SEMPRA ENERGY
Form 10-Q
May 02, 2007

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2007

Commission file number 1-14201

SEMPRA ENERGY

(Exact name of registrant as specified in its charter)

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

101 Ash Street, San Diego, California 92101

(Address of principal executive offices)
(Zip Code)

(619) 696-2034

(Registrant's telephone number, including area code)

No Change

(Former name, former address and former fiscal year, if changed since last report)

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

Yes	X	No

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

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

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

Yes	No	X

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock outstanding on April 30, 2007: 263,809,644

INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

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

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

PART I. FINANCIAL INFORMATION
ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEMPRA ENERGY
STATEMENTS OF CONSOLIDATED INCOME

	Three months ended March 31,	
(Dollars in millions, except per share amounts)	2007	2006
	(unaudited)	
OPERATING REVENUES		
Sempra Utilities	$ 2,059	$ 2,128
Sempra Global and parent	945	1,208
Total operating revenues	3,004	3,336
OPERATING EXPENSES		
Sempra Utilities:		
Cost of natural gas	1,050	1,130
Cost of electric fuel and purchased power	149	210
Sempra Global and parent:		
Cost of natural gas, electric fuel and purchased power	336	298
Other cost of sales	319	376
Other operating expenses	633	676
Depreciation and amortization	169	157
Franchise fees and other taxes	81	77
Total operating expenses	2,737	2,924
Operating income	267	412
Other income, net	11	4
Interest income	26	14
Interest expense	(70)	(96)
Preferred dividends of subsidiaries	(2)	(2)
Income from continuing operations before income taxes and equity in earnings of certain unconsolidated subsidiaries	232	332
Income tax expense	63	108
Equity in earnings of certain unconsolidated subsidiaries	58	10
Income from continuing operations	227	234

Discontinued operations, net of income tax	1	21
Net income	$ 228	$ 255
Basic earnings per share:		
Income from continuing operations	$ 0.88	$ 0.92
Discontinued operations, net of income tax	--	0.08
Net income	$ 0.88	$ 1.00
Weighted-average number of shares outstanding (thousands)	259,459	254,257
Diluted earnings per share:		
Income from continuing operations	$ 0.86	$ 0.90
Discontinued operations, net of income tax	--	0.08
Net income	$ 0.86	$ 0.98
Weighted-average number of shares outstanding (thousands)	263,996	259,251
Dividends declared per share of common stock	$ 0.31	$ 0.30

See Notes to Condensed Consolidated Financial Statements.

SEMPRA ENERGY
CONSOLIDATED BALANCE SHEETS

(Dollars in millions)	March 31, 2007	December 31, 2006
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,658	$ 920
Restricted cash	1	4
Trade accounts receivable, net	821	938
Other accounts and notes receivable, net	96	97
Deferred income taxes	376	270
Interest receivable	7	40
Trading-related receivables and deposits, net	2,452	3,047
Derivative trading instruments	3,332	4,068
Commodities owned	1,399	1,845
Inventories	111	215
Regulatory assets	143	193
Other	275	317
Current assets of continuing operations	10,671	11,954
Current assets of discontinued operations	60	62
Total current assets	10,731	12,016
Investments and other assets:		
Regulatory assets arising from fixed-price contracts and other derivatives	339	353
Regulatory assets arising from pension and other postretirement benefit obligations	367	356
Other regulatory assets	462	472
Nuclear decommissioning trusts	710	702
Investments	1,138	1,086
Sundry	791	789
Total investments and other assets	3,807	3,758
Property, plant and equipment:		

Property, plant and equipment		19,323		18,916
Less accumulated depreciation and amortization		(5,837)		(5,741)
Property, plant and equipment, net		13,486		13,175
Total assets	$	28,024	$	28,949

See Notes to Condensed Consolidated Financial Statements.

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SEMPRA ENERGY
CONSOLIDATED BALANCE SHEETS

(Dollars in millions)	March 31, 2007	December 31, 2006
	(unaudited)	
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Short-term debt	$ 101	$ 252
Accounts payable - trade	892	1,432
Accounts payable - other	121	155
Income taxes payable	114	9
Trading-related payables	2,769	3,211
Derivative trading instruments	2,450	2,304
Commodities sold with agreement to repurchase	144	537
Dividends and interest payable	153	145
Regulatory balancing accounts, net	457	332
Fixed-price contracts and other derivatives	55	87
Current portion of long-term debt	656	681
Other	1,283	1,197
Current liabilities of continuing operations	9,195	10,342
Current liabilities of discontinued operations	5	7
Total current liabilities	9,200	10,349
Long-term debt	4,520	4,525
Deferred credits and other liabilities:		
Due to unconsolidated affiliate	162	162
Customer advances for construction	124	126
Pension and other postretirement benefit obligations, net of plan assets	622	609
Deferred income taxes	378	412
Deferred investment tax credits	66	67
Regulatory liabilities arising from removal obligations	2,353	2,330
Asset retirement obligations	1,187	1,128
Other regulatory liabilities	224	221

Fixed-price contracts and other derivatives	346	358
Deferred credits and other	954	972
Total deferred credits and other liabilities	6,416	6,385
Preferred stock of subsidiaries	179	179
Commitments and contingencies (Note 9)		
Shareholders' equity:		
Preferred stock (50 million shares authorized; none issued)	--	--
Common stock (750 million shares authorized; 263 million and 262 million shares outstanding at March 31, 2007 and December 31, 2006, respectively; no par value)	3,287	3,245
Retained earnings	4,837	4,681
Deferred compensation	(24)	(25)
Accumulated other comprehensive income (loss)	(391)	(390)
Total shareholders' equity	7,709	7,511
Total liabilities and shareholders' equity	$ 28,024	$ 28,949

See Notes to Condensed Consolidated Financial Statements.

SEMPRA ENERGY
CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS

(Dollars in millions)	Three months ended March 31, 2007	2006
	(unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Income from continuing operations	$ 227	$ 234
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	169	157
Deferred income taxes and investment tax credits	(104)	(44)
Equity in income of unconsolidated subsidiaries	(52)	(6)
Other	20	32
Net changes in other working capital components	1,115	399
Changes in other assets	16	(18)
Changes in other liabilities	(7)	6
Net cash provided by continuing operations	1,384	760
Net cash provided by (used in) discontinued operations	(1)	95
Net cash provided by operating activities	1,383	855
CASH FLOWS FROM INVESTING ACTIVITIES		
Expenditures for property, plant and equipment	(423)	(415)
Proceeds from sale of assets from continuing operations	32	22
Expenditures for investments	(5)	(103)
Purchases of nuclear decommissioning and other trust assets	(211)	(122)
Proceeds from sales by nuclear decommissioning and other trusts	213	116
Other	(6)	(1)
Net cash used in continuing operations	(400)	(503)
Net cash used in discontinued operations	--	(2)
Net cash used in investing activities	(400)	(505)
CASH FLOWS FROM FINANCING ACTIVITIES		
Common dividends paid	(79)	(65)
Issuances of common stock	16	17

Repurchases of common stock	--	(12)
Decrease in short-term debt, net	(151)	(369)
Payments on long-term debt	(35)	(44)
Issuance of long-term debt	2	--
Other	2	2
Net cash used in continuing operations	(245)	(471)
Net cash provided by discontinued operations	--	2
Net cash used in financing activities	(245)	(469)
Increase (decrease) in cash and cash equivalents	738	(119)
Cash and cash equivalents, January 1	920	769
Cash and cash equivalents, March 31	$ 1,658	$ 650
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest payments, net of amounts capitalized	$ 62	$ 84
Income tax payments, net of refunds	$ 20	$ 19
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING ACTIVITIES		
Increase (decrease) in accounts payable from investments in property, plant and equipment	$ 15	$ (66)
Value of stock received for sale of investments	$ 26	$ --

See Notes to Condensed Consolidated Financial Statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. GENERAL

This Quarterly Report on Form 10-Q is that of Sempra Energy (the company), a California-based Fortune 500 holding company, and its consolidated subsidiaries. Sempra Energy s principal subsidiaries are San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) (collectively referred to as the Sempra Utilities) and Sempra Global, which is the holding company for Sempra Commodities, Sempra Generation, Sempra Pipelines & Storage, Sempra LNG and other, smaller businesses. The accompanying financial statements are the Consolidated Financial Statements of Sempra Energy and its consolidated subsidiaries.

The Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) and in accordance with the interim-period-reporting requirements of Form 10-Q. Results of operations for interim periods are not necessarily indicative of results for the entire year. In the opinion of management, the accompanying statements reflect all adjustments necessary for a fair presentation. These adjustments are only of a normal, recurring nature.

Information in this Quarterly Report should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2006 (the Annual Report).

The company s significant accounting policies are described in Note 1 of the Notes to Consolidated Financial Statements in the Annual Report. The same accounting policies are followed for interim reporting purposes.

Certain prior period financial statement items have been reclassified to reflect operations discontinued in the second quarter of 2006, as discussed in Note 4 of the Notes to Consolidated Financial Statements in the Annual Report.

The Sempra Utilities account for the economic effects of regulation on utility operations in accordance with Statement of Financial Accounting Standards (SFAS) 71*, Accounting for the Effects of Certain Types of Regulation.*

NOTE 2. NEW ACCOUNTING STANDARDS

Pronouncements that have recently become effective that are relevant to the company and/or have had or may have a significant effect on the company's financial statements are described below.

SFAS 157, "Fair Value Measurements" (SFAS 157): SFAS 157 defines fair value, establishes criteria to be considered when measuring fair value and expands disclosures about fair value measurements. SFAS 157 does not expand the application of fair value accounting to any new circumstances. The company applies fair value measurements to certain assets and liabilities, primarily trading derivatives and certain trading inventories, nuclear decommissioning and other trusts, and other miscellaneous derivatives.

SFAS 157 nullified a portion of Emerging Issues Task Force (EITF) Issue No. 02-3, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities* (EITF 02-3). Under EITF 02-3, the transaction price presumption prohibited recognition of a trading profit at inception of a derivative unless the positive fair value of that derivative was substantially based on quoted prices or a valuation process incorporating observable inputs. For transactions that did not meet this criterion at inception, trading profits that had been deferred were recognized in the period that inputs to value the derivative became observable or when the contract performed. SFAS 157 nullified this portion of EITF 02-3. SFAS 157 also: (1) establishes that fair value is based on a hierarchy of inputs into the valuation process (as described in Note 7), (2) clarifies that an issuer's credit standing should be considered when measuring liabilities at fair value, (3) precludes the use of a liquidity or block discount when measuring instruments traded in an actively quoted market at fair value, and (4) requires costs relating to acquiring instruments carried at fair value to be recognized as expense when incurred. SFAS 157 requires that a fair value measurement reflect the assumptions market participants would use in pricing an asset or liability based on the best available information. These assumptions include the risk inherent in a particular valuation technique (such as a pricing model) and the risks inherent in the inputs to the model.

The provisions of SFAS 157 are to be applied prospectively, except for the initial impact on three specific items: (1) changes in fair value measurements of existing derivative financial instruments measured initially using the transaction price under EITF 02-3, (2) existing hybrid financial instruments measured initially at fair value using the transaction price, and (3) blockage factor discounts. Adjustments to these items required under SFAS 157 are to be recorded as a transition adjustment to beginning retained earnings in the year of adoption.

Although this statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, early adoption may be elected if the reporting entity has not yet issued financial statements for the fiscal year, including interim period financial statements. The company has elected to early-adopt SFAS 157 in the first quarter of 2007. As a result of the company's adoption of SFAS 157, the transition adjustment to beginning retained earnings was a gain of $12 million, net of income tax. SFAS 157 also requires new disclosures regarding the level of pricing observability associated with financial instruments carried at fair value. This additional disclosure is provided in Note 7.

SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115" (SFAS 159): SFAS 159 allows measurement at fair value of eligible financial assets and liabilities that are not otherwise measured at fair value. If the fair value option for an eligible item is elected, unrealized gains and losses for that item are reported in current earnings at each subsequent reporting date. SFAS 159 also establishes presentation and disclosure requirements designed to draw comparison between the different measurement attributes the company elects for similar types of assets and liabilities. This statement is effective for fiscal years beginning after November 15, 2007. The company is in the process of evaluating the application of the fair value option and the effect on its financial position and results of operations.

Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109" (FIN 48): FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109, *Accounting for Income Taxes* (SFAS 109). FIN 48 addresses how an entity should recognize, measure, classify and disclose in its financial statements uncertain tax positions that it has taken or expects to take in an income tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The company adopted the provisions of FIN 48 on January 1, 2007. As a result, the company recognized a $2 million decrease in retained earnings. Including this adjustment, the company had unrecognized tax benefits of $110 million as of January 1, 2007. Of this amount, $99 million related to tax positions that, if recognized, would decrease the effective tax rate; however, $47 million related to tax positions that would increase the effective tax rate in subsequent years.

Effective January 1, 2007, the company s policy is to recognize accrued interest and penalties on accrued tax balances as components of tax expense. Prior to the adoption of FIN 48, the company accrued interest expense and penalties as a component of tax expense and interest income as a component of interest income.

As of January 1, 2007, the company had accrued a total of $11 million of interest expense and $2 million of penalties. Amounts accrued for interest expense and penalties associated with income taxes are included in income tax expense on the Statements of Consolidated Income and in various income tax balances on the Consolidated Balance Sheets.

The company is subject to U.S. federal income tax as well as income tax of multiple state and foreign jurisdictions. The company is no longer subject to examination by U.S. federal and major state tax jurisdictions for years before 2002. Federal, major state and most major foreign income tax returns from 2002 through the present are currently open to examination. Certain major foreign income tax returns from 1995 through the present are open to examination.

In addition, the company has filed federal and state refund claims for tax years back to 1989. The pre-2002 tax years are closed to new issues; therefore, no additional tax may be assessed by the taxing authorities for these years.

NOTE 3. RECENT INVESTMENT ACTIVITY

Sempra Pipelines & Storage

Sempra Pipelines & Storage is currently expanding its existing pipelines in Baja California, Mexico, and adding a spur line to connect Sempra LNG s Energía Costa Azul terminal to an existing Sempra Energy natural gas pipeline in Mexico with interconnection to the U.S. border. The estimated cost of this project is $200 million, of which $123 million has been expended through March 31, 2007. The expansion is expected to be completed in early 2008.

Sempra Pipelines & Storage and its 25-percent partner, ProLiance Transportation and Storage, LLC, currently are finalizing construction of Liberty Gas Storage, a salt-cavern natural gas storage facility located in Calcasieu Parish, Louisiana. Transportation-related services are expected to commence in mid-2007, and storage-related services, delayed due to construction-related issues, are now expected to commence in the second half of 2007. The facility will provide up to 17 billion cubic feet (bcf) of working natural gas capacity for storage and will be connected to the Cameron and Port Arthur Pipelines under development by Sempra Pipelines & Storage to connect liquefied natural gas (LNG) regasification terminals to the interstate gas transmission system. The estimated project cost is approximately $200 million, of which $134 million has been expended through March 31, 2007.

Sempra LNG

Sempra LNG s Energía Costa Azul LNG receipt terminal is currently under construction in Baja California, Mexico, and is expected to begin operations in early 2008. It is expected to cost approximately $900 million and will be capable of processing 1 bcf of natural gas per day. Through March 31, 2007, Sempra LNG has made expenditures of $702 million related to the terminal and the proposed expansion project. The ultimate scope and timing of the expansion project will depend on the outcome of negotiations for binding supply and/or terminal service agreements. As discussed above, Sempra

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Pipelines & Storage is expanding its Baja California pipelines to connect Energía Costa Azul to existing natural gas pipelines.

Sempra LNG s Cameron LNG receipt terminal is currently under construction in Hackberry, Louisiana. The estimated cost of this project is approximately $750 million, and construction is expected to be completed in late 2008. In January 2007, Sempra LNG received approval from the Federal Energy Regulatory Commission (FERC) for a possible expansion of the terminal s production capacity to 2.65 bcf per day of natural gas from 1.5 bcf per day. Through March 31, 2007, Sempra LNG has made expenditures of $453 million related to the terminal and the proposed expansion project. The ultimate scope and timing of the expansion project will depend on the outcome of negotiations for binding supply and/or terminal service agreements.

In March 2006, Sempra LNG executed a terminal services agreement with Merrill Lynch Commodities Inc. (MLC) to bring natural gas to the U.S. Gulf Coast, conditioned on MLC s obtaining a contract for the supply of LNG. The 20-year, full-service capacity agreement provides MLC the capability to process 500,000 million British thermal units (MMBtu) per day through the Cameron LNG receipt terminal. The agreement, as amended in March 2007, is subject to MLC obtaining a supply of LNG by June 30, 2008 and signing a transportation agreement on the connecting pipeline. MLC is subject to a termination fee if these conditions precedent are not satisfied.

NOTE 4. DISCONTINUED OPERATIONS

The company s discontinued operations are discussed in Note 4 of the Notes to Consolidated Financial Statements in the Annual Report. Information concerning discontinued operations for the three months ended March 31, 2007 and 2006 is summarized below:

(Dollars in millions)	Twin Oaks	Energy Services and Facilities Management	Bangor Gas and Frontier Energy	SEPCO	Total
Three months ended March 31, 2007:					
Operating revenues	$ --	$ --	$ 5	$ --	$ 5
Income from operations, before income taxes	$ --	$ --	$ 1	$ --	$ 1
Income tax expense	--	--	--	--	--
	$ --	$ --	$ 1	$ --	$ 1
Three months ended March 31, 2006:					
Operating revenues	$ 19	$ 28	$ 4	$ 8	$ 59
Income from operations, before income taxes	$ 1	$ 4	$ --	$ 3	$ 8
Income tax expense	--	2	--	1	3
	1	2	--	2	5
Gain on disposal, before income taxes	--	--	--	--	--
Income tax benefit *	--	(16)	--	--	(16)
	--	16	--	--	16
	$ 1	$ 18	$ --	$ 2	$ 21

* Consists of an income tax benefit related to the excess of income tax basis of this business over the basis for financial statement purposes, which was recognized in accordance with SFAS 109.

Current assets and liabilities of discontinued operations at March 31, 2007 and December 31, 2006 consist primarily of income tax balances related to Bangor Gas and Frontier Energy.

NOTE 5. OTHER FINANCIAL DATA

Investments in Unconsolidated Subsidiaries

In February 2007, Sempra Commodities sold its interests in an equity-method investment, along with a related cost-basis investment, receiving cash and a 12.7-percent interest in a newly formed entity. The after-tax gain on this transaction, recorded as Equity in Earnings of Certain Unconsolidated Subsidiaries on the Statements of Consolidated Income, was $30 million.

Available-for-Sale Securities

Sempra Commodities had $94 million and $55 million of available-for-sale securities included in Investments at March 31, 2007 and December 31, 2006, respectively. At March 31, 2007, the balance in Accumulated Other Comprehensive Income (Loss) related to these securities was $23 million net of

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income tax, comprised of $24 million of unrealized gains and $1 million of unrealized losses. At December 31, 2006, the balance in Accumulated Other Comprehensive Income (Loss) related to these securities was $18 million net of income tax, comprised of $19 million of unrealized gains and $1 million of unrealized losses.

Sempra Commodities recorded $5 million and $6 million in purchases of available-for-sale securities for the three months ended March 31, 2007 and 2006, respectively. Sempra Commodities sold available-for-sale securities with a cost basis of $3 million, yielding proceeds of $8 million for the three months ended March 31, 2007. The cost basis of the sales was determined by the specific identification method and pretax gains of $5 million were realized as a result of the sales for the three months ended March 31, 2007. There was a negligible amount of available-for-sale securities sales activity for the three months ended March 31, 2006.

The fair value of securities in an unrealized loss position at March 31, 2007 was $5 million. The unrealized losses were primarily caused by temporary declines in the market values of the securities. The company does not consider these investments to be other than temporarily impaired as of March 31, 2007.

Trading Securities

Sempra Commodities had securities of $13 million classified as trading securities at March 31, 2007 and December 31, 2006. There was a negligible amount of trading securities activity for the three months ended March 31, 2007. In the three months ended March 31, 2006, Sempra Commodities recorded $11 million of pretax gains related to trading securities, including a pretax gain of $9 million resulting from sales, an unrealized pretax gain of $1 million from the transfer of available-for-sale securities to trading securities, and an unrealized pretax gain of $1 million related to securities held at March 31, 2006.

Goodwill

The carrying amount of goodwill included in Sundry Assets on the Consolidated Balance Sheets was $170 million as of March 31, 2007 and December 31, 2006.

Asset Retirement Obligations

The company s asset retirement obligations, as defined in SFAS 143, *Accounting for Asset Retirement Obligations* and FIN 47*, Accounting for Conditional Asset Retirement Obligations, an interpretation of SFAS 143*, are discussed in Note 1 of the Notes to Consolidated Financial Statements in the Annual Report. Following are the changes in asset retirement obligations for the three months ended March 31, 2007 and 2006:

(Dollars in millions)	2007	2006
Balance as of January 1*	$ 1,163	$ 977
Accretion expense	20	16
Payments	(6)	(2)
Revisions to estimated cash flows**	44	--
Balance as of March 31*	$ 1,221	$ 991

*

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

** The revision is due to an increase in the present value of estimated liabilities for the San Onofre Nuclear Generating Station (SONGS) decommissioning costs.

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Pension and Other Postretirement Benefits

The following table provides the components of benefit costs for the three months ended March 31:

	Pension Benefits		Other Postretirement Benefits	
(Dollars in millions)	2007	2006	2007	2006
Service cost	$ 22	$ 18	$ 7	$ 6
Interest cost	41	39	14	12
Expected return on assets	(40)	(37)	(11)	(10)
Amortization of:				
Prior service cost	2	2	(1)	(1)
Actuarial loss	2	3	2	2
Regulatory adjustment	(16)	(16)	2	1
Total net periodic benefit cost	$ 11	$ 9	$ 13	$ 10

The company expects to contribute $62 million to its pension plans and $49 million to its other postretirement benefit plans in 2007. For the three months ended March 31, 2007, $7 million and $12 million of contributions were made to the pension and other postretirement benefit plans, respectively.

Earnings per Share (EPS)

Diluted EPS for the three months ended March 31, 2007 and 2006, respectively, reflects the inclusion of 4,537,000 and 4,994,000 additional shares in the weighted average shares outstanding for the dilutive effect of stock options and restricted stock awards.

The dilution from common stock options is based on the treasury stock method, whereby the proceeds from the exercise price and unearned compensation as defined by SFAS 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)), are assumed to be used to repurchase shares on the open market at the average market price for the period. The calculation excludes options for which the exercise price was greater than the average market price for common stock during the period. The company had 689,350 and 782,346 stock options that were outstanding during the three months ended March 31, 2007 and 2006, respectively, but were not included in the computation of diluted EPS for these periods because the effect of including these awards would be anti-dilutive, due to the inclusion of unearned compensation in the assumed proceeds.

The dilution from unvested restricted stock awards is based on the treasury stock method, whereby assumed proceeds equivalent to the unearned compensation as defined by SFAS 123(R) related to the awards are assumed to be used to repurchase shares on the open market at the average market price for the period. There were no anti-dilutive restricted stock awards for the three months ended March 31, 2007 and 2006.

Share-Based Compensation

Total share-based compensation expense, net of income tax, was $9 million in each of the three month periods ended March 31, 2007 and 2006. In January 2007, pursuant to the company's share-based compensation plans, 704,900 non-qualified stock options and 802,700 shares of restricted stock were granted.

Capitalized Interest

The company recorded $21 million and $14 million of capitalized interest for the three months ended March 31, 2007 and 2006, respectively, including the debt-related portion of allowance for funds used during construction.

Other Income, Net

Other Income, Net consists of the following:

	Three months ended March 31,	
(Dollars in millions)	2007	2006
Equity in losses of unconsolidated subsidiaries	$ (6)	$ (4)
Allowance for equity funds used during construction	6	4
Regulatory interest, net	(5)	(3)
Sundry, net	16	7
Total	$ 11	$ 4

Comprehensive Income

The following is a reconciliation of net income to comprehensive income.

	Three months ended March 31,	
(Dollars in millions)	2007	2006
Net income	$ 228	$ 255
Foreign currency adjustments	(6)	(12)
Financial instruments*	(1)	21
Available-for-sale securities**	5	1
Comprehensive income	$ 226	$ 265

* Net of income tax expense (benefit) of $(1) million and $12 million for the three months ended March 31, 2007 and 2006, respectively.

** Net of income tax expense of $3 million and $1 million for the three months ended March 31, 2007 and 2006, respectively.

NOTE 6. DEBT AND CREDIT FACILITIES

Committed Lines of Credit

At March 31, 2007, the company had available $6.3 billion in unused, committed lines of credit to provide liquidity and support commercial paper (the major components of which are detailed below). As of March 31, 2007, $8 million of the lines supported variable-rate debt.

Sempra Global has a $2.5 billion five-year syndicated revolving credit facility expiring in 2010 and a $750 million three-year syndicated revolving credit facility expiring in 2008. The five-year and three-year credit facilities also provide for the issuance of up to $400 million and $500 million, respectively, of letters of credit on behalf of Sempra Global. Sempra Global had letters of credit of $45 million outstanding at March 31, 2007 under the five-year facility. At March 31, 2007, Sempra Global had no outstanding borrowings under either facility.

Sempra Commodities has a five-year syndicated revolving credit facility expiring in 2010 that provides for up to $1.72 billion of extensions of credit (consisting of borrowings, letters of credit and other credit support accommodations) to Sempra Commodities and certain of its affiliates. Letters of credit of $436 million were outstanding under the facility at March 31, 2007. At March 31, 2007, Sempra Commodities had no outstanding borrowings under this facility.

Sempra Commodities also has a $500 million three-year credit facility expiring in 2009 that provides for extensions of credit (consisting of credit borrowings and the issuance of letters of credit and bank guarantees) to Sempra Commodities. Letters of credit of $479 million were outstanding under this facility at March 31, 2007. At March 31, 2007, Sempra Commodities had no outstanding borrowings under this facility.

Sempra LNG has a $1.25 billion five-year syndicated revolving credit facility expiring in 2009. The facility also provides for the issuance of letters of credit not exceeding $200 million outstanding at any one time. Sempra LNG had $85 million of outstanding letters of credit under this facility at March 31, 2007. At March 31, 2007, Sempra LNG had no outstanding borrowings under this facility.

The Sempra Utilities have a combined $600 million five-year syndicated revolving credit facility expiring in 2010, under which each utility individually may borrow up to $500 million, subject to a combined borrowing limit for both utilities of $600 million. At March 31, 2007, the Sempra Utilities had no outstanding borrowings under this facility.

Sempra Energy, ConocoPhillips (Conoco) and Kinder Morgan Energy Partners, L.P. (KMP) currently hold 25-percent, 24-percent and 51-percent ownership interests, respectively, in Rockies Express Pipeline LLC (Rockies Express) which is constructing a natural gas pipeline to link natural gas producing areas in the Rocky Mountain region to the upper Midwest and the eastern United States. Rockies Express has entered into a $2 billion five-year credit facility expiring in 2011 that provides for revolving extensions of credit that are guaranteed severally by Sempra Energy, Conoco and KMP in proportion to their respective ownership percentages. Rockies Express had no outstanding borrowings under this facility at March 31, 2007. This facility supports the Rockies Express commercial paper program, of which 25 percent is also guaranteed by Sempra Energy. The commercial paper program had $1.03 billion of outstanding borrowings at March 31, 2007, of which $258 million is guaranteed by Sempra Energy. The fair value of these guarantees is negligible.

Additional information concerning these credit facilities is provided in the Annual Report.

Uncommitted Lines of Credit

Under uncommitted facilities, lenders provide credit on a discretionary basis. Terms are generally consistent with existing committed credit facilities. At March 31, 2007, Sempra Commodities had $1.49 billion in various uncommitted lines of credit. Of the $1.49 billion at March 31, 2007, $937 million of the lines are fully guaranteed by Sempra Energy, and bear interest at rates varying with market rates. The remaining $550 million line is secured by certain assets at Sempra Commodities and guaranteed by Sempra Energy up to 20 percent, subject to additional amounts based on the recoverability of Sempra Commodities' collateral. At March 31, 2007, Sempra Commodities had $248 million of letters of credit outstanding supported by these lines. In addition, it had $75 million of short-term borrowings outstanding against these lines at March 31, 2007.

Other Short-term Debt

In addition to the lines of credit and commercial paper, Sempra Commodities had $26 million of other short-term debt outstanding at March 31, 2007.

Weighted Average Interest Rates

The company's weighted average interest rate on the total short-term debt outstanding was 5.92 percent at March 31, 2007.

Interest-Rate Swaps

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

Fair value hedges

During 2004, to balance its mix of fixed and floating-rate debt, Sempra Energy entered into interest-rate swaps that effectively exchanged the fixed rate on $300 million of its $500 million 7.95 percent notes maturing in 2010 for a floating rate. The swaps expire in 2010. During 2003, SoCalGas entered into an interest-rate swap that effectively exchanged the fixed rate on $150 million of its $250 million 4.375 percent first mortgage bonds maturing in 2011 for a floating rate. The swap expires in 2011. At March 31, 2007, market value adjustments of $3 million were recorded as a decrease primarily in Fixed-price Contracts and Other Derivatives (in noncurrent liabilities) and an offsetting increase in Long-term Debt without affecting net income or other comprehensive income. At March 31, 2006, market value adjustments of $7 million were recorded as an increase primarily in Fixed-price Contracts and Other Derivatives (in noncurrent liabilities) and an offsetting decrease in Long-term Debt without affecting net income or other comprehensive income. There has been no hedge ineffectiveness on these swaps.

Cash flow hedges

In the third quarter of 2005, Sempra Energy Mexico entered into derivative transactions to hedge future interest payments associated with forecasted borrowings of $450 million for facilities related to Sempra LNG's Energía Costa Azul project. The swaps expire in 2027. The fair values of these swaps at March 31, 2007 and December 31, 2006 were $14 million and $12 million, respectively. In September 2004, SDG&E entered into interest-rate swaps to exchange the floating rates on its $251 million Chula Vista Series 2004 bonds maturing from 2034 through 2039 for fixed rates. The swaps expire in 2009. The fair value of these swaps at both March 31, 2007 and December 31, 2006 was $3 million. For the three months ended March 31, 2007 and 2006, pretax income arising from the ineffective portion of interest-rate cash flow hedges was $1 million and $3 million, respectively, and was recorded in Other Income, Net on the Statements of Consolidated Income. The effects of interest-rate cash flow hedges on other comprehensive income for the three months ended March 31, 2007 and 2006 were gains of $1 million and $10 million, respectively. The balances in Accumulated Other Comprehensive Income (Loss) at March 31, 2007 and December 31, 2006, related to interest-rate cash flow hedges were gains of $10 million and $9 million, respectively.

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NOTE 7. FINANCIAL INSTRUMENTS

Fair Value Hedges

Interest-Rate Swaps

The company periodically enters into interest-rate swap agreements to moderate its exposure to interest-rate changes and to lower its overall cost of borrowing. The company's fair value interest-rate swaps are discussed in Note 6.

Commodity Fair Value Hedges

For commodity derivative instruments designated as fair value hedges, the company recognized net pretax unrealized gains (losses) of $27 million and $(61) million for the three months ended March 31, 2007 and 2006, respectively, which represents portions of gains or losses on hedging instruments determined to be ineffective. These pretax gains (losses) include losses of $2 million and $91 million for the three months ended March 31, 2007 and 2006, respectively, which represent time value of money which is excluded for hedge assessment purposes. The ineffectiveness gains and losses related to hedges of commodity inventory are included in Operating Revenues from Sempra Global and Parent on the Statements of Consolidated Income.

Cash Flow Hedges

Interest-Rate Swaps

The company's interest-rate swaps to hedge cash flows are discussed in Note 6.

Other Cash Flow Hedges

For other derivative instruments designated as cash flow hedges, the company recognized a net unrealized pretax loss of $10 million for the three months ended March 31, 2006, which represents portions of losses on hedging instruments determined to be ineffective. The ineffectiveness amounts relate to the potential phase-out of synthetic fuels income tax credits, as well as hedges of natural gas purchases and sales related to transportation and storage capacity arrangements. There were no hedging instruments determined to be ineffective for the three months ended March 31, 2007.

The balances in Accumulated Other Comprehensive Income (Loss) at March 31, 2007 and December 31, 2006 related to all cash flow hedges were losses of $51 million and $50 million, respectively, net of income tax. The company expects that $55 million, which is net of income tax, that is currently recorded in Accumulated Other Comprehensive Income (Loss) related to these cash flow hedges will be reclassified into earnings during the next twelve months as the hedged items affect earnings.

The carrying values of trading assets and trading liabilities, primarily at Sempra Commodities,

are as follows:

(Dollars in millions)	March 31, 2007	December 31, 2006
TRADING ASSETS		
Trading-related receivables and deposits, net:		
Due from trading counterparties	$ 2,211	$ 2,610
Due from commodity clearing organizations and clearing brokers	241	437
	2,452	3,047
Derivative trading instruments:		
Unrealized gains on swaps and forwards	1,923	2,389
OTC (over-the-counter) commodity options purchased	1,409	1,679
	3,332	4,068
Commodities owned	1,399	1,845
Total trading assets	$ 7,183	$ 8,960
TRADING LIABILITIES		
Trading-related payables	$ 2,769	$ 3,211
Derivative trading instruments sold, not yet purchased:		
Unrealized losses on swaps and forwards	1,948	1,670
OTC commodity options written	502	634
	2,450	2,304
Commodities sold with agreement to repurchase	144	537
Total trading liabilities	$ 5,363	$ 6,052

The average fair values during the three months ended March 31, 2007 for trading assets and liabilities approximate $8.1 billion and $5.7 billion, respectively. For the three months ended March 31, 2006, the amounts were $9.8 billion and $7.5 billion, respectively.

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

The following table summarizes the counterparty credit quality and exposure for Sempra Commodities, expressed in terms of net replacement value. These exposures are net of collateral in the form of customer margin and/or letters of credit of $1.3 billion and $1.9 billion at March 31, 2007 and December 31, 2006, respectively.

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(Dollars in millions)	March 31, 2007	December 31, 2006
Counterparty credit quality*		
Commodity exchanges	$ 241	$ 437
AAA	39	19
AA	257	262
A	662	654
BBB	827	1,032
Below investment grade or not rated	859	1,011
Total	$ 2,885	$ 3,415

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

Sempra Utilities

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

Adoption of SFAS 157

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

As defined in SFAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). However, as permitted under

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

Level 1 Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 primarily consists of financial instruments such as exchange-traded derivatives and listed equities.

Level 2 Pricing inputs are other than quoted prices in active markets included in level 1, which are either directly or indirectly observable as of the reported date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying