

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

FORM 10-Q

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

For the quarterly period ended September 30, 2003

Commission file number 1-3779

SAN DIEGO GAS & ELECTRIC COMPANY

(Exact name of registrant as specified in its charter)

California

95-1184800

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

8330 Century Park Court, San Diego, California 92123

(Address of principal executive offices)  
(Zip Code)

(619) 696-2000

(Registrant's telephone number, including area code)

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 an accelerated filer  
(as defined in Rule 12b-2 of the Exchange Act).

Yes X No

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: Wholly owned by Enova Corporation

## 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," "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 Legislature, the Department of Water Resources, and the Federal Energy Regulatory Commission; capital market conditions, inflation rates, interest rates and exchange rates; energy and trading markets, including the timing and extent of changes in commodity prices; weather conditions and conservation efforts; war and terrorist attacks; business, regulatory and legal decisions; the status of deregulation of retail natural gas and electricity delivery; the timing and success of business development efforts; 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.

ITEM 1. FINANCIAL STATEMENTS.

<table>

SAN DIEGO GAS & ELECTRIC COMPANY AND SUBSIDIARY  
STATEMENTS OF CONSOLIDATED INCOME

(Dollars in millions)

<caption>

	Three months ended September 30,	
	2003	2002
	-----	-----
<s>	<c>	<c>
OPERATING REVENUES		
Electric	\$ 579	\$ 358
Natural gas	88	67
	-----	-----
Total operating revenues	667	425
	-----	-----
OPERATING EXPENSES		
Electric fuel and net purchased power	128	81
Cost of natural gas	47	29
Other operating expenses	160	129
Depreciation and amortization	63	59
Income taxes	105	42
Franchise fees and other taxes	30	21
	-----	-----
Total operating expenses	533	361
	-----	-----
Operating income	134	64
	-----	-----
Other income and (deductions)		
Interest income	1	3
Regulatory interest - net	--	(4)
Allowance for equity funds used during construction	3	4
Income taxes on non-operating income	(3)	--
Other - net	4	--
	-----	-----
Total	5	3
	-----	-----
Interest charges		
Long-term debt	17	18
Other	2	3
Allowance for borrowed funds used during construction	(1)	(2)
	-----	-----
Total	18	19
	-----	-----
Net income	121	48
Preferred dividend requirements	1	2
	-----	-----
Earnings applicable to common shares	\$ 120	\$ 46
	=====	=====

See notes to Consolidated Financial Statements.

</table>

<table>  
SAN DIEGO GAS & ELECTRIC COMPANY AND SUBSIDIARY  
STATEMENTS OF CONSOLIDATED INCOME  
(Dollars in millions)  
<caption>

	Nine months ended September 30,	
	2003	2002
	-----	-----
<s>	<c>	<c>
OPERATING REVENUES		
Electric	\$ 1,378	\$ 962
Natural gas	371	309
	-----	-----
Total operating revenues	1,749	1,271
	-----	-----
OPERATING EXPENSES		
Electric fuel and net purchased power	428	221
Cost of natural gas	199	149
Other operating expenses	428	384
Depreciation and amortization	179	171
Income taxes	179	88
Franchise fees and other taxes	84	58
	-----	-----
Total operating expenses	1,497	1,071
	-----	-----
Operating income	252	200
	-----	-----
Other income and (deductions)		
Interest income	4	8
Regulatory interest - net	(4)	(6)
Allowance for equity funds used during construction	9	9
Income taxes on non-operating income	(2)	1
Other - net	4	2
	-----	-----
Total	11	14
	-----	-----
Interest charges		
Long-term debt	51	57
Other	5	6
Allowance for borrowed funds used during construction	(3)	(4)
	-----	-----
Total	53	59
	-----	-----
Net income	210	155
Preferred dividend requirements	4	5
	-----	-----
Earnings applicable to common shares	\$ 206	\$ 150
	=====	=====

See notes to Consolidated Financial Statements.  
</table>

<table>  
SAN DIEGO GAS & ELECTRIC COMPANY AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS  
(Dollars in millions)  
<caption>

	September 30, 2003	December 31, 2002
	-----	-----
<s>	<c>	<c>
<b>ASSETS</b>		
Utility plant - at original cost	\$5,706	\$5,408
Accumulated depreciation and amortization	(2,586)	(2,775)
	-----	-----
Utility plant - net	3,120	2,633
	-----	-----
Nuclear decommissioning trusts	529	494
	-----	-----
Current assets:		
Cash and cash equivalents	174	159
Accounts receivable - trade	115	163
Accounts receivable - other	53	18
Due from unconsolidated affiliates	248	292
Regulatory assets arising from fixed-price contracts and other derivatives	59	59
Other regulatory assets	75	75
Inventories	78	46
Other	23	11
	-----	-----
Total current assets	825	823
	-----	-----
Other assets:		
Deferred taxes recoverable in rates	168	190
Regulatory assets arising from fixed-price contracts and other derivatives	535	579
Other regulatory assets	286	342
Sundry	60	62
	-----	-----
Total other assets	1,049	1,173
	-----	-----
Total assets	\$5,523	\$5,123
	=====	=====

See notes to Consolidated Financial Statements.  
</table>

<table>  
SAN DIEGO GAS & ELECTRIC COMPANY AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS  
(Dollars in millions)  
<caption>

	September 30, 2003	December 31, 2002
	----- <c>	----- <c>
<s>		
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Common stock (255 million shares authorized; 117 million shares outstanding)	\$ 937	\$ 943
Retained earnings	291	235
Accumulated other comprehensive income (loss)	(39)	(34)
	-----	-----
Total common equity	1,189	1,144
Preferred stock not subject to mandatory redemption	79	79
	-----	-----
Total shareholders' equity	1,268	1,223
Preferred stock subject to mandatory redemption	--	25
Long-term debt	1,105	1,153
	-----	-----
Total capitalization	2,373	2,401
	-----	-----
Current liabilities:		
Accounts payable	164	159
Interest payable	13	12
Due to unconsolidated affiliates	--	3
Income taxes payable	85	41
Deferred income taxes	44	53
Regulatory balancing accounts - net	381	394
Fixed-price contracts and other derivatives	59	59
Current portion of long-term debt	66	66
Other	212	170
	-----	-----
Total current liabilities	1,024	957
	-----	-----
Deferred credits and other liabilities:		
Customer advances for construction	59	54
Deferred income taxes	589	602
Deferred investment tax credits	40	42
Fixed-price contracts and other derivatives	535	579
Due to unconsolidated affiliates	16	16
Regulatory liabilities arising from asset retirement obligations	241	--
Asset retirement obligations	301	--
Mandatorily redeemable preferred securities	23	--
Deferred credits and other liabilities	322	472
	-----	-----
Total deferred credits and other liabilities	2,126	1,765
	-----	-----
Contingencies and commitments (Note 3)		
Total liabilities and shareholders' equity	\$5,523	\$5,123
	=====	=====
See notes to Consolidated Financial Statements.		
</table>		

<table>  
SAN DIEGO GAS & ELECTRIC COMPANY AND SUBSIDIARY  
CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS  
(Dollars in millions)  
<caption>

	Nine months ended September 30,	
	2003	2002
	-----	-----
<s>	<c>	<c>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 210	\$ 155
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	179	171
Deferred income taxes and investment tax credits	(2)	92
Non-cash rate reduction bond expense	51	61
Net change in other working capital components	18	5
Changes in other assets	6	110
Changes in other liabilities	3	34
	-----	-----
Net cash provided by operating activities	465	628
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(285)	(274)
Loan to/from affiliate - net	45	(336)
Other - net	(6)	(9)
	-----	-----
Net cash used in investing activities	(246)	(619)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends paid	(155)	(5)
Payments on long-term debt	(48)	(85)
Redemptions of preferred stock	(1)	--
	-----	-----
Net cash used in financing activities	(204)	(90)
	-----	-----
Increase (decrease) in cash and cash equivalents	15	(81)
Cash and cash equivalents, January 1	159	322
	-----	-----
Cash and cash equivalents, September 30	\$ 174	\$ 241
	=====	=====
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest payments, net of amounts capitalized	\$ 48	\$ 55
	=====	=====
Income tax payments, net of refunds	\$ 138	\$ 14
	=====	=====
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES		
Property, plant and equipment contribution from Sempra Energy	\$ 1	\$ 86
	=====	=====

See notes to Consolidated Financial Statements.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. GENERAL

This Quarterly Report on Form 10-Q is that of San Diego Gas & Electric Company (SDG&E or the company). SDG&E's common stock is wholly owned by Enova Corporation (Enova), which is a wholly owned subsidiary of Sempra Energy, a California-based Fortune 500 holding company. The financial statements herein are the Consolidated Financial Statements of SDG&E and its sole subsidiary, SDG&E Funding LLC.

Sempra Energy also indirectly owns all of the common stock of Southern California Gas Company (SoCalGas). SDG&E and SoCalGas are collectively referred to herein as "the California Utilities."

The accompanying Consolidated Financial Statements have been prepared 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. Certain changes in classification have been made to prior presentations to conform to the current financial statement presentation.

Information in this Quarterly Report is unaudited and should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2002 (Annual Report) and the Quarterly Reports on Form 10-Q for the three months ended March 31, 2003 and June 30, 2003.

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.

As described in the notes to Consolidated Financial Statements in the Annual Report, SDG&E accounts for the economic effects of regulation on utility operations (excluding generation operations) in accordance with *Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation"*.

## COMPREHENSIVE INCOME

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

(Dollars in millions)	Three months ended September 30,		Nine months ended September 30,	
	2003	2002	2003	2002
Net income	\$ 121	\$ 48	\$ 210	\$ 155
Minimum pension liability adjustments	--	--	(6)*	(1)
Comprehensive income	\$ 121	\$ 48	\$ 204	\$ 154

\* This amount does not equal the change in the reported balance of accumulated other comprehensive income due to rounding.

## 2. NEW ACCOUNTING STANDARDS

*SFAS 143, "Accounting for Asset Retirement Obligations"*: The adoption of SFAS 143 on January 1, 2003 resulted in the recording of an addition to utility plant of \$71 million, representing the company's share of the San Onofre Nuclear Generating Station's (SONGS) estimated future decommissioning costs (as discounted to the present value at the dates the units began operation), and accumulated depreciation of \$41 million related to the increase to utility plant, for a net increase of \$30 million. In addition, the company recorded a corresponding retirement obligation liability of \$309 million (which includes accretion of that discounted value to December 31, 2002) and a regulatory liability of \$215 million to reflect that SDG&E has collected the funds from its customers more quickly than SFAS 143 would accrete the retirement liability and depreciate the asset. These liabilities, less the \$494 million recorded as accumulated depreciation prior to January 1, 2003 (which represents amounts collected for future decommissioning costs), comprise the offsetting \$30 million.

On January 1, 2003, the company recorded additional asset retirement obligations of \$10 million associated with the future retirement of a former power plant.

The change in the asset retirement obligations for the nine months ended September 30, 2003 is as follows (dollars in millions):

Balance as of January 1, 2003	\$ --
Adoption of SFAS 143	319
Accretion expense	16
Payments	(12)
	-----
Balance as of September 30, 2003	\$ 323*
	=====

\*A portion of the obligation is included in other current liabilities on the Consolidated Balance Sheets.

Had SFAS 143 been in effect, the asset retirement obligation liability would have been \$307 million, \$330 million, \$354 million and \$319 million as of January 1, 2000 and December 31, 2000, 2001 and 2002, respectively.

Except for the items noted above, the company has determined that there is no other material retirement obligation associated with tangible long-lived assets.

Implementation of SFAS 143 has had no effect on results of operations and is not expected to have a significant one in the future.

*SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities"*: SFAS 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS 133. The adoption of SFAS 149 did not have an effect on the company's consolidated results of operations and financial position.

*SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity"*: This statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS 150 requires that certain mandatorily redeemable financial instruments previously classified in the mezzanine section of the balance sheet be reclassified as liabilities. The company has adopted SFAS 150 beginning July 1, 2003 by reclassifying \$23 million of mandatorily redeemable preferred stock to deferred credits and other liabilities.

### 3. MATERIAL CONTINGENCIES

#### ELECTRIC INDUSTRY REGULATION

The restructuring of California's electric utility industry has significantly affected the company's electric utility operations and the power crisis of 2000-2001 caused the California Public Utilities Commission (CPUC) to adjust its plan for restructuring the electricity industry. The background of this issue is described in the Annual Report. Subsequent developments are described herein.

Various projections of electricity demand in SDG&E's service territory indicate that, without additional electrical generation and transmission and reductions in electrical usage, beginning in 2005 electricity demand could begin to outstrip available resources. SDG&E has issued a request for proposals (RFP) to meet the electric capacity shortfall, estimated at 69 megawatts in 2005 and increasing annually by approximately 100 megawatts, and has filed a proposed plan at the CPUC for meeting these capacity requirements.

On October 7, 2003, SDG&E applied to the CPUC for approval of its RFP results. SDG&E's electric procurement plan contemplates (i) procuring 643 megawatts of energy and demand reduction resources (73 megawatts beginning in 2005 with contracts extending through 2020 and 570 megawatts beginning in 2007 and extending through 2017); (ii) acquiring 601 megawatts of new generation, including a 555-megawatt power plant in Escondido, California, to be constructed by Semptra Energy Resources, an affiliate, for completion in 2006; and (iii) constructing new transmission lines. The capital cost related to this proposed plan is approximately \$640 million and the plan includes a mix of energy supply sources, including renewable resources. Hearings will be held during the fourth quarter of 2003 and a CPUC decision is expected during the first half of 2004. In connection with the possible return to a generation-ownership role for investor-owned utilities (IOUs), SDG&E required bidders to include both power purchase and SDG&E ownership options in their response to the RFP noted above.

The California Department of Water Resources' (DWR) Operating Agreement with SDG&E, approved by the CPUC, governs SDG&E's administration of the allocated DWR contracts. The agreement provides that SDG&E is acting as a limited agent on behalf of the DWR in undertaking energy sales and natural gas procurement functions under the DWR contracts allocated to SDG&E's customers. Legal and financial risks associated with these activities will continue to reside with the DWR. However, in certain limited circumstances involving transactions in which SDG&E, as DWR's limited agent, is selling DWR surplus energy pursuant to the terms of the Operating Agreement, SDG&E may be obligated to provide lines of credit in connection with the allocated contracts. The risk associated with these lines of credit is considered to be minimal. Since the DWR retains legal and financial responsibility for the contracts allocated to SDG&E, the costs associated with the contracts were not included in the Statements of Consolidated Income during 2003. On July 10, 2003, the CPUC approved SDG&E's natural gas supply plan related to certain DWR contracts for the five-month period May 1, 2003 to September 30, 2003. On August 15, 2003, SDG&E filed with the CPUC its natural gas supply plan related to certain DWR contracts for the six-month period October 1, 2003 to March 31, 2004. CPUC action on this filing is pending.

On September 4, 2003, the CPUC approved a \$1-billion refund to consumers of the three major California IOUs as a result of the DWR's lowering its revenue requirement for 2003. The refund is being returned to customers in the form of a one-time bill credit. SDG&E's portion is 13.51 percent or about \$135 million. The bill credit will have no effect on SDG&E's net income and net cash flows because customer savings are coming from lower charges by the DWR, and SDG&E is merely

transmitting the electricity from the DWR to the customers, without taking title to the electricity.

The final true-up of DWR's 2001/2002 energy costs among California's three major investor-owned electric utilities could result in SDG&E's customers being allocated up to \$60 million of additional costs or having their allocation reduced by as much as \$100 million. In either case, SDG&E would account for any adjustment in its commodity balancing account, which would be repaid to its customers or collected from its customers in the near future. Either change in allocation would have a short-term effect on SDG&E's cash flow (positive or negative as the case may be), but would not otherwise affect its results of operations.

On August 21, 2003, the CPUC denied a rehearing requested by opponents of its December 2002 decision that had approved a settlement with SDG&E allocating between SDG&E customers and shareholders the profits from intermediate-term purchase power contracts that SDG&E had entered into during the early stages of California's electric utility industry restructuring. As previously reported, the settlement provided \$199 million of these profits to customers, by reductions to balancing account undercollections in prior years. The settlement provided the remaining \$173 million of profits to SDG&E shareholders, of which \$57 million had been recognized for financial reporting purposes in prior years. As a result of the decision, SDG&E recognized additional after-tax income of \$65 million in the third quarter of 2003. On September 25, 2003 the Utility Consumers' Action Network (UCAN), a consumer-advocacy group which had requested the CPUC rehearing, appealed the decision to the California Court of Appeals. On October 24, 2003, SDG&E and the Commission filed responses with the court to the UCAN appeal, setting forth the reasons why there is no issue of law for the court to consider and that the appeal should be denied. UCAN has twenty days to file a reply. Acceptance of any appeal is at the discretion of the court. There is no deadline by which the court must act.

#### NATURAL GAS INDUSTRY RESTRUCTURING

As discussed in Note 11 of the notes to Consolidated Financial Statements in the Annual Report, in December 2001 the CPUC issued a decision related to natural gas industry restructuring, with implementation anticipated during 2002. During 2002 the California Utilities filed a proposed implementation schedule and revised tariffs and rules required for implementation. However, on February 27, 2003, the CPUC issued a resolution rejecting without prejudice those proposed tariffs and rules.

On September 29, 2003, the CPUC issued a ruling indicating that the proceeding will initially only consider implementation of the original December 2001 decision, but the Assigned Commissioner said he will informally look at the alternatives proposed by SoCalGas. The matter has been set for hearing and a CPUC decision is expected by January 2004. If the December 2001 decision is implemented, it is not expected to have a material effect on the company's earnings.

## BORDER PRICE INVESTIGATION

In November 2002, the CPUC instituted an investigation into the Southern California natural gas market and the price of natural gas delivered to the California-Arizona (CA-AZ) border during the period of March 2000 through May 2001. If the investigation determines that the conduct of any respondent contributed to the natural gas price spikes at the CA-AZ border during this period, the CPUC may modify the respondent's applicable natural gas procurement incentive mechanism, reduce the amount of any shareholder award for the period involved, and/or order the respondent to issue a refund to ratepayers to offset the higher rates paid. The California Utilities, included among the respondents to the investigation, are fully cooperating in the investigation and believe that the CPUC will ultimately determine that they were not responsible for the high border prices during this period. On August 1, 2003, the Administrative Law Judge (ALJ) issued a revised schedule with hearings scheduled to begin in March 2004 and with a Commission decision by late 2004.

## CPUC INVESTIGATION OF COMPLIANCE WITH AFFILIATE RULES

On February 27, 2003, the CPUC opened an investigation of the business activities of SDG&E, SoCalGas and Sempra Energy to ensure that they have complied with relevant statutes and CPUC decisions in the management, oversight and operations of their companies. On September 18, 2003, the Commission suspended the procedural schedule until the CPUC completes an independent audit to evaluate energy-related business activities undertaken by Sempra Energy within the service territories of SDG&E and SoCalGas, relative to holding company systems and affiliate activities. The audit will be combined with the annual affiliate audit and should be completed by the end of 2004. The scope of the audit will be broader than the annual affiliate audit. In addition to an evaluation of compliance with CPUC rules and requirements, this audit will assess the potential for conflicts between the interests of Sempra Energy and the interests of the California Utilities and their ratepayers, and examine whether business activities undertaken by the utilities and/or their holding company and affiliates pose potential problems or unjust or unreasonable impacts on utility customers.

## COST OF SERVICE FILING

As previously reported, the California Utilities have filed cost of service applications with the CPUC seeking rate increases designed to reflect forecasts of 2004 capital and operating costs. SDG&E is requesting revenue increases of approximately \$76 million. The CPUC's Office of Ratepayer Advocates (ORA) filed its prepared testimony in the applications on August 8, 2003, recommending rate decreases that would reduce annual revenues by \$41 million from their current level. UCAN has proposed rates for SDG&E that would reduce annual revenues by \$88 million from their current level. Hearings are expected to conclude by the end of this month. The procedural schedule for the cost of service applications permits a decision as early as March 2004, and the California Utilities have filed a petition for interim rate relief for the period from January 1, 2004 until the effective date of the decision. On November 3, 2003, the CPUC ALJ released a Proposed

Decision that would authorize the California Utilities to create a memorandum account as of January 1, 2004, to record the difference between existing rates and those that are later authorized in the Commission's final decision in this case. The difference would then be amortized in rates. The full Commission can vote on the Proposed Decision as soon as December 4, 2003. The California Utilities have also filed for continuation through 2004 of existing PBR mechanisms for service quality and safety that would otherwise expire at the end of 2003.

#### MARKET INDEXED CAPITAL ADJUSTMENT MECHANISM (MICAM)

MICAM has the potential to revise a utility's rates to reflect changes in market interest rates. On September 4, 2003, the CPUC approved an all-party settlement that modified the MICAM such that the possibility of a MICAM-caused reduction in SDG&E's authorized return on common equity for 2004 has been eliminated.

#### PERFORMANCE-BASED REGULATION (PBR)

On August 21, 2003, the CPUC issued a final resolution approving SDG&E's 2001 and 2002 Distribution PBR Performance Reports. SDG&E was awarded \$12.2 million for exceeding PBR benchmarks on all six of its performance indicators in 2001, and \$6.0 million for exceeding the PBR benchmarks on five of its six performance indicators in 2002. These rewards were included in income in the third quarter of 2003. The total maximum reward (or penalty) SDG&E could earn in a given year under the Distribution PBR mechanism is \$14.5 million.

On July 16, 2003, SDG&E filed an Advice Letter requesting approval of a shareholder penalty of \$1.4 million for Year 9 (August 1, 2001 through July 31, 2002) of its Gas Procurement PBR mechanism. The \$1.4 million penalty was recorded in 2002 and is consistent with the ORA's March 19, 2003 Monitoring and Evaluation Report on SDG&E's natural gas procurement activities in Year 9. In its report, the ORA recommended the extension of the PBR mechanism, as modified in Years 8 and 9, to Year 10 and beyond, and stated that the CPUC's adoption of the natural gas procurement PBR mechanism is beneficial both to ratepayers and to shareholders of SDG&E.

On July 10, 2003, the CPUC issued a decision relative to SDG&E's Year 11 Gas PBR application, which would extend the PBR mechanism with some modification. The decision approved the Joint Parties' Motion for an Order Adopting Settlement Agreement filed by SDG&E and the ORA, which will apply to Year 10 and beyond. The effect of the modifications is to reduce slightly the potential size of future PBR rewards or penalties.

SDG&E's request for a reward of \$6.7 million for the PBR natural gas procurement period ended July 31, 2001 (Year 8) was approved by the CPUC on January 30, 2003. This award was recorded in income in the first quarter of 2003. Since part of the reward calculation is based on CA-AZ natural gas border price indices, the decision reserved the right to revise the reward in the future, depending on the outcome of the CPUC's border price investigation (see above) and the FERC's investigation into alleged energy price manipulation (see below).

Performance incentives rewards are not included in the company's earnings before CPUC approval is received.

#### DEMAND SIDE MANAGEMENT (DSM) AND ENERGY EFFICIENCY AWARDS

Since the 1990s, IOUs have been eligible to earn awards for implementing and administering energy conservation and efficiency programs. The California Utilities have offered these programs to customers and have consistently achieved significant earnings therefrom. On October 16, 2003, the CPUC issued a decision that the pre-1998 DSM earnings mechanism would not be reopened. Therefore, the CPUC will not redetermine the uncollected portion of past awards earned by the IOUs and will not be recomputing the amounts of the awards, but may adjust such amounts consistent with the application of known, standard measurement and verification protocols.

The CPUC has consolidated the 2000, 2001, 2002 and 2003 award applications. On May 2, 2003, the CPUC released an RFP to conduct a review of the IOUs' studies used as the basis for the awards claims. The review should be completed by the second quarter of 2004. All outstanding claims are on hold pending completion of the independent review. As of September 30, 2003, SDG&E had \$36 million in DSM/energy efficiency rewards requested but pending CPUC approval and had \$26 million in rewards for which it has not yet requested approval.

#### BLYTHE GAIN ON SALE

The ORA is proposing to use a risk analysis to allocate the 2001 gain on the sale of SDG&E's surplus property in Blythe, California rather than the time in rate base versus out of rate base methodology proposed by SDG&E and historically used by the CPUC. SDG&E's proposal would allocate \$3.1 million to ratepayers, whereas the ORA proposes to allocate \$14.4 million. This issue is being addressed in the Cost of Service filing described above. A decision is expected as early as March 2004.

#### TRANSMISSION RATE INCREASE

SDG&E's retail-related rates applicable to transmission service were set based on a 1998 test year, at a level that during 2002 was substantially lower than needed to maintain an adequate return on equity (ROE). Consequently, SDG&E filed revised rates on March 7, 2003, proposing a formula rate that would allow, through June 2007, the full recovery of all transmission-related rate base and expenses on a true-up basis. Thus, SDG&E would earn no more nor no less than its transmission cost of service at the FERC-adopted ROE for the predetermined period. On May 2, 2003, the FERC accepted SDG&E's request for modification of its Transmission Owner Tariff to adopt a rate increase, subject to hearing and, if appropriate, refunds. New transmission rates, which are subject to refund based on the FERC's final order, became effective October 1, 2003.

On October 9, 2003, SDG&E filed a proposed settlement agreement with the FERC, supported by the FERC trial staff, the CPUC and the Independent System Operator (ISO). As a result of the settlement, SDG&E's ROE would be 11.25 percent, rather than the 13 percent SDG&E requested. SDG&E's revenue requirements for its retail and wholesale

customers for the initial 12-month period beginning October 1, 2003, would be \$142.1 million and \$135.6 million, respectively, rather than the \$149.5 million and \$143.7 million requested. The settlement contemplates that SDG&E will fully recover its cancelled Valley-Rainbow Project costs of \$19 million over a ten-year amortization period without interest. The transmission rate formula is to be in effect through June 30, 2007. A final decision is not expected before late November 2003.

In August 2002 the FERC issued Opinion No. 458, which effectively disallowed SDG&E's recovery of the differentials between certain costs paid to SDG&E under existing transmission contracts (the Participation Agreements) and charges assessed to SDG&E under the ISO FERC tariff for transmission line losses and grid management charges related to its Southwest Powerlink. SDG&E had previously been recovering these costs by charging them through the Transmission Revenue Balancing Account, but Opinion No. 458 rejected this approach and required SDG&E to refund the cost differentials so recovered. SDG&E's request for rehearing was denied. As a result, SDG&E is incurring unreimbursed costs of \$4 million to \$8 million per year. SDG&E has petitioned the United States Court of Appeals for review of these FERC orders and has submitted to the FERC a refund plan which would refund \$21 million to transmission customers via the Transition Cost Balancing Account. This refund arrangement is subject to FERC acceptance, which is pending. In addition, SDG&E is challenging the propriety of the ISO charges as applied to the portions of the Southwest Powerlink jointly owned with Arizona Public Service Co. and the Imperial Irrigation District in proceedings before the FERC, and in an arbitration under the ISO tariff. On October 27, 2003, an independent arbitrator found in SDG&E's favor on this matter. The ISO has the right to appeal this result to the FERC. To the extent SDG&E prevails in these matters, the FERC may require the ISO to refund to SDG&E all or part of the costs. SDG&E has also commenced a private arbitration to reform the Participation Agreements to remove prospectively SDG&E's obligation to provide services giving rise to unreimbursed ISO tariff charges.

#### FERC ACTIONS

##### Refund Proceedings

The FERC is investigating prices charged to buyers in the California Power Exchange (PX) and ISO markets by various electric suppliers. The FERC is seeking to determine the extent to which individual sellers have yet to be paid for power supplied during the period of October 2, 2000 through June 20, 2001 and to estimate the amounts by which individual buyers and sellers paid and were paid in excess of competitive market prices. Based on these estimates, the FERC could find that individual net buyers, such as SDG&E, are entitled to refunds and individual net sellers are required to provide refunds. To the extent any such refunds are actually realized by SDG&E, they would reduce SDG&E's rate-ceiling balancing account.

In December 2002, a FERC ALJ issued preliminary findings indicating that the California PX and ISO owe power suppliers \$1.2 billion (the \$3.0 billion that the California PX and ISO still owe energy companies less \$1.8 billion that the energy companies charged California customers in excess of the preliminarily determined competitive market

clearing prices). On March 26, 2003, the FERC largely adopted the ALJ's findings, but expanded the basis for refunds by adopting a staff recommendation from a separate investigation to change the natural gas proxy component of the mitigated market clearing price that is used to calculate refunds. The March 26 order estimates that the replacement formula for estimating natural gas prices will increase the refund obligations from \$1.8 billion to more than \$3 billion. The FERC recently released its final instructions, and the ISO and PX have five months to recalculate the precise number through their settlement models. California is seeking \$8.9 billion in refunds and has appealed the FERC's preliminary findings and requested rehearing of the March 26 order.

#### Manipulation Investigation

The FERC is also investigating whether there was manipulation of short-term energy markets in the West that would constitute violations of applicable tariffs and warrant disgorgement of associated profits. In this proceeding, the FERC's authority is not confined to the October 2, 2000 through June 20, 2001 period relevant to the refund proceeding. In May 2002 the FERC ordered all energy companies engaged in electric energy trading activities to state whether they had engaged in various specific trading activities in violation of the PX and ISO tariffs (generally described as manipulating or "gaming" the California energy markets).

On June 25, 2003, the FERC issued several orders requiring various entities to show cause why they should not be found to have violated California ISO and PX tariffs. FERC directed 43 entities, including SDG&E, to show cause why they should not disgorge profits from certain transactions between January 1, 2000 and June 20, 2001 that are asserted to have constituted gaming and/or anomalous market behavior under the California ISO and/or PX tariffs. SDG&E agreed to pay \$28 thousand into a FERC-established fund on behalf of customers in order to bring its case to closure. FERC approval is pending.

On June 25, 2003, the FERC also determined that it was appropriate to initiate an investigation into possible physical and economic withholding in the California ISO and PX markets. For this purpose, FERC used an initial screen of \$250 per MW for all bids between May 1, 2000 and October 2, 2000. SDG&E received data requests from the FERC staff and have provided responses. FERC staff will prepare a report to the Commission, which will be the basis to decide whether additional proceedings are warranted. SDG&E believes that its bids and bidding procedures were consistent with ISO and PX tariffs and protocols and applicable FERC price caps. On August 1, 2003, FERC staff issued an initial report that determined there was no need to further investigate particular entities for physical withholding of generation.

#### Price Reporting Practices

On September 26, 2003, FERC sent a survey to 266 companies concerning natural gas and electric price reporting practices. The survey is being conducted in support of FERC's "*Policy Statement on Natural Gas and Electric Price Indices*" issued in July 2003, to measure industry progress in voluntary reporting of energy trade data to publishers of energy price indices. Responses to the survey were provided on behalf

of SDG&E. A second survey is expected to be conducted in March 2004 in FERC's continuing effort to monitor energy price reporting.

#### NUCLEAR INSURANCE

SDG&E and the other co-owners of SONGS have insurance to respond to any nuclear liability claims related to SONGS. The insurance policy provides \$300 million in coverage, which is the maximum amount available. The Price-Anderson Act provides for up to \$10.6 billion of secondary financial protection if the liability loss exceeds the insurance limit. Should any of the licensed/commercial reactors in the United States experience a nuclear liability loss which exceeds the \$300 million insurance limit, all utilities owning nuclear reactors could be assessed under the Price-Anderson Act to provide the secondary financial protection. SDG&E and the other co-owners of SONGS could be assessed up to \$201 million under the Price-Anderson Act. SDG&E's share would be \$40 million unless default occurs by any other SONGS co-owner. In the event the secondary financial protection limit is insufficient to cover the liability loss, Congress could impose an additional assessment on all licensed reactor operators.

SDG&E and the other co-owners of SONGS have \$2.75 billion of nuclear property, decontamination and debris removal insurance. The coverage also provides the SONGS owners up to \$490 million for outage expenses incurred because of accidental property damage. This coverage is limited to \$3.5 million per week for the first 52 weeks, and \$2.8 million per week for up to 110 additional weeks. Coverage is also provided for the cost of replacement power, which includes indemnity payments for up to three years, after a waiting period of 12 weeks. The insurance is provided through a mutual insurance company owned by utilities with nuclear facilities. Under the policy's risk sharing arrangements, SDG&E could be assessed up to \$7.4 million if losses at any covered facility exceed the insurance company's surplus and reinsurance funds.

Both the nuclear liability and property insurance programs include industry aggregate limits for terrorism-related SONGS losses, including replacement power costs.

#### LITIGATION

During the third quarter of 2003, the company recorded additional charges against income for litigation costs and possible resolution of certain cases. Management believes that none of these matters will have further material adverse effect on the company's financial condition or results of operations. Except for the matters referred to below, neither the company nor its subsidiary are party to, nor is their property the subject of, any material pending legal proceedings other than routine litigation incidental to their businesses.

##### Antitrust Litigation

Lawsuits filed in 2000 and currently consolidated in San Diego Superior Court seek class-action certification and damages, alleging that Sempra Energy, SoCalGas and SDG&E, along with El Paso Energy Corp. (El Paso) and several of its affiliates, unlawfully sought to control natural gas and electricity markets. In March 2003, plaintiffs in these cases and

the applicable El Paso entities announced that they had reached a \$1.5 billion settlement, of which \$125 million is allocated to customers of the California Utilities. The proceeding against Sempra Energy and the California Utilities has not been settled and continues to be litigated.

*Natural Gas Cases:* Similar lawsuits have been filed by the Attorney General of Arizona and the Attorney General of Nevada alleging that El Paso and certain Sempra Energy subsidiaries unlawfully sought to control the natural gas market in their respective states. In April 2003, Sierra Pacific Resources and its utility subsidiary Nevada Power filed a lawsuit in U.S. District Court in Las Vegas against major natural gas suppliers, including Sempra Energy, the California Utilities and other company subsidiaries, seeking damages resulting from an alleged conspiracy to drive up or control natural gas prices, eliminate competition and increase market volatility, breach of contract and wire fraud.

*Electricity Cases:* Various lawsuits, which seek class-action certification, allege that Sempra Energy and certain company subsidiaries, including SDG&E, unlawfully manipulated the electric-energy market. In January 2003, the applicable Federal Court granted a motion to dismiss a similar lawsuit on the grounds that the claims contained in the complaint were subject to the Filed Rate Doctrine and were preempted by the Federal Power Act. That ruling has been appealed in the Ninth Circuit Court of Appeals and a decision is expected in the first quarter of 2004. Similar suits filed in Washington and Oregon were voluntarily dropped by the plaintiffs without court intervention in June 2003.

#### PENDING INTERNAL REVENUE SERVICE MATTERS

The company is in discussions with the Internal Revenue Service (IRS) to resolve issues related to various prior years' returns. A Revenue Ruling dealing with utility balancing accounts, and discussions with the IRS concerning this Ruling and another matter lead the company to believe it will be entitled to record a reduction in previously recorded income tax expense, accrue significant interest income on overpayments of tax in certain prior periods and reverse recorded interest associated with the reporting of these items in other prior periods. The company expects that these matters will be resolved before year end and estimates that favorable resolution could increase reported earnings by in excess of \$60 million.

The company is unable to predict the net effect of the ultimate resolution of these income tax matters.

#### RECENT SOUTHERN CALIFORNIA FIRES

Several major wildfires that began on October 26, 2003 severely damaged some of SDG&E's infrastructure, causing a significant number of customers to be without utility services. On October 27, 2003, Governor Gray Davis declared a "state of emergency" for four counties, including the County of San Diego.

The declaration of a state of emergency invokes Public Utilities Code Section 454.9, which authorizes a public utility to establish a

catastrophic event memorandum account (CEMA) to record all costs associated with (1) restoring utility services to customers; (2) repairing, replacing or restoring damaged utility facilities and (3) complying with governmental agency orders in connection with events declared disasters by competent state or federal authorities.

The costs recorded in the CEMA are recoverable in rates separate from ordinary costs currently recovered in rates. Public Utilities Code Section 454.9 requires that the CPUC hold expedited hearings in response to the utilities' request for recovery. SDG&E is recording fire damage costs and the costs of restoring electric and natural gas service in the CEMA account. Therefore, the company expects no significant effect on earnings from the fires.

#### 4. FINANCIAL INSTRUMENTS

Note 8 of the notes to Consolidated Financial Statements in the Annual Report discusses the company's financial instruments, including the adoption of *SFAS 133, "Accounting for Derivative Instruments and Hedging Activities,"* as amended by *SFAS 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities"* and *SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities"*. The effect is to recognize all derivatives as assets or liabilities on the balance sheet, measure those instruments at fair value, and recognize any changes in fair value in earnings for the period that the change occurs unless the derivative qualifies as an effective hedge that offsets other exposures.

The company utilizes derivative financial instruments to manage its exposure to unfavorable changes in commodity prices, which are subject to significant and often volatile fluctuations. Derivative financial instruments include futures, forwards, swaps, options and long-term delivery contracts. These contracts allow the company to predict with greater certainty the effective prices to be received by the company and its customers. In accordance with SFAS 133, the company has elected to account for contracts that are settled by physical delivery at historical cost, with gains and losses reflected in the income statement at the contract settlement date.

Fixed-price contracts and other derivatives on the Consolidated Balance Sheets primarily reflect the company's derivative gains and losses related to long-term delivery contracts for purchased power and natural gas transportation. The company has established regulatory assets and liabilities to the extent that these gains and losses are recoverable or payable through future rates. The changes in fixed-price contracts and other derivatives on the Consolidated Balance Sheets for the nine months ended September 30, 2003 were primarily due to physical deliveries under long-term purchased-power and natural gas transportation contracts. The transactions associated with fixed-price contracts and other derivatives had no material impact to the Statements of Consolidated Income for the nine months ended September 30, 2003 or 2002.

ITEM 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the financial statements contained in this Form 10-Q and "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in the Annual Report.

RESULTS OF OPERATIONS

Electric revenues increased to \$1.4 billion for the nine months ended September 30, 2003 from \$962 million for the same period in 2002, and the cost of electric fuel and purchased power increased to \$428 million in 2003 from \$221 million in 2002. Additionally, electric revenues increased to \$579 million for the three months ended September 30, 2003 from \$358 million for the same period in 2002, and the cost of electric fuel and purchased power increased to \$128 million in 2003 from \$81 million in 2002. These changes were mainly due to the effect of the DWR's purchasing the net short position of SDG&E during 2002, increases in electric commodity costs, the increase in authorized distribution revenue and higher volumes in 2003, and, for the quarter, recognition of \$116 million related to the approved settlement of intermediate-term purchase power contracts and higher earnings from PBR awards. See discussion of performance awards in Note 3 of the notes to Consolidated Financial Statements.

Under the current regulatory framework, changes in commodity costs do not affect net income. The commodity costs associated with the DWR's purchases and the corresponding sales to SDG&E's customers were not included in the Statements of Consolidated Income as SDG&E was merely transmitting electricity from the DWR to the customers without taking title to the electricity. During 2003, costs associated with long-term contracts allocated to SDG&E from the DWR were likewise not included in the income statement, since the DWR retains legal and financial responsibility for these contracts.

Natural gas revenues increased to \$371 million for the nine months ended September 30, 2003 from \$309 million for the corresponding period in 2002, and the cost of natural gas increased to \$199 million in 2003 from \$149 million in 2002. Additionally, natural gas revenues increased to \$88 million for the three months ended September 30, 2003 from \$67 million for the corresponding period in 2002, and the cost of natural gas increased to \$47 million in 2003 from \$29 million in 2002. These changes were primarily attributable to natural gas price increases (which are passed on to customers) partially offset by reduced volumes.

Under the current regulatory framework, changes in core-market natural gas prices for core customers (primarily residential and small commercial and industrial customers) do not affect net income, since core-customer rates generally recover the actual cost of natural gas on a substantially concurrent basis and are fully balanced. However, SDG&E's gas procurement PBR mechanism provides an incentive mechanism by measuring SDG&E's procurement of natural gas against a benchmark

price comprised of monthly natural gas indices, resulting in shareholder rewards for costs achieved below the benchmark and shareholder penalties when costs exceed the benchmark.

The tables below summarize the electric and natural gas volumes and revenues by customer class for the nine months ended September 30, 2003 and 2002.

<table>

Electric Distribution and Transmission

(Volumes in millions of kilowatt hours, dollars in millions)

<caption>

	2003		2002	
	Volumes	Revenue	Volumes	Revenue
<s>	<c>	<c>	<c>	<c>
Residential	4,988	\$ 561	4,673	\$ 486
Commercial	4,681	526	4,517	481
Industrial	1,468	126	1,393	121
Direct access	2,456	62	2,618	90
Street and highway lighting	68	8	66	7
Off-system sales	26	1	3	--
	13,687	1,284	13,270	1,185
Balancing accounts and other		94		(223)
Total	13,687	\$ 1,378	13,270	\$ 962

</table>

Although commodity-related revenues from the DWR's purchasing of SDG&E's net short position or from the DWR's allocated contracts are not included in revenue, the associated volumes and distribution revenue are included herein.

<table>  
Gas Sales, Transportation and Exchange  
(Volumes in billion cubic feet, dollars in millions)  
<caption>

	Gas Sales		Transportation & Exchange		Total	
	Volumes	Revenue	Volumes	Revenue	Volumes	Revenue
<s>	<c>	<c>	<c>	<c>	<c>	<c>
2003:						
Residential	24	\$ 220	--	\$ --	24	\$ 220
Commercial and industrial	13	95	3	4	16	99
Electric generation plants	--	3	45	22	45	25
	37	\$ 318	48	\$ 26	85	344
Balancing accounts and other						27
Total						\$ 371
2002:						
Residential	26	\$ 190	--	\$ --	26	\$ 190
Commercial and industrial	13	71	4	6	17	77
Electric generation plants	--	--	68	18	68	18
	39	\$ 261	72	\$ 24	111	285
Balancing accounts and other						24
Total						\$ 309

</table>

SDG&E recorded net income of \$210 million and \$155 million for the nine-month periods ended September 30, 2003 and 2002, respectively, and net income of \$121 million and \$48 million for the three-month periods ended September 30, 2003 and 2002, respectively. The increases were primarily due to income of \$65 million after-tax related to the approved settlement of intermediate-term purchase power contracts, higher earnings from PBR awards, and higher transportation and distribution revenue. These factors were partially offset by higher operating expenses including litigation charges in the third quarter of 2003, and the end of sharing of the merger savings (which positively impacted earnings by \$6 million for the nine-month period and \$2 million for the three-month period in 2002). Additionally, for the nine-month period, the increases were offset by the \$25 million benefit from the favorable resolution of prior years' income-tax issues recorded in the second quarter of 2002.

## CAPITAL RESOURCES AND LIQUIDITY

The company's operations are the major source of liquidity. In addition, working capital requirements can be met through the issuance of short-term and long-term debt. Cash requirements primarily consist of capital expenditures for utility plant. At September 30, 2003, the company had \$174 million in cash and \$300 million in unused, committed lines of credit available. Management believes these amounts and cash flows from operations and new debt issuances will be adequate to finance capital expenditure requirements and other commitments.

For additional discussion, see "Factors Influencing Future Performance-- Electric Industry Restructuring and Electric Rates" herein and Note 3 of the notes to Consolidated Financial Statements.

## CASH FLOWS FROM OPERATING ACTIVITIES

Net cash provided by operating activities totaled \$465 million and \$628 million for the nine months ended September 30, 2003 and 2002, respectively. The decrease was attributable to 2003's lower rate of recovery of the AB 265 undercollection and higher natural gas inventory (due to higher natural gas prices).

During the third quarter of 2003, the company made a pension plan contribution of \$17.2 million for the 2003 plan year.

## CASH FLOWS FROM INVESTING ACTIVITIES

Net cash used in investing activities totaled \$246 million and \$619 million for the nine months ended September 30, 2003 and 2002, respectively. The change was primarily due to the \$45 million repayment by Semptra Energy in 2003 compared to \$336 million of advances from SDG&E in 2002.

Capital expenditures for property, plant and equipment are estimated to be \$400 million for the full year 2003 and are being financed primarily by internally generated funds and security issuances. Construction, investment and financing programs are continuously reviewed and revised in response to changes in competition, customer growth, inflation, customer rates, the cost of capital, and environmental and regulatory requirements.

## CASH FLOWS FROM FINANCING ACTIVITIES

Net cash used in financing activities totaled \$204 million and \$90 million for the nine months ended September 30, 2003 and 2002, respectively. The change was attributable to higher dividends paid to Semptra Energy in 2003, partially offset by reduced payments on long-term debt in 2003. During the nine months ended September 30, 2003, SDG&E repaid \$48 million of rate-reduction bonds.

## CREDIT RATINGS

On October 7, 2003, Standard & Poor's reduced the corporate credit ratings of SDG&E from A+ to A. The company's prior ratings for senior secured debt were affirmed at A+. All ratings were issued with a stable outlook.

On October 14, 2003 Fitch Ratings affirmed the senior secured debt ratings of SDG&E at AA, senior unsecured debt ratings at AA-, and preferred stock ratings at A+.

Moody's senior secured debt ratings of SDG&E remained unchanged at A1, the senior unsecured debt ratings at A2, and preferred stock ratings at Baa1. All ratings maintained their prior stable outlook.

## FACTORS INFLUENCING FUTURE PERFORMANCE

Performance of the company will depend primarily on the ratemaking and regulatory process, electric and natural gas industry restructuring, and the changing energy marketplace. These factors are discussed in the Annual Report and in Note 3 of the notes to Consolidated Financial Statements herein.

### Income Tax Issues

Resolution of the income tax issues described in Note 3 of the notes to Consolidated Financial Statements herein could have a material impact on results of operations for 2003, or one or more future periods.

### Electric Industry Restructuring and Electric Rates

Supply/demand imbalances and a number of other factors resulted in abnormally high electric-commodity costs beginning in mid-2000 and continuing into 2001. This caused SDG&E's customer bills to be substantially higher than normal. In response, legislation enacted in September 2000 imposed a ceiling on the cost of electricity that SDG&E could pass on to its small-usage customers on a current basis. SDG&E accumulated the amount that it paid for electricity in excess of the ceiling rate in an interest-bearing balancing account, which it continues to collect from its customers. During the nine months ended September 30, 2003, the balance in the balancing account declined from \$215 million to \$156 million.

Subsequent to the electric capacity shortages of 2000-2001, SDG&E's service territory had and continues to have an adequate supply of electricity. However, various projections of electricity demand in SDG&E's service territory indicate that, without additional electrical generation and transmission and reductions in electrical usage, beginning in 2005 electricity demand could begin to outstrip available resources. SDG&E's strategy for meeting this demand is to: (1) reduce power demand through conservation and efficiency; (2) increase the supply of electricity from renewable sources, including wind and solar; (3) establish a new transmission interconnect by 2008 or as soon thereafter as practicable; and (4) provide new electric generation to address the reliability deficiency identified by SDG&E as beginning in 2005. SDG&E has issued a request for proposals (RFP) to meet the

electric capacity shortfall, estimated at 69 megawatts in 2005 and increasing annually by approximately 100 megawatts, and has filed a proposed plan at the CPUC for meeting these capacity requirements. SDG&E is currently ahead of the interim schedule required by California legislation in meeting the CPUC's requirement of obtaining 20 percent of its electricity from renewable sources by 2017. On October 7, 2003, SDG&E filed a motion for approval of its RFP results. See Note 3 of the notes to Consolidated Financial Statements for additional information regarding the RFP results.

Operating costs of SONGS Units 2 and 3, including nuclear fuel and related financing costs, and incremental capital expenditures are recovered through the Incremental Cost Incentive Pricing (ICIP) mechanism which allows SDG&E to receive approximately 4.4 cents per kilowatt-hour for SONGS generation. Any differences between these costs and the incentive price affect net income. This mechanism expires on December 31, 2003. For the year ended December 31, 2002, ICIP contributed \$50 million to SDG&E's net income. The company is in the process of addressing the SONGS revenue requirement, primarily in conjunction with the General Rate Case of Southern California Edison (the operator and 75-percent owner of SONGS), for rates that begin in January 2004. (SDG&E seeks to recover approximately 95 percent of its 2004 SONGS operating & maintenance and capital revenue requirements in that case.) The remaining five percent of the company's SONGS revenue requirement is being addressed in SDG&E's Cost Of Service proceeding.

See additional discussion of this and related topics, including the CPUC's adjustment to its plan for deregulation of electricity, in Note 3 of the notes to Consolidated Financial Statements.

#### Natural Gas Restructuring and Rates

As discussed in the Annual Report, in December 2001 the CPUC issued a decision related to natural gas industry restructuring, with implementation anticipated during 2002. During 2002 the California Utilities filed a proposed implementation schedule and revised tariffs and rules required for implementation. However, on February 27, 2003, the CPUC issued a resolution rejecting without prejudice those proposed tariffs and rules. On September 29, 2003, the CPUC issued a ruling indicating that the proceeding will initially only consider implementation of the original December 2001 decision, but the Assigned Commissioner said he will informally look at the alternatives proposed by SoCalGas. The matter has been set for hearing and a CPUC decision is expected by January 2004. If the December 2001 decision is implemented, it is not expected to have a material effect on the company's earnings.

#### CPUC Investigation of Compliance with Affiliate Rules

On February 27, 2003, the CPUC opened an investigation of the business activities of SDG&E, SoCalGas and Sempra Energy to ensure that they have complied with relevant statutes and CPUC decisions in the management, oversight and operations of their companies. On September 18, 2003, the Commission suspended the procedural schedule until the CPUC completes an independent audit to evaluate energy-related business activities undertaken by Sempra Energy within the service territories of SDG&E and SoCalGas, relative to holding company systems and affiliate activities. The audit will be combined with the annual

affiliate audit and should be completed by the end of 2004. The scope of the audit will be broader than the annual affiliate audit. In addition to an evaluation of compliance with CPUC rules and requirements, this audit will assess the potential for conflicts between the interests of Sempra Energy and the interests of the California Utilities and their ratepayers, and examine whether business activities undertaken by the California Utilities and/or their holding company and affiliates pose potential problems or unjust or unreasonable impacts on utility customers.

#### Cost of Service Filing

As previously reported, the California Utilities have filed cost of service applications with the CPUC seeking rate increases designed to reflect forecasts of 2004 capital and operating costs. SDG&E is requesting revenue increases of approximately \$76 million. The ORA filed its prepared testimony in the applications on August 8, 2003, recommending rate decreases that would reduce annual revenues by \$41 million from their current level. UCAN has proposed rates for SDG&E that would reduce annual revenues by \$88 million from their current level. Hearings are expected to conclude by the end of this month. The procedural schedule for the cost of service applications permits a decision as early as March 2004, and the California Utilities have filed a petition for interim rate relief for the period from January 1, 2004 until the effective date of the decision. On November 3, 2003, the CPUC ALJ released a Proposed Decision that would authorize the California Utilities to create a memorandum account as of January 1, 2004, to record the difference between existing rates and those that are later authorized in the Commission's final decision in this case. The difference would then be amortized in rates. The full Commission can vote on the Proposed Decision as soon as December 4, 2003. The California Utilities have also filed for continuation through 2004 of existing PBR mechanisms for service quality and safety that would otherwise expire at the end of 2003.

An October 10, 2001 decision denied the California Utilities' request to continue equal sharing between ratepayers and shareholders of the estimated savings for the 1998 Enova-PE business combination that created Sempra Energy and, instead, ordered that all of the estimated 2003 merger savings go to ratepayers. In 2002, merger savings to shareholders for the three-month and nine-month periods were \$2 million and \$6 million, respectively.

#### NEW ACCOUNTING STANDARDS

Relevant pronouncements that have recently become effective or that are yet to be effective are SFAS 143, 148, 149 and 150, Interpretations 45 and 46, and EITF 02-3. See discussion in Note 2 of the notes to Consolidated Financial Statements.

*SFAS 143, "Accounting for Asset Retirement Obligations"* is the only one of the above pronouncements that is material to the company. Issued in July 2001, SFAS 143 addresses financial accounting and reporting for legal obligations associated with the retirement of tangible long-lived assets. It requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. The company adopted SFAS 143 on January 1, 2003.

ITEM 3. MARKET RISK

There have been no significant changes in the risk issues affecting the company subsequent to those discussed in the Annual Report.

As of September 30, 2003, the total Value at Risk of SDG&E's natural gas positions was not material.

ITEM 4. CONTROLS AND PROCEDURES

The company has designed and maintains disclosure controls and procedures to ensure that information required to be disclosed in the company's reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and is accumulated and communicated to the company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating these controls and procedures, management recognizes that any system of controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired objectives and necessarily applies judgment in evaluating the cost-benefit relationship of other possible controls and procedures.

Under the supervision and with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, the company as of the date of this quarterly report has evaluated the effectiveness of the design and operation of the company's disclosure controls and procedures. Based on that evaluation, the company's Chief Executive Officer and Chief Financial Officer have concluded that the controls and procedures are effective.

There have been no significant changes in the internal controls or in other factors that could significantly affect the internal controls subsequent to the date the company completed its evaluation.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Except as described in Note 3 of the notes to Consolidated Financial Statements, neither the company nor its subsidiary is party to, nor is their property the subject of, any material pending legal proceedings other than routine litigation incidental to their businesses.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit 12 - Computation of ratios

12.1 Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends.

Exhibit 31 -- Section 302 Certifications

31.1 Statement of Registrant's Chief Executive Officer pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934.

31.2 Statement of Registrant's Chief Financial Officer pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934.

Exhibit 32 -- Section 906 Certifications

32.1 Statement of Registrant's Chief Executive Officer pursuant to 18 U.S.C. Sec. 1350.

32.2 Statement of Registrant's Chief Financial Officer pursuant to 18 U.S.C. Sec. 1350.

(b) Reports on Form 8-K

The following report on Form 8-K was filed after June 30, 2003:

Current Report on Form 8-K filed August 7, 2003, filing as an exhibit Sempra Energy's press release of August 7, 2003, giving the financial results for the three months ended June 30, 2003.

Current Report on Form 8-K filed September 2, 2003, announcing CPUC approval of certain performance rewards and the CPUC's denial of rehearing requested by opponents of an approved settlement agreement with SDG&E.

Current Report on Form 8-K filed November 6, 2003, filing as an exhibit Sempra Energy's press release of November 6, 2003, giving the financial results for the three months ended September 30, 2003.

SIGNATURE

Pursuant to the requirement of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SAN DIEGO GAS & ELECTRIC COMPANY  
(Registrant)

Date: November 6, 2003

By: /s/ D.L. Reed

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D.L. Reed  
President and  
Chief Financial Officer