoCal's

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System; being the 1993 expansion facilities of ANG, PGT  
and PG&E;"

(c) The following subsection 1.1(mm.1) is added after  
subsection 1.1(mm):

"(mm.1) "SoCal's System" means the facilities owned and  
operated by SoCal for the transmission of natural gas and  
for the purposes of Article VI shall be deemed to  
interconnect with the facilities of PG&E at Kern River  
Station, California and deemed to interconnect with the  
facilities of El Paso and Transwestern at the  
California border near Blythe, California and Needles,  
California;"

(d) Subsection 1.1(qq) is deleted.

3. Section 6.1 is amended as follows:

(a) The definition of Contract Price is deleted and replaced  
with the following:

"Contract Price = Reference Price - SDG&E's Unit Transportation Cost"

- (b) The definition of Reference Price is amended by deleting "as set forth in Schedule "A" and indexed in the manner set forth in Schedule "A"" and inserting "as calculated pursuant to Appendix "A"."
- (c) Schedule "A" to the Gas Purchase Agreement is deleted and replaced with Appendix "A" attached hereto. Appendix A" is incorporated into and is a part of the Gas Purchase Agreement by this reference as though contained in the body of such Agreement.
- (d) The definition of SoCal Unit Transportation Cost is deleted.
- (e) The definition of SDG&E's Unit Transportation Cost is deleted and replaced with the following:

"SDG&E's Unit Transportation Cost = in respect of any Month, SDG&E's unit cost (in \$U.S./MMBtu), being the sum of all SDG&E's Transporters' fixed and variable charges or surcharges, net of any credits, that apply to the firm transportation of gas hereunder in such Month from the Delivery Point to SoCal's System, including any non-tariff costs such as shipper provided fuel and line loss. This unit cost will be the 100% load factor rate calculated based on an assumed full utilization of transportation capacity held on SDG&E's Transporters equal to the MDQ

regardless of whether Seller delivered and SDG&E received less than the MDQ."

(f) The last paragraph of Section 6.1 is amended by deleting "the SoCal Unit Transportation Cost or".

4. Section 6.3 is deleted and replaced with the following:

"6.3 Rolled-in Rates.

If FERC authorizes rolled-in rates on the PGT pipeline, the resulting transportation charges, including any surcharges associated with the restructuring of PG&E's Alberta and Southern Gas Co. Ltd. obligation:

(a) shall be the responsibility of Seller if and to the extent it assumes SDG&E's present capacity rights on the PGT pipeline; or

(b) shall continue to be otherwise included within the definition of "SDG&E's Unit Transportation Cost"."

5. Section 7.1 is amended by:

(a) deleting "SoCal Unit Transportation Cost," and

(b) by replacing "WACOG" with "Base Price".

6. SDG&E and Seller each restate as being true and correct as of the date of this Amending Agreement each of the representations and warranties made by them and set forth in Article XII of the Gas Purchase Agreement.

7. Section 15.1 is amended by:

(a) in the fifth line by replacing "been unable" with "failed or will fail";

(b) in the fourteenth line adding after "SDG&E's System" the words ", SoCal's System"; and

(c) in the last line by replacing "is unable" with "has failed or will fail".

8. Section 15.2(c)(iv) is amended by replacing in the seventh line "is unable" with "has failed or will fail".

9. Section 17.1 is amended by replacing "assigns" with "permitted assigns".

10. Subsections 17.2(b), (c) and (d) are deleted and replaced by the following new subsections 17.2(b), (c), and (d), and an additional subsection 17.2(e) is added::

(b) SDG&E shall not require Seller's consent under subsection (a) to assign all of its rights, obligations and interests in this Agreement to an affiliate of SDG&E that provides gas service to markets that includes core customers in San Diego County (the "Affiliate"). In such circumstances the Affiliate shall be bound by all of the terms and conditions of this Agreement and, notwithstanding such assignment, SDG&E shall continue to remain liable for all of the obligations of the Affiliate, whether such obligations arose prior to the effective date of the assignment, or arise from or after the effective date of the assignment unless and until the Affiliate can demonstrate to Seller's reasonable satisfaction the Affiliate's ability to meet all existing and continuing obligations under this Agreement.

For the purposes of this subsection 17.2(b), the term "Affiliate" shall mean, with respect to any person, any other person (other than an individual) that, directly or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with, such person. For the purposes of the foregoing definition, "control" means the direct or indirect ownership of more than 50% of the outstanding capital stock or other equity interests having ordinary voting power.

(c) In the event that SDG&E reasonably believes that Seller's ability to meet its material obligations under this Agreement is materially impaired, SDG&E may, by written notice to Seller, require Seller to provide further assurances within ninety (90) days, which in SDG&E's reasonable judgment are adequate to provide comfort that Seller can continue to perform its material obligations hereunder. If Seller is unable to provide such assurances, SDG&E may upon thirty (30) days written notice terminate this Agreement.

(d) In the event that Seller reasonably believes that SDG&E's ability to meet its material obligations under this Agreement is materially impaired, Seller may, by written notice to SDG&E, require SDG&E to provide further assurances within ninety (90) days, which in Seller's reasonable judgment are adequate to provide comfort that SDG&E can continue to perform its material obligations hereunder. If SDG&E is unable to provide such assurances, Seller may upon thirty (30) days written notice terminate this Agreement. This subsection (d) shall not apply to the assignment described in subsection 17.2(b).

(e) For purposes of subsections 17(2)(c) and 17(2)(d), Seller shall mean both Seller and its permitted assigns and SDG&E shall mean both SDG&E and its permitted assigns."

11. The Seller's address for notices in Section 19.1 is deleted and replaced with the following:

"To Seller: Husky Oil Operations Ltd.  
707 - 8th Avenue S.W.  
P.O. Box 6525, Station "D"  
Calgary, Alberta T2P 2G7  
  
Attention: Manager, Natural Gas Supply  
and Marketing  
Telecopy: (403) 298-6093"

12. Section 22.2 is amended by replacing "assigns" with "permitted assigns".

13. The following sections are added to Article XXII:

"22.7 Time of Essence. Time shall be of the essence of this Agreement.

22.8 Severability. If one or more provisions contained in this Agreement are invalid, illegal or unenforceable in any respect under any applicable law the validity, legality and enforceability of the remaining provisions of this Agreement shall not be affected or impaired thereby.

22.9 Preparation. This Agreement was prepared with each of the parties having access to its own counsel and the parties waive any claim they may have now or in the future based on this Agreement not having been prepared jointly by the parties or by either to the exclusion of the other.

14. This Amending Agreement was prepared with each of the parties having access to its own counsel and the parties waive any claim they may have now or in the future based on this Amending Agreement not having been prepared jointly by the parties or by either to the exclusion of the other.

15. This Amending Agreement may be executed in any number of counterparts, each of which when so executed shall be deemed to be an originally executed copy, and it shall not be necessary in making proof of the Amending Agreement to produce all of such counterparts.

16. Each party represents and warrants that the officer or officers signing this Amending Agreement on its behalf is authorized to do so.

17. This Amending Agreement shall be governed by and construed according to the laws of the Province of Alberta.

IN WITNESS WHEREOF this Agreement is executed in multiple originals effective as of the date and year first above written.

SAN DIEGO GAS & ELECTRIC COMPANY      HUSKY OIL OPERATIONS LTD.

By: \_\_\_\_\_ By: \_\_\_\_\_

Name: \_\_\_\_\_ Name: \_\_\_\_\_

Title: \_\_\_\_\_ Title: \_\_\_\_\_

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

APPENDIX "A" ATTACHED TO AND FORMING PART OF A GAS PURCHASE AGREEMENT BETWEEN SAN DIEGO GAS & ELECTRIC COMPANY AND HUSKY OIL OPERATIONS LTD. DATED MARCH 12, 1991 AS AMENDED BY AMENDING AGREEMENT MADE EFFECTIVE AS OF NOVEMBER 1, 1994.

- 1.0 "Reference Price" for the Month = Base Price for the Month x 0.97
- 2.0 "Base Price" for the Month = Southwest Basin Index for the Month plus Southwest Transportation Cost for the Month.
- 3.0 The Reference Price and Base Price shall be rounded to four decimal places.
- 4.0 The terms and expressions which are defined in the Gas Purchase Agreement shall have the same meanings when used in this Appendix unless the context otherwise requires.

CALCULATION OF SOUTHWEST BASIN INDEX

- 5.0 "Southwest Basin Index" for the Month (expressed in \$/MMBTU) = (0.70 x San Juan Index Price) plus (0.30 x Permian Index Price) as described in sections 6.0 and 6.1.
- 6.0 "San Juan Index Price" for the Month:
  - (a) shall equal the index price of gas supply for deliveries from the San Juan basin into the El Paso system as published in the first issue of the current month by Inside FERC's Gas Market Report, in the table Prices of Spot Gas Delivered to Pipelines, El Paso Natural Gas Co. San Juan Basin (expressed in \$/MMBTU); or
  - (b) if the index described in section 6.0(a) is not published in the first issue of the current month, shall equal the first posted Contract Index as published by Natural Gas Intelligence, for deliveries from the San Juan basin into the El Paso system for the current month in the table Spot Gas delivered to Pipelines 30 Day Supply Transactions, Rocky Mountains, El Paso San Juan (expressed in \$/MMBTU).

- 6.1 "Permian Index Price" for the Month:
  - (a) shall equal the index price of gas supply for deliveries from the Permian basin into the Transwestern system as published in the first issue of the current month by Inside FERC's Gas Market Report, in the table "Prices of Spot Gas Delivered to Pipelines", Transwestern Pipeline Co. Permian Basin (expressed in \$/MMBTU); or
  - (b) If the index described in section 6.1(a) is not published in the first issue of the current month, shall equal the first posted Contract Index as published by Natural Gas Intelligence, for deliveries from the Permian basin into the Transwestern system for the current month in the table Spot Gas Prices Delivered to Pipelines, 30 Day Supply Transactions, West Texas/Permian Basin Transwestern (expressed in \$/MMBTU).

CALCULATION OF SOUTHWEST TRANSPORTATION COST

- 7.0 "Southwest Transportation Cost" for the Month (expressed in \$/MMBTU) = Transportation Fuel Cost plus Transportation Variable Cost plus Transportation Fixed Cost.

#### TRANSPORTATION FUEL COST

8.0 "Transportation Fuel Cost" for the Month (expressed in \$/MMBTU) =  $(0.70 \times \text{El Paso Fuel Cost})$  plus  $(0.30 \times \text{Transwestern Fuel Cost})$  as described in sections 8.1 and 8.2.

8.1 "El Paso Fuel Cost" for the Month, (expressed in \$/MMBTU) = [San Juan Index Price divided by  $(1 - \text{EP \% of Fuel Use})$ ] minus San Juan Index Price

where "EP % of Fuel Use" means the applicable figure published in the Firm Transportation Tariff, T-3, for the El Paso system, or any equivalent replacement or successor rate or rate schedule. Currently the EP % of Fuel Use is documented on Original Sheet No. 116 of Rate Schedule T-3 issued on May 23, 1994, paragraph 7a.

8.2 "Transwestern Fuel Cost" for the Month (expressed in \$/MMBTU) = [Permian Index Price divided by  $(1 - \text{TW \% of Fuel Use})$ ] minus Permian Index Price

where "TW % of Fuel Use" means the applicable figure published in the Firm Transportation Tariff, FTS-1, for the Transwestern system, or any equivalent replacement or successor rate or rate schedule. Currently the TW % of Fuel Use is documented on 109th Revised Sheet No. 5 issued on August 31, 1994 in the column titled Maximum Fuel % for the East of Thoreau Receipt Point Area.

#### TRANSPORTATION VARIABLE COST

9.0 "Transportation Variable Cost" for the Month (expressed in \$/MMBTU) =  $(0.70 \times \text{El Paso Variable Cost})$  plus  $(0.30 \times \text{Transwestern Variable Cost})$  as described in sections 9.1 and 9.2, but excluding Transportation Fuel Cost.

9.1 "El Paso Variable Cost" means all the transportation variable cost components of the Firm Transportation Tariff, T-3, including any present or future commodity or usage surcharges or any equivalent replacement or successor rate or rate schedule, from the San Juan basin to the interconnection with SoCal's System (expressed in \$/MMBTU). Currently El Paso variable costs are documented on second revised sheet No. 23 issued on November 30, 1994 in the column titled Maximum Rate. The components are Mainline transportation from San Juan to California on line 1F, GRI surcharge on line 6, ACA surcharge on line 7 and Take-or Pay Surcharge on line 8.

9.2 "Transwestern Variable Cost" means all the transportation variable cost components of the Firm Transportation Tariff, FTS-1, including any present or future commodity surcharges for the Transwestern system, or any equivalent replacement or successor rate or rate schedule, from the Permian basin to the interconnection with SoCal's System (expressed in \$/MMBTU). Currently Transwestern variable costs are documented on 109th Revised Sheet No. 5 under the heading FTS-1 Commodity for the East of Thoreau Receipt point area.

#### TRANSPORTATION FIXED COST

10.0 "Transportation Fixed Cost" for the Month (expressed in \$/MMBTU) shall equal the greater of the Floor Cost as described in section 10.1 or Average Transportation Fixed Cost as described in section 10.2.

10.1 (a) The "Floor Cost" for the Month (expressed in \$/MMBTU) shall equal the lesser of:

(i) \$0.15; or

(ii) the Full As-Billed SW Firm Service Cost as described in section 10.1(b).



(b) The "Full As-Billed SW Firm Service Cost" for the Month (expressed in \$/MMBTU) shall equal the sum of, all for the Month:

( $0.70 \times$  El Paso Reservation Charge) plus ( $0.30 \times$  Transwestern Reservation Charge).

(c) "El Paso Reservation Charge" shall be as determined in section 10.3.

(d) "Transwestern Reservation Charge" for the Month (expressed in \$/MMBTU) means the reservation charge cost component of the Firm Transportation Tariff, FTS-1, including any present or future reservation surcharges for the Transwestern system, or any equivalent replacement or successor rate or rate schedule, from the Permian basin to the interconnection with SoCal's System. This charge is currently documented on 109th Revised Sheet No. 5 in the column headed MAXIMUM FTS-1 RESERVATION CHARGE for the East of Thoreau Receipt Point Area at the line labeled TOTAL RATE.

10.2 "Average Transportation Fixed Cost" for the Month (expressed in \$/MMBTU) shall equal the quotient obtained by dividing the sum of the following products:

(a) El Paso Reservation Charge multiplied by El Paso Volume (both for the Month) as described in sections 10.3 and 10.4;

(b) New SW Contracted Fixed Rate multiplied by New SW Contracted Volume (both for the Month) as described in sections 10.5 and 10.6; and

(c) Other SW Deemed Fixed Rate multiplied by Other SW Volume (both for the Month) as described in sections 10.7 and 10.8;

by Total SW Volume (for the Month) as described in section 10.9.

10.3 "El Paso Reservation Charge" for the Month (expressed in \$/MMBTU) shall for the term of the Gas Purchase Agreement equal the reservation charge published in the Firm Transportation Tariff, T-3, including any present or future reservation surcharges for the El Paso system or any equivalent replacement or successor rate or rate schedule, from the San Juan basin to the interconnection with SoCal's System. The reservation charge currently includes the sum of Transportation Reservation Charge documented on First Revised Sheet No. 22, line 1G - California in the column titled Maximum Rate, plus the GRI Surcharge - High Load Factor documented on line 3A of the same page, plus the Washington Ranch Surcharge, as documented on Second Revised Sheet No. 29, in the line labeled California Reservation Surcharge, all divided by the number of days in the current month.

10.4 "El Paso Volume" for the Month (expressed in MMBTU's) shall equal the product of 10,300 MMBTU per day multiplied by the number of days in that Month.

10.5 (a) The "New SW Contracted Fixed Rate" for the Month (expressed in \$/MMBTU) shall equal the quotient obtained by dividing the sum of:

(i) The reservation charge, including any present or future reservation surcharges, (expressed in \$/MMBTU) as stated in each acquired capacity agreement or transportation contract of one year or longer for firm transportation service held by SDG&E to deliver gas from the San Juan or Permian basin on the El Paso or Transwestern systems to SoCal's System multiplied by the volume of gas actually transported under each such contract,

by New SW Contracted Volume as described in section 10.6.

The charges and volumes referenced in section 10.2(a) and all charges and volumes referenced in section 10.5(b) shall be excluded from this calculation.

(b) "Excluded Contracts" means:

- (i) Any firm service transportation capacity acquired by or for the account of SDG&E as the result of the Southern California Edison ITCS Proposal (OIR R.88-08-018, joint petition No.92-07-025) or similar proposals as approved or directed by the CPUC relating to the assignment or release to SDG&E of El Paso or Transwestern firm transportation service held by SoCal; and
- (ii) SDG&E's 90 Mmcf/d firm service transportation contract with SoCal which is comprised of transportation contracts Nos. EP98L8, EP98L2 and TW22513;

(c) If SDG&E secures any acquired capacity agreement or transportation contract as described in section 10.5(a) that has (1) variable costs higher than (2) the applicable tariff variable costs in sections 9.1 or 9.2, then the positive difference of (1) minus (2) will be added to and deemed part of the reservation charge of that contract in section 10.5(a). The resulting reservation charge cannot exceed the Full As-Billed SW Firm Service Cost as defined in section 10.1(b.)

10.6 "New SW Contracted Volume" for the Month (expressed in MMBTU's) shall equal the aggregate of the volumes of gas actually transported by SDG&E in the Month under the firm transportation service contracts described in section 10.5(a) and excluding only the El Paso Volume referred to in section 10.4 and Excluded Contracts' volumes as described in section 10.5(b).

10.7 "Other SW Deemed Fixed Rate" for the Month (expressed in \$/MMBTU) shall equal the California Index minus (Transportation Fuel Cost plus Transportation Variable Cost plus Southwest Basin Index).

The "California Index" for the Month (expressed in \$/MMBTU) shall equal the current month Index under the line titled Southern CA Border on the table titled U.S. SPOT MARKET SUMMARY in the publication titled BTU's Daily Gas Wire in the first issue of the current month or if that index is not published for the current month then the replacement index will be: The California Border Contract Index Price on the table titled Spot Gas Prices Delivered to Pipelines 30 Day Supply Transactions from the publication Natural Gas Intelligence.

10.8 "Other SW Volume" for the Month (expressed in MMBTU's) shall equal the positive difference, if any, obtained by subtracting from Total SW Volume, as described in section 10.9, the sum of El Paso Volume plus New SW Contracted Volume.

10.9 "Total SW Volume" means the total quantity of gas (expressed in MMBTU's) received by SDG&E in the Month:

- (a) at the interconnection of the El Paso system and SoCal's System;
- (b) at the interconnection of the Transwestern system and SoCal's System.

10.10 If requested by Seller, SDG&E shall provide Seller with current copies of all firm acquired capacity agreements and transportation contracts, as amended from time to time, as described in section 10.5 and as applicable to the pricing terms of this Agreement.

#### ARBITRATION

11.0 (a) Subject to any other provisions of this Appendix:

- (i) if any published index or price, or any rate or tariff or other provision of the Gas Purchase Agreement, including this Appendix, which is required to determine the Base Price:

(A) ceases to be available or ascertainable;  
or

(B) assumes a measure or value that is wholly  
inconsistent with the measure or value  
represented by the component in December,  
1994; or

(ii) if in the reasonable opinion of either party  
the Base Price no longer represents a price  
which is competitive with SDG&E's alternative  
southwest gas supplies

(any of the circumstances described in (i) or (ii)  
shall, subject to section 11.0(b), be referred to as  
a "Pricing Event"),

then either party may by notice in writing, within ninety  
(90) days of the Pricing Event, require the other party to  
meet and attempt in good faith to negotiate a replacement  
index, price, rate, tariff or mechanism in order that the  
Base Price will be:

(iii) competitive with the cost of SDG&E's  
alternative southwest gas supplies; and

(iv) insofar as possible, consistent with the  
pricing structure as set out in this Appendix;

((iii) and (iv) herein shall be referred to as the  
"Standard").

(b) Notwithstanding the provisions of subsection 11.0(a), in  
no event shall:

(i) the concept of the Floor Cost as described in  
section 10.1(a) (which may be zero or any other  
amount up to and including \$0.15);

(ii) the amount set forth in section 10.1(a)(i); or

(iii) the 70%/30% allocations contained in the  
calculation of the Base Price, so long as gas  
continues to be supplied to California from  
both the San Juan and Permian basins on the  
El Paso and Transwestern systems respectively;

be cause for a Pricing Event or subject to  
redetermination as part of any arbitration.

(c) If the parties are unable to negotiate a replacement  
index, price, rate, tariff or mechanism within three (3)  
months following the provision of the notice referred to  
in section 11.0(a), the parties shall proceed to  
arbitration pursuant to the following provisions of this  
section.

(d) The matter shall be referred to and finally resolved by  
arbitration under the rules of the British Columbia  
International Commercial Arbitration Centre. The  
appointing authority shall be the British Columbia  
International Commercial Arbitration Centre. The case  
shall be administered by the British Columbia  
International Commercial Arbitration Centre in  
accordance with its "procedures for cases under the  
BCICAC Rules". The place for arbitration shall be  
Vancouver, British Columbia, Canada.

(e) Any such arbitration shall be limited to determining a  
replacement index, price, rate, tariff or mechanism  
which will result in a Base Price formula which will  
meet the Standard. If the arbitrator determines that no  
appropriate replacement index, price, rate, tariff or  
mechanism exists then the arbitrator shall determine a  
Base Price to apply to the Gas Purchase Agreement which  
will meet the Standard.

(f) Upon a replacement index, price, rate, tariff, mechanism

or Base Price being determined by negotiation or arbitration, the Base Price and Contract Price shall be adjusted to reflect the difference, if any, for the applicable month or months following the month of the Pricing Event and any payment adjustment will be recovered in the first payment period immediately following

that determination and shall include interest accrued as if the adjustment was a Disputed Amount under Article 7 of the Gas Purchase Agreement.

Pacific Gas and Electric Company (PG&E) and San Diego Gas & Electric Company (SDG&E) hereby agree to amend the Firm Transportation Service Agreement (FTSA) between them, dated December 31, 1991, as follows:

1. For the "Negotiated Period" as defined in Section 11, SDG&E's rate for gas transportation service under the FTSA shall be a "Negotiated Rate".
  - 1.1. NEGOTIATED RATE:

The "Negotiated Rate" shall be \$ 0.28 per decatherm. SDG&E shall pay PG&E each month an amount calculated as follows. SDG&E shall pay a reservation charge equal to the Negotiated Rate times the number of calendar days in the month times the Maximum Daily Quantity. There shall be no usage charge.
  - 1.2. The payment provisions of PG&E's tariffs shall apply.
  - 1.3. During the Negotiated Period, SDG&E shall have a one-time option to elect to pay the standard tariff rates applicable to Expansion deliveries to the Southern Terminus for delivery off system. If SDG&E elects to pay standard tariff rates, SDG&E shall not be able to revert to the Negotiated Rate.
2. Following the Negotiated Period, SDG&E shall pay rates and charges as specified in the CPUC-approved tariff applicable to firm Expansion service, with the exception that such rates and charges shall be no higher than a rate calculated using the methodology in effect at the time the rates and charges are calculated, with a Line 401 capital cost of \$736 million, and a utility capital structure. SDG&E shall pay rates on an SFV basis.
3. Upon a CPUC decision on the PEBA balance, the owing party shall pay all amounts due in a manner consistent with the CPUC decision. Payment of the balance shall be independent of the monthly payments calculated in Section 1.1.
4. SDG&E agrees that PG&E may transfer all or part of its ownership interest in Line 401 without SDG&E's consent and, if PG&E's successor in interest assumes all of PG&E's obligations under the FTSA, PG&E shall have no further or continuing obligations to SDG&E, its successor, or its assignees.
5. SDG&E agrees that, if PG&E or its successor in interest at any time seeks, in accordance with California Public Utilities Commission (CPUC) Resolution L-244, to transfer

- 1 -

Line 401 to the jurisdiction of the Federal Energy Regulatory Commission, SDG&E will neither oppose such a transfer nor claim that such a transfer violates any provision of the FTSA.

6. As consideration for PG&E's agreement to the Negotiated Rate set forth in paragraph 1, effective immediately, and for the remainder of the 30-year term of the FTSA, SDG&E irrevocably waives rights it has under the "Uniform Terms of Service" set forth in the March, 1994 Amendment to the FTSA, and relinquishes all claims it may have either arising under or relating in any way to rights under that provision.
7. For the period beginning on the first day of the Negotiated Period and ending on the last day of the Negotiated Period, SDG&E agrees to deliver all gas transported under this amendment off PG&E's system, using the delivery point specified in Exhibit A attached to the original FTSA. Following the Negotiated Period, SDG&E shall have a right to

whatever delivery point options are available in effective CPUC-approved tariffs applicable to long-term firm Expansion service.

8. Within five calendar days of execution of this amendment by both SDG&E and PG&E, SDG&E agrees to withdraw with prejudice all opposition to PG&E's positions in all phases of the consolidated PEPR/ITCS cases; including the so-called 'statewide ITCS' issue.
9. SDG&E agrees to: (a) actively support approval by the CPUC of this amendment, without modification or condition; and (b) actively support PG&E's Gas Accord before the CPUC.
10. Within 60 days of execution of this amendment, PG&E shall file the amendment with the CPUC by advice letter.
11. The Negotiated Period shall begin on the date the CPUC approves this amendment and shall continue until the later of (a) five years from the date or (b) the end of the Gas Accord period, as approved by the CPUC.
12. As consideration for SDG&E's agreement to execute this amendment by December 2, 1996 without the limited protection of a favored-nations provision granting SDG&E the right to take possible subsequent arrangements PG&E might agree to with other firm Expansion shippers under the August 12, 1996 letter, PG&E shall pay to SDG&E the sum of \$150,000 within thirty (30) calendar days from the date this amendment is approved by the CPUC.

13. Prior to any future expansion of PG&E's Line 400/401 system, PG&E agrees to offer SDG&E the option to reduce its firm transportation commitment by the lesser of SDG&E's contract demand, the proposed amount of the new expansion, or, if applicable, a pro rata share (with other firm Expansion Shippers) of the amount of the new expansion.

14. Each provision of this amendment is agreed to by the parties as quid pro quo consideration for each of the other provisions, so that no provision of this amendment is separable from the others for any purpose. If any provision of this amend is deleted, this amendment shall be null and void and of no binding effect on any party.

For SDG&E:

For PG&E:

By: \_\_\_\_\_ By: \_\_\_\_\_  
Title: \_\_\_\_\_ Title: \_\_\_\_\_  
Date: \_\_\_\_\_ Date: \_\_\_\_\_

FIRM TRANSPORTATION SERVICE AGREEMENT

THIS AGREEMENT is made and entered into this 13th day of October, 1994 by and between

PACIFIC GAS TRANSMISSION COMPANY, a California corporation  
(hereinafter referred to as "PGT")

and

SAN DIEGO GAS & ELECTRIC COMPANY, a California corporation existing under the laws of the State of California, (hereinafter referred to as "Shipper").

WHEREAS, PGT owns and operates a natural gas pipeline transmission system which extends from a point of interconnection with the pipeline facilities of Alberta Natural Gas Company Ltd. (ANG) at the International Boundary near Kingsgate, British Columbia, through the states of Idaho, Washington and Oregon to a point of interconnection with Pacific Gas and Electric Company at the Oregon-California border near Malin, Oregon; and

WHEREAS, Shipper desires PGT, on a firm basis, to transport certain quantities of natural gas as specified on Exhibit A of this Agreement; and

WHEREAS, PGT is willing to transport certain quantities of natural gas for Shipper, on a firm basis,

NOW, THEREFORE, the parties agree as follows:

I. GOVERNMENTAL AUTHORITY

1.1 This Firm Transportation Agreement ("Agreement") is made pursuant to the regulations of the Federal Energy Regulatory Commission (FERC) contained in 18 CFR Part 284, as amended from time to time.

1.2 This Agreement is subject to all valid legislation with respect to the subject matters hereof, either state or federal, and to all valid present and future decisions, orders, rules, regulations and ordinances of all duly constituted governmental authorities having jurisdiction.

I. GOVERNMENTAL AUTHORITY  
(continued)

1.3 Shipper shall reimburse PGT for any and all FERC filing fees incurred by PGT in seeking governmental authorization for the initiation, extension, or termination of service under this Agreement and Rate Schedule FTS-1. Shipper shall reimburse PGT for such fees at PGT's designated office within ten (10) days of receipt of notice from PGT that such fees are due and payable. Additionally, Shipper shall reimburse PGT for any and all penalty fees or fines assessed PGT by either the government of the United States or Canada caused strictly by the negligence of Shipper or Shipper's Agent in not obtaining all proper Canadian and U.S. domestic import/export licenses, surety bonds or any other documents and approvals related to the Canadian exportation and subsequent domestic importation of natural gas transported by PGT hereunder.

II. QUANTITY OF GAS AND PRIORITY OF SERVICE

2.1 Subject to the terms and provisions of this Agreement and PGT's Transportation General Terms and Conditions contained in PGT's FERC Gas Tariff, First Revised Volume No. 1-A or superseding tariff(s) (Transportation General Terms and Conditions) applicable to Rate Schedule FTS-1 or superseding rate schedule(s) (Effective Rate Schedule) daily receipts of gas by PGT from Shipper at the point(s) of receipt shall be equal to daily deliveries of gas by PGT to Shipper at the point(s) of delivery; provided, however, Shipper shall deliver to PGT an additional quantity of natural gas at the point(s) of receipt as compressor station fuel, line loss and unaccounted for gas as specified in the Statement of Effective Rates and Charges of PGT's FERC Gas

Tariff, First Revised Volume No. 1-A or superseding tariff(s) (Statement of Effective Rates and Charges). Any limitations of the quantities to be received from each point of receipt and/or delivered to each point of delivery shall be as specified on the Exhibit A attached hereto.

2.2 The maximum quantities of gas to be delivered by PGT for Shipper's account at the point(s) of delivery are set forth in Exhibit A.

2.3 In providing service to its existing or new customers, PGT will use the priorities of service specified in Paragraph 18 of PGT's Transportation General Terms and Conditions on file with the FERC.

2.4 Prior to initiation of service, Shipper shall provide PGT with any information required by the FERC, as well as all information identified in PGT's Transportation General Terms and Conditions applicable to the Effective Rate Schedule.

### III. TERM OF AGREEMENT

3.1 This Agreement shall become effective \_\_\_\_\_, and shall continue in full force and effect until October 31, 2023 (Initial Term). Thereafter, this Agreement shall continue in full force and effect from year to year (Subsequent Term) unless either party gives twelve (12) months prior written notice of its desire to terminate this Agreement.

3.2 Neither party may terminate this Agreement during the Initial Term except as provided by Paragraph 6.9 of this Agreement.

### IV. POINTS OF RECEIPT AND DELIVERY

4.1 The point(s) of receipt of gas deliveries to PGT is/are as designated in Exhibit A, attached hereto.

4.2 The point(s) of delivery of gas to Shipper is/are as designated in Exhibit A, attached hereto.

4.3 Shipper shall deliver or cause to be delivered to PGT the gas to be transported hereunder at pressures sufficient to deliver such gas into PGT's system at the point(s) of receipt. PGT shall deliver the gas to be transported hereunder to or for the account of Shipper at the pressures existing in PGT's system at the point(s) of delivery.

4.4 Pursuant to PGT's Transportation General Terms and Conditions, Shipper may designate other receipt and/or delivery points as secondary receipt and/or delivery points.

### V. OPERATING PROCEDURES

5.1 Both PGT's and Shipper's performance hereunder shall be subject to and must conform with all applicable operating procedures contained in PGT's Transportation General Terms and Conditions.

5.2 PGT shall have the right to interrupt or curtail the transport of gas for the account of Shipper pursuant to PGT's Transportation General Terms and Conditions.

VI. RATE(S), RATE SCHEDULES, AND  
GENERAL TERMS AND CONDITIONS OF SERVICE

6.1 Shipper shall pay PGT each month for services rendered pursuant to this Agreement in accordance with the, Effective Rate Schedule, on file with and subject to the jurisdiction of the FERC.

6.2 Shipper shall provide PGT each month with gas for compressor station fuel, line loss and other unaccounted for gas associated with this transportation service provided herein in accordance with PGT's Statement of Effective Rates and Charges on file with. and subject to the jurisdiction of the FERC.

6.3 This Agreement in all respects shall be and remains subject to the applicable provisions of the Effective Rate Schedule and of the applicable Transportation General Terms and Conditions , all of which are by this reference made a part hereof.

6.4 PGT shall have the right from time to time to propose and file with the FERC such changes in the rates and charges applicable to transportation services pursuant to this Agreement, the rate schedule(s) under which this service is hereunder provided, or any provisions of PGT's Transportation General Terms and Conditions applicable to such services. Shipper shall have the right to protest any such changes proposed by PGT and to exercise any other rights that Shipper may have with respect thereto.

6.5 If PGT fails to deliver to Malin, Oregon ninety-five percent (95%) or more of the aggregate Confirmed Daily Nominations (as hereinafter defined) of all Converting Shippers with a Malin primary delivery point receiving service under the Effective Rate Schedule (hereinafter referred to as the "Non-Deficiency Amount") for more than twenty-five (25) days in any given Contract Year, then for each day during that Contract Year in excess of twenty-five (25) days that PGT so fails to deliver the Non-Deficiency Amount (a "Credit Day"), Converting Shipper shall be entitled to a Reservation Charge Credit calculated in the manner hereinafter set forth.

For the purpose of this Paragraph 6.5, Confirmed Daily Nomination shall mean for any day, the lesser of (i) Converting Shipper's Maximum Daily Quantity or (ii) the actual quantity of gas that the connecting pipeline upstream of PGT is capable of delivering for Converting Shipper's account to PGT at Converting Shipper's primary point(s) of receipt on PGT less Converting Shipper's requirement to provide compressor fuel and line losses under PGT's Statement of Effective Rates and Charges or (iii) the quantity of gas that Pacific Gas and Electric Company (PG&E) is capable of accepting at Malin for Converting Shipper's account, or (iv) Converting Shipper's nomination to PGT.

VI. RATE(S), RATE SCHEDULES, AND  
GENERAL TERMS AND CONDITIONS OF SERVICE  
(continued)

The Reservation Charge Credit for each Credit Day for a particular Converting Shipper shall be computed as follows:

$$\begin{array}{rcl} \text{Reservation Charge} & & \\ \text{Credit for Each} & = & \begin{array}{c} A \\ \text{-----} \\ 30.4 \end{array} \times \begin{array}{c} B - C \\ \text{-----} \\ B \end{array} \end{array}$$

- where
- A = Converting Shipper's Monthly Reservation Charge
  - B = Converting Shipper's confirmed daily nomination for the Credit Day
  - C = Actual quantity of gas delivered by PGT to PG&E at Malin for Converting Shipper's account for the Credit Day

Except as provided for in Paragraphs 6.6 and 6.9 of this Agreement, these circumstances are the only circumstances under which a Reservation Charge Credit will be provided and except to this limited extent, the provisions of Paragraph 10.3 of PGT's General Terms and Conditions continue to apply.

6.6 If PGT fails to deliver to a primary delivery point on its system other than Malin, Oregon ninety-five percent (95%) or more of the aggregate Confirmed Daily Nominations (as hereinafter defined) of all Converting Shippers at such primary delivery point other than Malin receiving service under this rate schedule (hereinafter referred to as the "Non-Deficiency Amount") for more than twenty-five (25) days that PGT so fails to deliver the Non-Deficiency Amount (a "Credit Day"), Converting Shipper shall be entitled to a Reservation Charge Credit calculated in the manner hereinafter set forth.

For the purpose of this Paragraph 6.6, Confirmed Daily Nomination shall mean for any day, the lesser of (i) Converting Shipper's Maximum Daily Quantity or (ii) the quantity of gas that the connecting downstream pipeline(s), local distribution company pipeline(s), or end-user(s) is/are capable of accepting for Converting Shipper's account at Converting Shipper's primary point(s) of delivery on PGT or (iii) the quantity of gas that the connecting pipeline upstream of PGT is capable of delivering for the Converting Shipper's primary point(s) of receipt on PGT less Converting Shipper's requirement to provide compressor fuel and line losses under PGT's Statement of Effective Rates and Charges, or (iv) Converting Shipper's nomination to PGT.

VI. RATE(S), RATE SCHEDULES, AND  
GENERAL TERMS AND CONDITIONS OF SERVICE  
(continued)

The Reservation Charge Credit for each Credit Day for a particular Converting Shipper shall be computed as follows:

$$\begin{array}{rcll} \text{Reservation Charge} & & & \\ \text{Credit for Each} & = & A & \times & B - C \\ & & \text{-----} & & \text{-----} \\ \text{Credit Day} & & 30.4 & & B \end{array}$$

where A = Converting Shipper's Monthly Reservation Charge  
B = Converting Shipper's confirmed daily nomination for the Credit Day  
C = Actual quantity of gas delivered by PGT to a Converting Shipper's primary delivery point(s) (other than Malin) for Converting Shipper's account for the Credit Day

Except as provided for in Paragraphs 6.5 and 6.9 of this Agreement, these circumstances are the only circumstances under which a Reservation Charge Credit will be provided and except to this limited extent, the provisions of Paragraph 10.3 of PGT's General Terms and Conditions continue to apply.

6.7 For the purposes of Paragraphs 6.5, 6.6, 6.9, and 7.9 of this Agreement, (i) the term "Converting Shipper" shall mean any Shipper receiving service under PGT's Effective Rate Schedule which has converted its firm transportation service from Rate Schedule T-3 in accordance with the FERC's July 2, 1993 order at Docket No. RS92-46, and (ii) the term "Contract Year" shall be the period of twelve (12) consecutive months commencing the first month that this Agreement becomes effective and each such consecutive twelve (12) month period thereafter during the term of this Agreement.

6.8 The Reservation Charge Credit contemplated in Paragraphs 6.5, 6.6 and 6.9 of this Agreement shall only apply to the reservation charges associated with the firm capacity that Shipper has not permanently released in accordance with PGT's Transportation General Terms and Conditions.

VI. RATE(S), RATE SCHEDULES, AND  
GENERAL TERMS AND CONDITIONS OF SERVICE  
(continued)

6.9 Shipper shall be relieved from its Reservation Charge payment obligation for any period ("Relief Period") when an unforeseeable action, after service commences on the PGT Expansion Project, by the federal or provincial governments of Canada or the United States having jurisdiction ("Event") occurs which: (1) prohibits directly all gas exports or imports through the PGT Expansion Project, or (2) prohibits through economic means intended to have prohibitory effect, all gas exports or imports from Canada to the U.S.. This provision shall only apply, however, if the Event: is equally applicable to all Converting Shippers subject to such governmental jurisdiction; is not peculiar to the circumstances of a particular Converting Shipper; and is not attributable to the actions or non-actions of any particular Converting Shipper. In order for Shipper to invoke this provision, Shipper must notify PGT of such Event within four weeks after Shipper becomes aware of such Event. The Relief Period shall commence twelve months after service is curtailed as a result of such Event ("Commencement Date") provided Shipper has resisted such Event by all reasonable means (including appeals) within the twelve month period whether or not all such appeals have been resolved as of the Commencement Date.

If this provision is invoked by a Shipper to relieve its Reservation Charge payment obligations, PGT shall have the unilateral right during the first two years of the Relief Period to terminate the Firm Transportation Service Agreement with that Shipper, however, such right to terminate may be exercised by PGT only if the PG&E and ANG Firm Transportation Service Agreements are coincidentally terminated.

6.10 The Reservation Charge Relief contemplated in Paragraph 6.9 of this Agreement shall terminate and have no force or effect if the FERC should require PGT to offer such relief to any Part 284 firm shipper on PGT which is not a "Converting Shipper" as that term is defined in Paragraph 6.7 of this Agreement.

#### VII. MISCELLANEOUS

7.1 This Agreement shall be interpreted according to the laws of the State of California.

7.2 Unless otherwise stated in this Agreement, in the case of inconsistencies between this Agreement, the applicable Transportation General Terms and Conditions, and PGT's Effective Rate Schedule, the applicable Transportation General Terms and Conditions and PGT's Effective Rate Schedule shall control. In the case of inconsistencies between PGT's Effective Rate Schedule and the applicable Transportation General Terms and Conditions, PGT's Effective Rate Schedule shall control.

VII. MISCELLANEOUS  
(continued)

7.3 Shipper agrees to indemnify and hold PGT harmless for refusal to transport gas hereunder in the event any upstream or downstream transporter fails to receive or deliver gas as contemplated by this Agreement, except to the extent such failure to receive or deliver gas by the upstream or downstream transporter is a direct result of PGT's failure to perform according to the terms and conditions of this Agreement.

7.4 Unless herein provided to the contrary, any notice called for in this Agreement shall be in writing and shall be considered as having been given if delivered by facsimile or registered mail with all postage or charges prepaid, to either PGT or Shipper at the place designated below. Routine communications, including monthly statements, shall be considered duly delivered when received by ordinary mail or facsimile. Payments shall be considered duly delivered when received by ordinary mail, registered mail, or electronic wire transfer. Shipper's daily nomination shall be considered as duly delivered when received by electronic data interchange when such system(s) is/are available. If such system(s) is/are not available, Shipper's daily nominations shall be considered duly delivered when received by facsimile. Unless changed, the addresses of the parties are as follows:

"PGT"                   PACIFIC GAS TRANSMISSION COMPANY  
160 Spear Street  
Room 1900  
San Francisco, California 94105-1570  
Attention: President & CEO

"Shipper"               SAN DIEGO GAS & ELECTRIC COMPANY  
101 Ash Street  
San Diego, California 92101  
Attention: Manager, Fuels Department

7.5 A waiver by either party of any one or more defaults by the other hereunder shall not operate as waiver of any future default or defaults, whether of a like or of a different character.

7.6 This Agreement may only be amended by an instrument in writing executed by both parties hereto.

7.7 Nothing in this Agreement shall be deemed to create any rights or obligations between the parties hereto after the expiration of the Initial or Subsequent Terms set forth herein, except that termination of this Agreement shall not relieve either party of the obligation to correct any quantity imbalances or Shipper of the obligation to pay any amounts due hereunder to PGT.

VII. MISCELLANEOUS  
(continued)

7.8 Exhibits A and C attached hereto are incorporated herein by reference and made a part hereof for all purposes.

7.9 If PGT modified or changes any term or condition specified in an effective Firm Transportation Service Agreement with any Converting Shipper receiving service under PGT's Effective Rate Schedule, within sixty (60) days thereafter, PGT shall offer to make the same term(s) and condition(s) applicable to any other Converting Shipper then receiving service under the Effective Rate Schedule.

IN WITNESS WHEREOF the parties hereto have caused this Agreement to be executed as of the day and year first above written.

PACIFIC GAS TRANSMISSION COMPANY

By: \_\_\_\_\_

Name: Stephen P. Reynolds

Title: President & CEO

SAN DIEGO GAS & ELECTRIC COMPANY

By: \_\_\_\_\_

Name: Edwin A. Guiles

Title: Senior Vice President - Energy Supply

Date: October 11, 1994



TO BE COMPLETED WHEN SHIPPER RELEASES CAPACITY

EXHIBIT C

To the  
FIRM TRANSPORTATION SERVICE AGREEMENT  
Dated                      Between  
PACIFIC GAS TRANSMISSION COMPANY  
And  
SAN DIEGO GAS & ELECTRIC COMPANY

Type of Replacement Service:

Replacement Shipper:

Receipt Point:

Delivery Point:

Maximum Daily Quantity:

Commencement of Credit:

Termination of Credit:

Level of Credit: \_\_\_\_\_percent of the maximum rate defined as  
\_\_\_\_\_  
\_\_\_\_\_

applicable for service under Rate Schedule FTS-1

Other Terms and Conditions:

- 1) \_\_\_\_\_
- 2) \_\_\_\_\_
- 3) \_\_\_\_\_

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YEAR	DEC-31-1997	DEC-30-1997	PER-BOOK
	2,936,084		
	406,259		
	1,007,845		
	119,468		
		184,837	
		4,654,493	
			291,458
	566,233		
		529,672	
1,387,363			
	25,000		
		78,475	
	1,699,245		
		0	
	0		
	0		
66,302			
	0		
	88,578		
		6,723	
1,303,257			
4,654,493			
	2,167,548		
		217,083	
	1,633,377		
	1,850,460		
		317,088	
		7,362	
324,450			
	86,218		
		238,232	
	6,582		
231,650			
	178,423		
	69,545		
	380,847		
		0	
		0	

EXHIBIT 12.1  
SAN DIEGO GAS & ELECTRIC COMPANY  
COMPUTATION OF RATIO OF EARNINGS TO COMBINED FIXED CHARGES  
AND PREFERRED STOCK DIVIDENDS

	1993	1994	1995	1996	1997
Fixed Charges:					
Interest:					
Long-Term Debt	\$ 84,830	\$ 81,749	\$ 82,591	\$ 76,463	\$ 69,546
Short-Term Debt	6,676	8,894	17,886	12,635	13,825
Amortization of Debt Discount and Expense, Less Premium	4,162	4,604	4,870	4,881	5,154
Interest Portion of Annual Rentals	9,881	9,496	9,631	8,446	9,496
<b>Total Fixed Charges</b>	<b>105,549</b>	<b>104,743</b>	<b>114,978</b>	<b>102,425</b>	<b>98,021</b>
Preferred Dividends Requirements	8,565	7,663	7,663	6,582	6,582
Ratio of Income Before Tax to Net Income	1.79353	1.83501	1.78991	1.88864	1.91993
Preferred Dividends for Purpose of Ratio	15,362	14,062	13,716	12,431	12,637
<b>Total Fixed Charges and Preferred Dividends for Purpose of Ratio</b>	<b>\$120,911</b>	<b>\$118,805</b>	<b>\$128,694</b>	<b>\$114,856</b>	<b>\$110,658</b>
Earnings:					
Net Income (before preferred dividend requirements)	\$215,872	\$206,296	\$219,049	\$222,765	\$238,232
Add:					
Fixed Charges (from above)	105,549	104,743	114,978	102,425	98,021
Less: Fixed Charges Capitalized	1,483	1,424	2,040	1,495	2,052
Taxes on Income	171,300	172,259	173,029	197,958	219,156
<b>Total Earnings for Purpose of Ratio</b>	<b>\$491,238</b>	<b>\$481,874</b>	<b>\$505,016</b>	<b>\$521,653</b>	<b>\$553,357</b>
Ratio of Earnings to Combined Fixed Charges and Preferred Dividends	4.06	4.06	3.92	4.54	5.00