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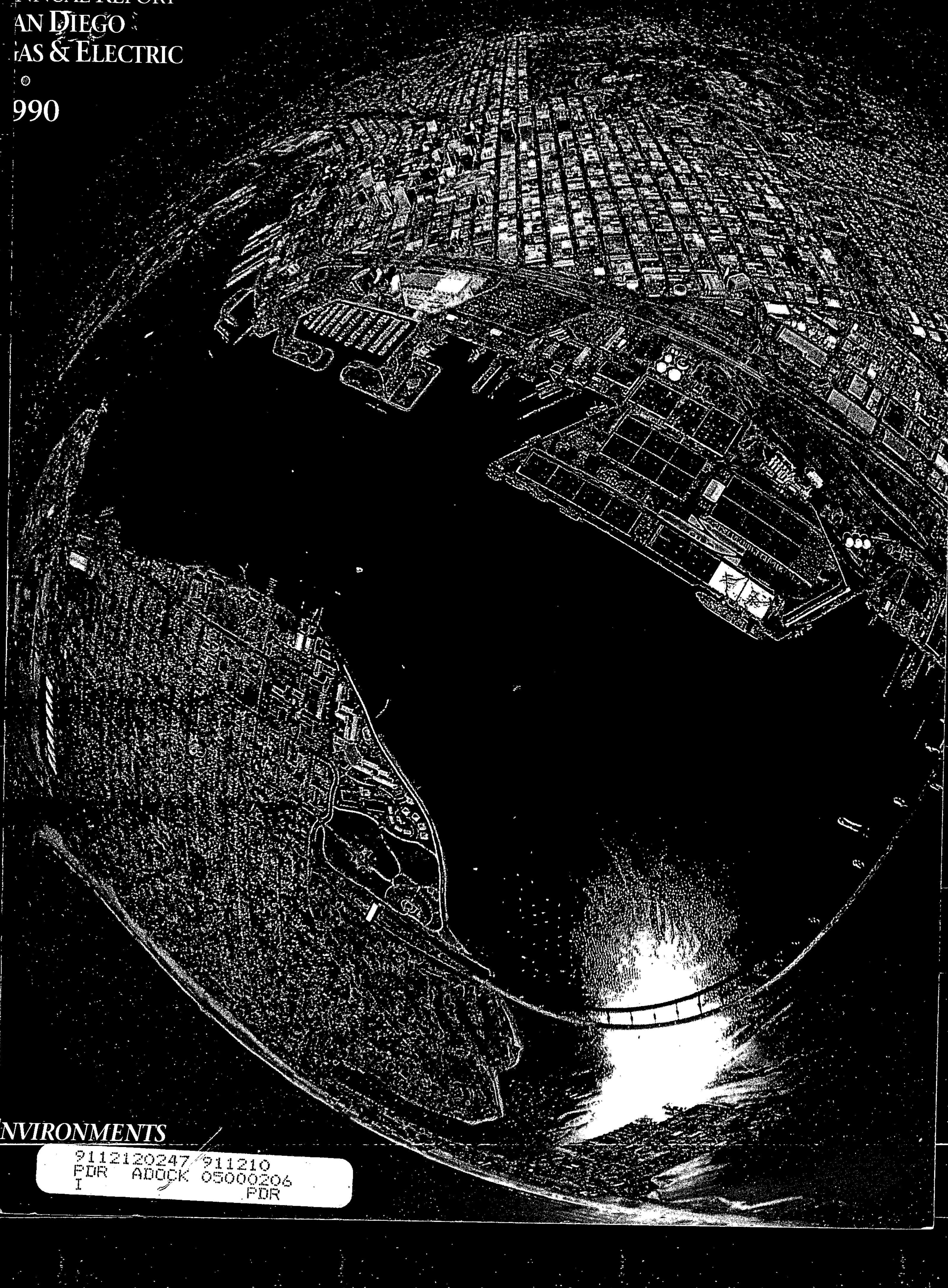


NVIRONMENTS

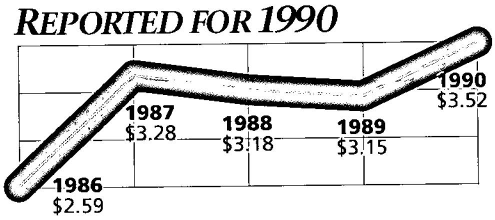
1990 Highlights

CUSTOMERS LIKE OUR SERVICE, 89 PERCENT "VERY SATISFIED"

We've taken steps to provide better and faster customer service, and customers are recognizing our efforts. During 1990, our surveys showed that 89 percent of customers were "very satisfied" with the company's service. It's the highest-ever annual rating of customer satisfaction.

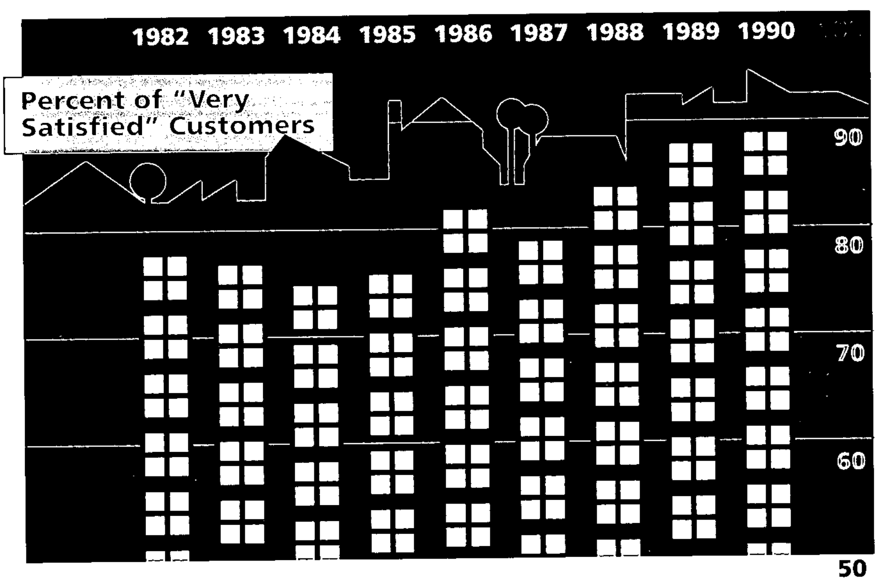
See page 4 for more information on our customer surveys, and pages 4 through 7 for details on some of the special programs and services we now provide our customers.

RECORD ANNUAL EARNINGS REPORTED FOR 1990



SDG&E common stock earnings reached a record annual high of $3.52 per share for 1990. Total earnings applicable to common shares were $197 million for the year, up from $176 million in 1989. The common stock price also reached an all-time high of $46.25 per share on November 13, 1990.

See page 2.



SDG&E SUBSIDIARY'S ENVIRONMENTAL BUSINESS LISTED ON NYSE

On April 25, 1990, SDG&E's wholly owned subsidiary, Pacific Diversified Capital, made a public stock offering of 20 percent of the ownership of Wahlco Environmental Systems. That environment-related company is now listed on the New York Stock Exchange under the ticker symbol WAL.

PDC continues to own 80 percent of WES; so in effect, SDG&E shareholders retain 80 percent ownership of WES. WES sells pollution control equipment that's used primarily at coal-fired power plants throughout the United States and in foreign countries.

WES also expanded its products and services in 1990, and is better prepared to benefit from the worldwide emphasis on improving air quality.

See pages 16 and 17.

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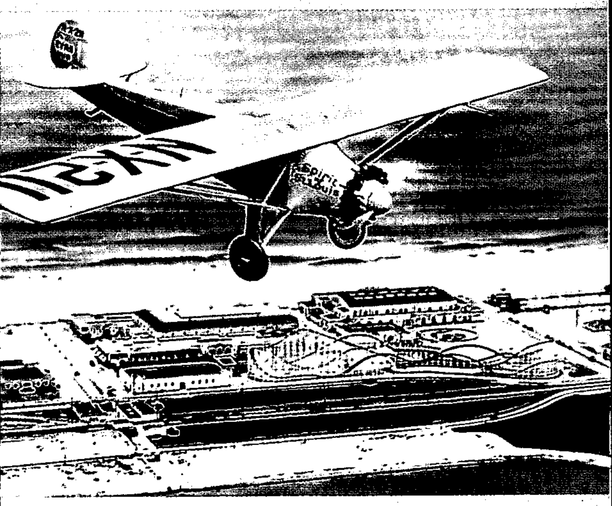


Charles A. Lindbergh was test-flying his 'Spirit of St. Louis' over Belmont Park in 1927 (the park's roller coaster is prominent). His plane was built in San Diego, and his flight across the Atlantic brought attention to the city's growing aerospace industry. Highlights of SDG&E's history, linked strongly with the growth of San Diego, are depicted in photos and captions in this annual report.

"Spirit of St. Louis" composite photograph: San Diego Historical Society
Restoration © copyright: Take Two

About the Cover:
It's common to use the word "environment" to refer to the physical or natural surroundings. However, dictionaries define the word "environment" as all the conditions, surroundings and events that affect the growth of an organism, an individual or an organization. The definition of "environment" goes far beyond our physical surroundings.

The cover displays an unusual view of a key part of SDG&E's service territory, downtown San Diego and San Diego County's South Bay area. Inside this report, we focus on conditions and events that affect four of SDG&E's most important environments: our customer, business, regulatory and employee environments. In the process of describing these key facets of our company, we also will discuss actions SDG&E takes to benefit our natural environment—such as encouraging our customers to use existing energy resources more efficiently, and supporting the development of low emission natural gas vehicles.

Company Description
San Diego Gas & Electric is an energy management company. It operates a gas and electric utility that serves nearly 2.7 million people in Southern California.

Through its subsidiary, Pacific Diversified Capital, it owns companies in other industries.

CHAIRMAN'S LETTER

San Diego's grand old roller coaster at Belmont Park, on the shores of the Pacific Ocean, shares some similarities with your company.

The roller coaster started operation July 4, 1925, and went through a number of ownership changes. Over the years, the roller coaster was partially burned by fire three times, and charred by financial problems even more often.

The weathered and worn coaster stood idle from 1976 until 1990. With much planning and hard work, it was rebuilt and reopened.

Now, with the benefit of modern technology and a fresh coat of paint, it's stronger, safer and more striking than the original. The roller coaster once stood on wooden pilings buried in the sand. Today, it's anchored securely in concrete. It's fun to ride — I've been on it.

Just as the Belmont Park roller coaster was tested by fire, so, in a way, was San Diego Gas & Electric. Two separate oil embargoes during the 1970s led to serious problems. By the early 1980s, customer rates were soaring upward, while our employee morale and our financial performance were plunging downward. Customers were angry, employees discouraged and shareholders disappointed.

Just as the roller coaster was rebuilt, so was your company. We began that effort with a plan of action and faith in the abilities of SDG&E's employees. We set strategic goals and steadily worked toward their achievement. We implemented strategies that enabled us to transform a troubled utility into an energy management business ready to capture future opportunities. Now we're more flexible, more responsive, more capable of dealing with the roller coaster ride of change in a business which is dramatically different from what it was a decade ago.

In the not-so-distant past, it was common for utilities to begin planning 10 years ahead for a large-scale power plant. Today forward-looking energy providers rely on a combination of smaller power-producing efforts which require shorter lead times to meet their future energy needs.

It also was easier to estimate the future availability and costs of various energy resources, such as oil. In prior times, utilities tended to depend on a single energy resource to meet energy needs, such as oil or coal. Now there's an emphasis on fuel diversification, developing a mix of different energy sources.

In today's and in tomorrow's energy marketplace, the most successful companies will be those that implement short-term strategies to achieve long-term goals. They will always be ready to respond quickly to new challenges and opportunities.

Like a roller coaster ride, facing the prospect of more rapid changes can be scary, or fun — or a mixture of both. Much depends on skills, preparation and attitude. For SDG&E, however, facing change is like looking forward to a roller coaster ride that's challenging, to be sure, but one that also promises rewards.

Take 1990, for instance.

Record Earnings, High Rating from Customers

We achieved significant progress during the past year in financial results and in customer satisfaction. Record annual earnings for 1990 were $3.52 per share of common stock, up from $3.15 in 1989.

In addition, for the second consecutive year, our common stock hit a new record high. On November 13, 1990 our common stock reached an all-time high of $46.25 per share. The high for 1989 was set on December 27 of that year, $45.63 per share.

Continued emphasis on improving customer service and customer satisfaction was rewarded in 1990 with a strong vote of customer confidence. The average results of customer surveys for the year showed 89 percent were "very satisfied" with SDG&E's service. Our highest ratings were achieved during the fourth quarter of 1990: 92 percent of customers surveyed were "very satisfied."

Your company's key achievements for 1990 — record earnings and high customer satisfaction — were made possible by the leadership of a quality management team and by the individual efforts of each and every SDG&E employee.

FINANCIAL HIGHLIGHTS

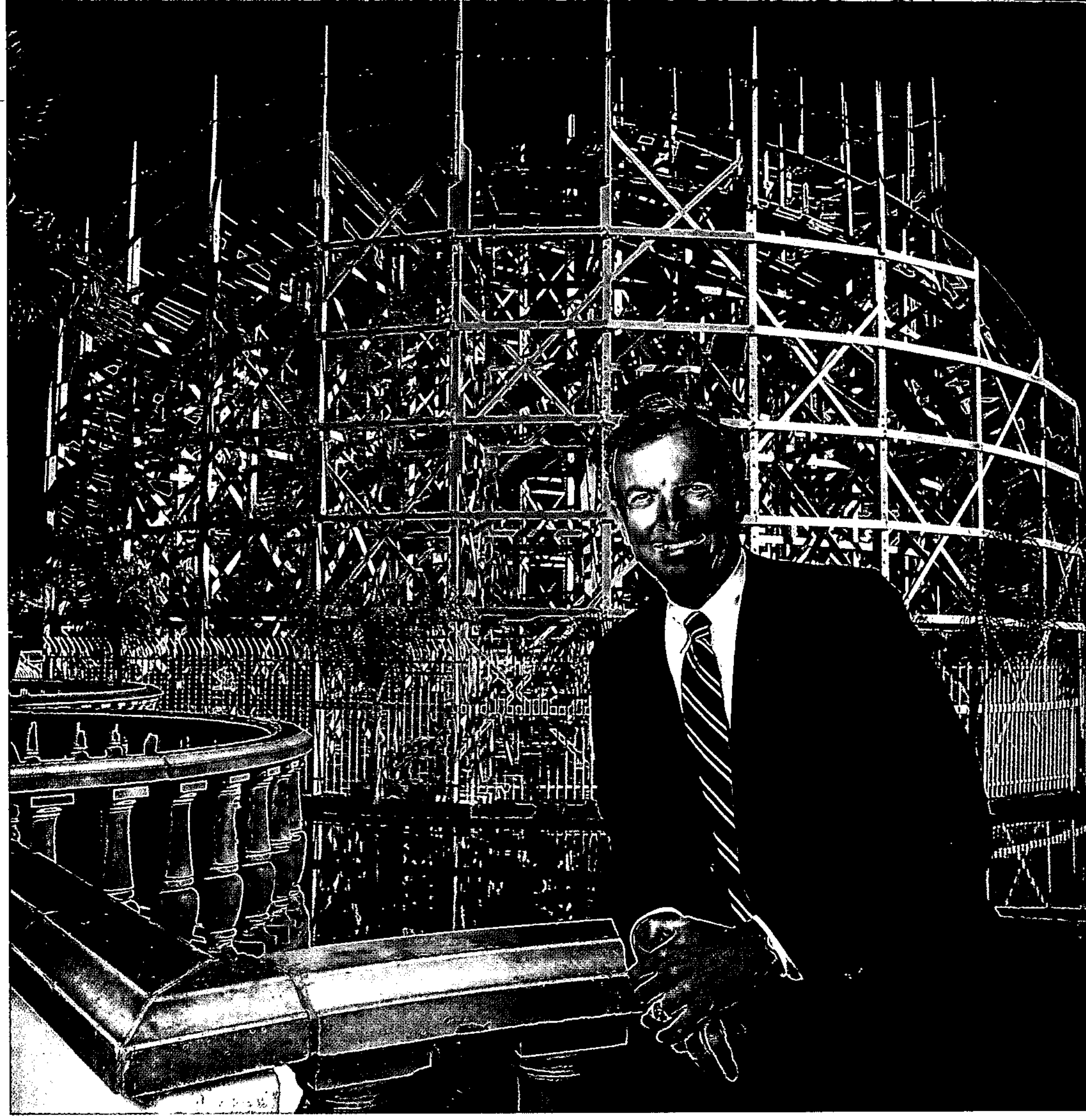
In thousands of dollars except per share amounts	1990	1989	Percent Change
Operating revenues	$1,771,868	$1,669,471	+ 6.1%
Operating expenses	$1,470,719	$1,384,707	+ 6.2%
Net income (before preferred dividend requirements)	$ 207,841	$ 187,126	+11.1%
Earnings applicable to common shares	$ 196,978	$ 175,924	+12.0%
Earnings per common share	$ 3.52	$ 3.15	+11.7%
Dividends declared per common share	$ 2.70	$ 2.70	—
Retail energy sales			
Electric (billions of kilowatt-hours)	14.3	13.4	+ 6.7%
Gas (millions of therms)	613	584	+ 5.0%

Customer Rates, Subsidiary Operations

I do have some unpleasant news concerning our rates for customers. Despite our efforts to cut expenses and to search diligently for low-cost power supplies for our customers, electric rates increased by about 5 percent in January 1991. This increase was due mainly to inflation and to the ending of a customer refund.

Even with this increase, our rates continue to be the lowest among California's investor-owned utilities. Of special note, SDG&E's electric rates are now about 25 percent below our 1985 levels.

I also want to address the 1990 results of our subsidiary, Pacific Diversified Capital. PDC's net income was about $12 million for 1990, up significantly from $4 million in 1989. Although results from operations were up, the $12 million includes the gain from a public stock offering by PDC's subsidiary, Wahlco Environmental Systems, Inc. This gain was partially offset by losses on the sale of Mock Resources, Inc. and from the real estate investment activities of another PDC subsidiary.



We had expected higher revenues from the sales of pollution control equipment than were achieved. Unfortunately, delays by Congress in approving amendments to the Clean Air Act led to postponements in orders. Now that the new air quality law has been passed, we are confident that Wahlco is well positioned to increase sales in the U.S. and world markets.

The Merger

We continue to seek federal and state regulatory approvals of our proposed merger with Southern California Edison Company. The merger will produce savings for customers, and benefits for shareholders and for San Diego County and southern Orange County communities.

Although recommendations against approval of the merger were issued by federal and state administrative law judges, we hope to persuade the regulatory commissions to reject the judges' recommendations and approve the merger.

We are working with Edison on plans that will enable the two companies to move quickly to capture merger benefits when, and if, the required regulatory approvals are granted.

On Track and Moving Forward

Similar to the Belmont Park roller coaster, SDG&E is anchored securely in today's energy business, and our performance in 1990 was more striking than ever.

Your company is on track, whether SDG&E's future is as part of a merged company or as a standalone business. But we're not satisified with just remaining on track. As the cowboy-philosopher Will Rogers noted, "Even if you're on the right track, you'll get run over if you just sit there."

We're moving forward by continuously striving for improvement in all areas of our business. At the same time, we're keeping abreast of change so that we can better maneuver the twists and turns ahead.

Thomas A. Page
Chairman, President and Chief Executive Officer

March 1, 1991

THE CUSTOMER ENVIRONMENT

Customers Enjoy Better and More Specialized Service

1990 might well be called "The Year of the Customer" at SDG&E. During the year:

- We completed a major restructuring of our Customer Services Division, which reduced layers of management and gave front-line employees more authority to respond to customer needs. We also increased the number of service personnel. The result? Better and faster customer service.
- Customers told us they like the results of our ongoing efforts to improve service. During 1990, they gave us the highest-ever ratings in our ongoing quarterly surveys of customer satisfaction. The average results of the four surveys taken during the year show that 89 percent of those interviewed were "very satisfied" with SDG&E service. For the last quarter of the year, the rating was even higher: 92 percent were "very satisfied." Just three years ago, in 1987, only 78 percent of customers rated our service that high.

Another measure of satisfaction is that the number of informal complaints filed by customers with the California Public Utilities Commission in 1990 decreased by about one-third from the previous year, and by more than two-thirds from 1987. There were no informal complaints filed with the commission during September 1990, the first month that has occurred in 15 years.

- We gained approval for and began implementing a $25 million package of energy efficiency and energy conservation programs for low-income, other residential, and business customers. These new programs, developed as a result of a statewide collaborative effort with consumer groups, environmental organizations, state regulators and other utilities, promise to provide significant benefits.

Although customers will pay for these new programs through slightly higher rates (about $1 per month for the typical home), they benefit from reduced energy use. Every dollar spent on conservation programs is expected to yield about $2 in energy savings.

More efficient use of existing energy resources helps to defer the need for additional power plant capacity, which minimizes customer rates in the long term and also benefits the environment.

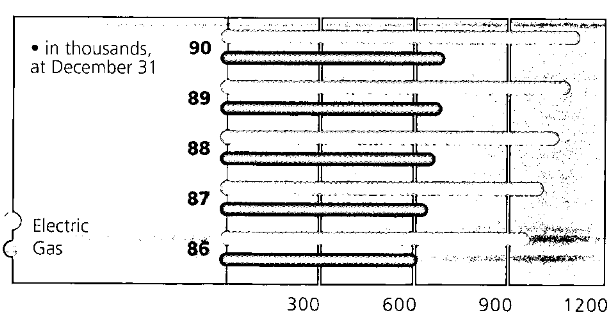
We're already helping customers save energy with these new programs which, like some of our continuing programs for our larger customers, offer the potential for shareholder incentive rewards if we achieve certain energy conservation goals.

- We received Public Utilities Commission approval for a $5.6 million shareholder incentive for the significant energy conservation results we helped our larger business and industrial customers to achieve during 1989. The approval was anticipated and the money was included in 1989 shareholder earnings. This shared savings approach offers benefits to both customers and the company for cooperating on ways to make better use of existing energy resources.
- We expanded our 24-hour phone service, making it more convenient for customers to do business with us. We've always offered 24-hour emergency response. But now customers can call us any time about other energy service matters, from billing questions to requests for energy conservation tips.

The company's customer service operations are divided into two main areas: residential and small business customers, who are served by the Customer Services Division; and our larger business, industrial and governmental customers, served by our Marketing Department.

While the rate of customer growth slowed in 1990, there was a significant increase: 25,000 new electric customers and 11,000 new gas customers.

Electric and Gas Customers



Service to Residential and Small Business Customers

Senior Vice President Al Davis, who heads the Customer Services Division, believes that "providing reliable, quality customer service is our number one responsibility." While SDG&E has always emphasized good service, he says, "today's customers expect a higher level of service. They want us to provide the same or better service than they can get from supermarkets and retail stores."

For example, our customers want "one-stop shopping." When customers call an SDG&E service representative, they want to handle all their service needs with one call. Our front-line employees now have the training and the management support to provide that one-stop shopping service for our customers.

Customer Services Division employees developed a strong mission: "We will exceed customers' expectations in the delivery of the highest quality service, and will be the recognized service management leader in the industry." And with their conscientious efforts, employees are meeting that challenge. In fact, several utilities from other parts of the U.S. and from foreign countries have sent representatives to SDG&E to learn how our employees provide such a high level of quality service.

"We have steadily improved the service we provide our customers," notes Davis. "But it requires ongoing efforts, so we're constantly looking for new ways to be even more responsive to individual customer needs."

One example is the company's increased effort to provide customer service to a population with a rich mix of different cultures. The company has long provided telephone service in Spanish, the language of our service area's largest non-English speaking population. By the end of 1990, we were able to communicate with customers in 20 different languages, thanks to employees who serve as interpreters.

"We've also expanded the number of hours we have repair crews on duty, so that we can more quickly respond to customer needs during outages that occur in the late night and early morning hours," says Davis.

"The best way for us to assure customer satisfaction is to provide personal attention in combination with high quality technical service," Davis continues. "And we're doing just that."

Davis says the company continues to look for new ways to meet customer needs, sometimes in collaboration with others. For example, SDG&E is working with consumer groups, other California utilities, state regulators, building industry groups, realtors and lenders to develop an energy efficiency rating, similar to the miles-per-gallon rating for new cars, that can help new home buyers estimate a home's monthly energy consumption. Like many of our customer programs, this offers potential for educating customers on efficient ways to use energy, while also improving our relationship with customers.

Specialized Service for Business Customers

There's an intense effort to provide specialized customer services to our large business, industrial and governmental customers.

Customer telephone service was expanded to 24 hours a day during 1990, making it more convenient for customers to do business with us. Al Davis, senior vice president of customer services, visits with Kim Fremo in the company's telephone call center. Lela Manning is seated in the foreground.

"In terms of the services we provide our larger customers, we're a totally different company than we were just a few years ago," says Don Felsinger, vice president of marketing and resource planning. "We've become a very customer-driven organization," Felsinger continues. "We put ourselves in our customers' shoes to look for effective energy solutions that provide mutual benefits for our customers and our company."

One example is our commercial/industrial Customer Advisory Panel. Started in 1989, this panel's more than a dozen members each represent a particular type of business, industry or public organization. Large hospitals, hotels, electronics manufacturers and school districts all are examples of participating customers.

"The panel serves as a source of practical ideas on how we can improve existing customer service, and better deal with important energy use issues facing our large customers," says Felsinger. "It also serves as a sounding board for new energy efficiency programs we are considering."

In 1990, the Customer Advisory Panel was instrumental in helping SDG&E to simplify commercial/industrial rate structures that had become increasingly complex during the 1980s. The new, simplified rate structures were recently approved by the California Public Utilities Commission. "Now, it's much easier for many of our business and industrial customers to understand how they are charged for the energy they use," says Felsinger.

In 1935, an innovative poncho allowed meter reading in the rain.

"I'm impressed with SDG&E's commitment to energy efficiency."
***Tom Novak**, chief engineer for San Diego's Executive One office complex*

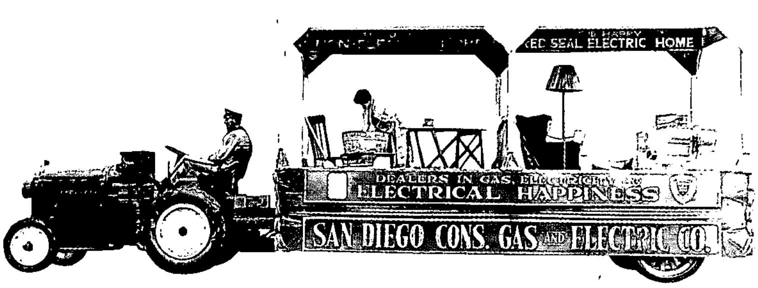
The Marketing Department provides specialized service to customers because different energy needs require different solutions. SDG&E has developed a team of account executives, each with training in specific types of customer operations, such as hospitals, hotels or aerospace manufacturing. This specialization enables our representatives to work more effectively with both individual customers and groups of customers to help them find better and more efficient ways to use energy. Customers gain better control over their operating costs, and SDG&E further strengthens its energy partnerships with these customers.

The company's representative for the hotel industry, for example, encouraged hotel engineers in the San Diego area to form a Hotel Engineers Association, which now represents 50 of the area's largest hotel and conference facilities. The association meets regularly and discusses a wide range of mutual topics, including energy issues. During 1991, SDG&E will offer training seminars to association members to suggest energy-efficient equipment and conservation measures for heating and air conditioning systems.

Customers appreciate the increased level of technical assistance they now receive from us. "I'm impressed with SDG&E's commitment to energy efficiency," says Tom Novak, chief engineer for downtown San Diego's Executive One office complex. In 1990, the chillers for the cooling system were due for replacement, and SDG&E's account executive helped Novak to select high-efficiency cooling equipment that resulted in energy savings. "I can't imagine that we would make any future equipment changes without consulting SDG&E," says Novak.

Following are just a few examples of innovative SDG&E programs aimed at satisfying the energy needs of large business, industrial and governmental customer organizations:

"Electrical Happiness" displays in 1927 showed modern home appliances.



• **Building Design Review Program:** SDG&E's energy specialists work with our customers' architects and engineers on design plans for new buildings, so that suggestions for improved energy efficiency can be considered and implemented in the planning stage. For a customer, designing energy efficiency into the planning phase of a new building is less expensive and results in greater energy savings than waiting until a building is completed.

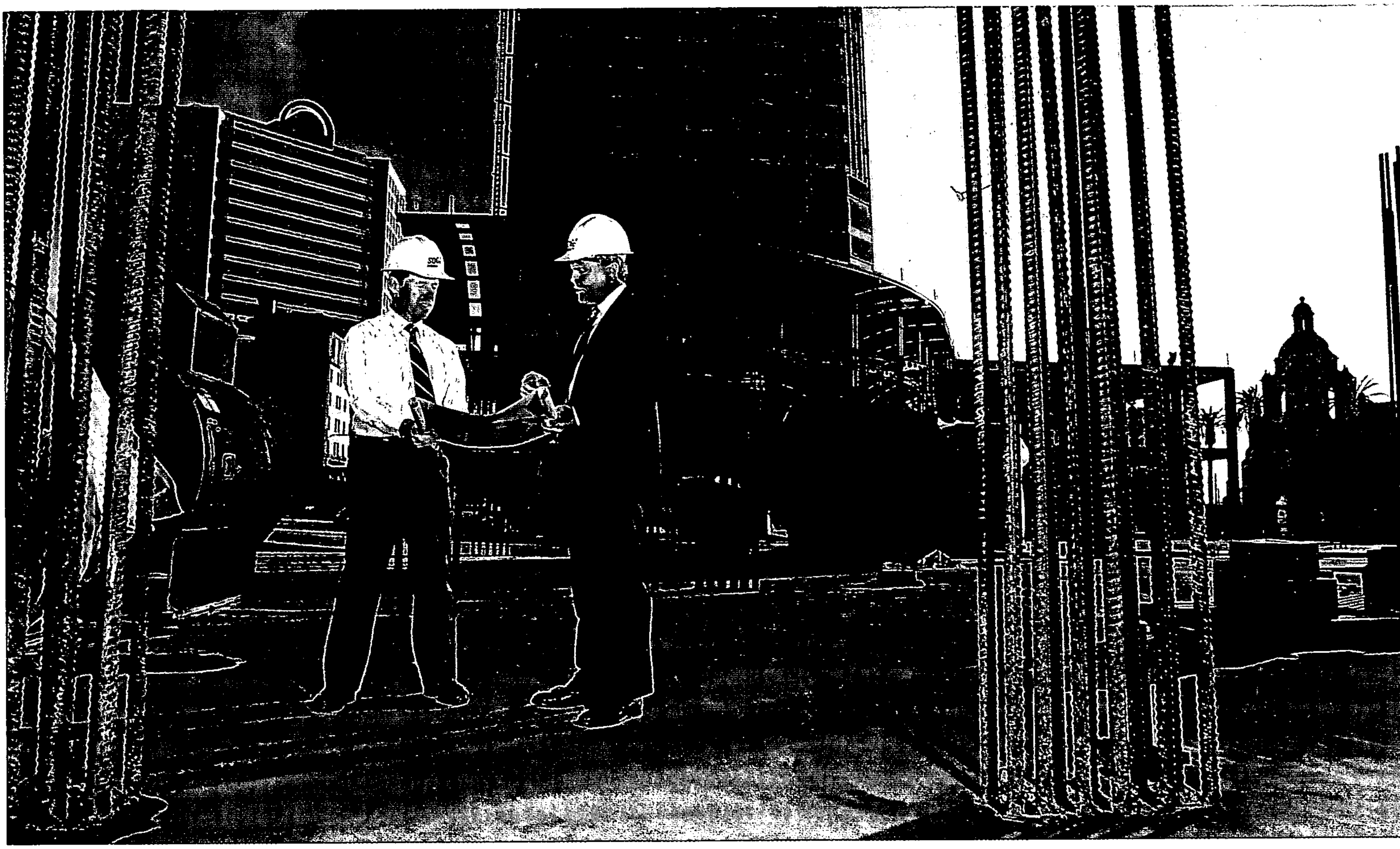
• **Commercial/Industrial Incentive Program:** Energy efficiency improvements often are costly. SDG&E's Commercial/Industrial Incentive Program is a highly customized program that assists customers financially with some of the up-front costs associated with energy-efficient equipment and conservation measures. The incentives often make the difference in the customer's decision about whether to implement recommended equipment changes.

At Southwestern College, for instance, John Wilson, director of business/operations, liked the lighting retrofit recommendations suggested by SDG&E's account executive. "SDG&E offered us a $75,000 incentive that represented 10 percent of the entire project's cost," recalls Wilson. "That incentive helped convince our Board of Trustees that SDG&E was serious about helping us to reduce energy costs through becoming more energy efficient."

• **Cogeneration Program:** Some business customers find cogeneration (on-site energy plants) an attractive energy option. But often, they don't want the risks associated with operating and maintaining a cogeneration system. SDG&E offers an answer by installing, owning and operating a cogeneration system located on a customer's property. We offer the customer energy savings and freedom from installation and maintenance responsibilities, while giving SDG&E an easily manageable way of increasing generating capacity to meet growing customer needs.

In 1990, SDG&E installed its first company-owned cogeneration system at the Ramada Inn in San Diego's Old Town.

• **Retrofit Lighting Program:** Sometimes business customers want to conserve energy, but just don't have the time and experience needed to select high quality, energy-efficient equipment, or to bid the work through competent contractors and/or oversee equipment installation. Our lighting retrofit program is unique in the utility industry, for it offers a "turnkey" approach that removes these barriers and allows customers to devote their time to running their businesses.



SDG&E works with customers during the design phase of buildings to help them save energy and reduce energy costs. Don Felsinger, vice president of marketing and resource development (right), talks with Dave Himchak, an SDG&E account executive, about an off-peak cooling system for the Great American Plaza Project in downtown San Diego. The cooling system will freeze water during the night and on weekends, when energy costs are lower. The ice can then be stored to provide daytime cooling for the 34-story office building and a planned 14-story hotel.

We provide the customer with a lighting survey, recommendations for improving energy efficiency, and a cost analysis. If the customer decides to implement our recommendations, we oversee the project from start to finish. In the process, we obtain competitive bids from highly qualified lighting contractors, which can significantly reduce the customer's cost for lighting system changes.

• **Energy Education Programs:** Through seminars, newsletters, informative brochures and free services, we're telling customers about energy saving measures and a variety of energy topics.

Take, for example, SDG&E's Power Quality Program. Some customers, particularly those with sensitive electronic equipment, can have serious power disturbances, causing excessive downtime, employee frustration and lost production.

SDG&E provides informational material, seminars and direct customer assistance to help business customers understand not only what causes power disturbances, but how to analyze and to solve them. This proactive and individualized customer approach helps us to improve customer relations and overcome the misconception that all power problems are directly associated with the utility system.

Dennis Rutherford, assistant manager of maintenance for San Diego-based Jet Products, is one of the customers who benefited from this effort. "In the beginning we thought SDG&E's power supply was the problem," says Rutherford, "but in the end we found we were our own worst enemy. Thanks to SDG&E's power quality services and seminars, we've all but eliminated our power disturbances. And we're grateful for SDG&E's assistance."

THE BUSINESS ENVIRONMENT

Meeting the Energy Needs of a Growing Customer Population

SDG&E met its key business challenges in 1990, providing competitively priced energy supplies and a high level of service to customers, and record earnings to shareholders.

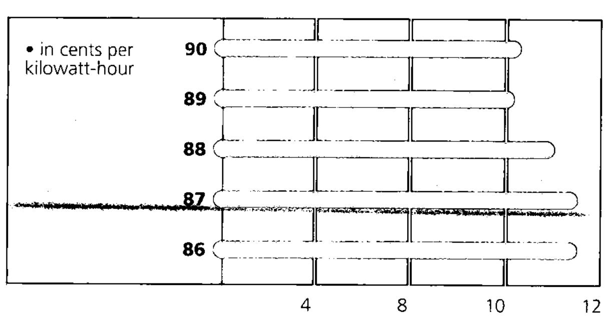
During the year the company also continued to build on its strengths as an innovative energy management company, taking actions to assure future energy supplies for customers, success for the company and benefits to shareholders.

The company's primary challenge for the future is to provide a growing customer population with reliable energy supplies.

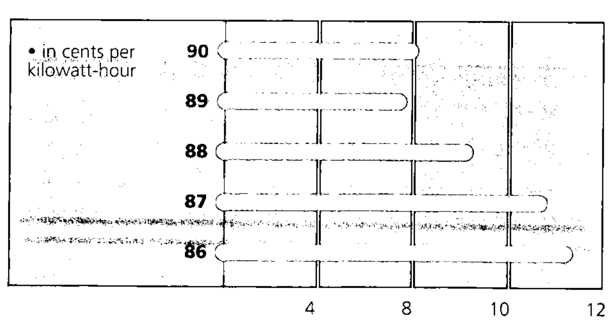
Customer energy needs are expected to increase by about 100 megawatts per year, so we'll need about 1,000 megawatts of additional capacity by the year 2000. That's enough power to meet the average needs of about one million households and it represents a 33 percent increase over our peak electricity use in 1990. Most of the additional power will be required by business and industry, not by residential customers.

Despite a slight increase in 1990, customer electricity rates are well below 1986 levels.

Average Residential Electric Rate



Average Commercial/Industrial Electric Rate



Our main challenge is all the more difficult because there are no natural energy resources in San Diego County or in southern Orange County. The company's service area often is described as an energy desert.

Since 1988, SDG&E and Southern California Edison Company have been working toward a merger that would link our company's need for energy with Edison's power surplus and its more diverse mix of energy resources. The merger also would produce substantial savings to help minimize customer rates better than either company could achieve on a stand-alone basis.

The merger requires approval by both the California Public Utilities Commission and the Federal Energy Regulatory Commission. Final decisions by those regulatory agencies probably could be issued during the first half of 1991.

"We continue to expect the merger to occur," says Jack Thomas, SDG&E's executive vice president and chief operating officer. "We've been working with Edison on transition planning, so that the merged company can be operating effectively soon after we receive regulatory approvals.

"At the same time," adds Thomas, "it's also prudent for us to continue to take steps to assure our success as a stand-alone company, just in case the merger is not approved."

The task of simultaneously pursuing these two paths isn't as difficult as it sounds, adds Lee Haney, chief financial officer and senior vice president for finance. "Many of the steps we take to cut costs, to improve efficiency and to plan for the future benefit us whether we merge with Edison or continue as a stand-alone company," Haney emphasizes.

For example, maintaining customer rates that are competitive with other companies in the energy business is important under either of the two future scenarios.

Customer Rates

SDG&E's customer rates were among the highest in the nation from 1980 to 1985. As a result of continuous efforts to improve efficiency and reduce costs, SDG&E's rates now are competitive with those of other utilities.

Due mainly to inflation and the ending of a customer refund, SDG&E's customer rates for electricity increased by about 5 percent in January 1991. Even with that increase, however, our rates remain competitive with those of other utilities, many of which are facing substantially higher increases during 1991.

SDG&E's 1991 overall customer rates also are now about 25 percent below our 1985 levels.

1990 Achievements

During 1990:

• The company placed an increased emphasis on energy efficiency and conservation programs to meet the growing power needs of our customers. Such programs help to obtain maximum use of energy resources and to defer the need to build additional generating capacity.

• We continued to operate and maintain our power plants at performance levels that are among the highest in our industry. Each year since 1985, SDG&E has achieved at least an 89 percent level of power plant availability, compared to the industry's average of 78 percent for 1985 through 1989 (1990 national ratings are not yet available).

Our successful power plant operating and maintenance efforts improve efficiency, reduce costs, extend the service life of those facilities and give the company leverage to buy surplus power from other utilities at economical prices. All of this, in turn, helps to minimize customer rates.

• SDG&E realized a record $39 million in savings by effectively managing electric power supplies. The bulk of these savings relate to our short-term purchases of electricity, ranging from one hour to one year. These savings are measured against the costs of producing power at our own generating plants and purchasing power under long-term contracts of a year or more.

• We achieved $29 million in savings by purchasing gas supplies on the spot market. These are savings achieved in comparison to the cost of purchases from a single wholesale supplier. The savings we achieve through economical purchases of electricity and natural gas help to minimize customer rates.

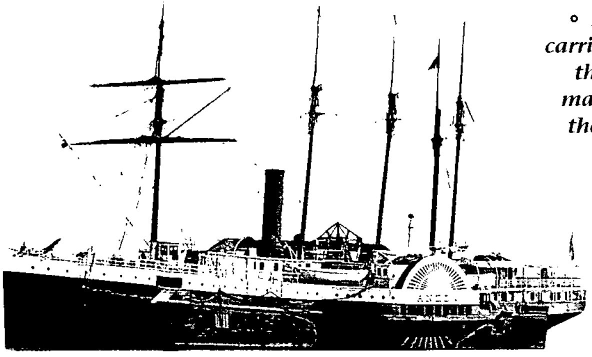
• SDG&E implemented a new gas service agreement with Southern California Gas Company which includes additional gas storage capacity, equivalent to about 10 percent of our annual needs. This improves our ability to purchase gas supplies during the summer, when prices are lower, and then store the gas for the winter, when customer demand is high.

• We signed letters of intent with Canadian gas suppliers to purchase up to 100 million cubic feet of natural gas per day for the next 30 years, beginning in November 1993. This is enough gas to meet the total summer load of our residential customers. The company is now working toward final contract agreements with those Canadian suppliers.

Company officers meet regularly with financial analysts to keep them aware of company issues and projects. Pictured (left to right) are Malyn Malquist, treasurer, and Lee Haney, senior vice president of finance and chief financial officer.

Simultaneously, SDG&E continued to cooperate with 19 other companies on the expansion of a gas transmission pipeline that could deliver these dependable, long-term supplies of Canadian gas to our service territory. The actual volume contracted by SDG&E on the pipeline is expected to be determined sometime in 1991.

The planned $1.2 billion expansion of the existing Pacific Gas Transmission pipeline gained needed approvals from the California Public Utilities Commission and from the Federal Energy Regulatory Commission. However, additional U.S. and Canadian regulatory approvals are required before the project can be built.



◦ In 1882, steamships carried oil from Ventura to the company's oil gas manufacturing plant at the Station A complex.

During 1990 we continued to operate and maintain our power plants at performance levels that are among the highest in our industry.

• We worked on projects to expand electric and natural gas facilities to meet our customers' energy needs. Our two largest expansion projects involve the Peñasquitos electric substation, a $19 million project, and the Moreno natural gas compressor station, a $14 million effort.

The existing Peñasquitos electric substation will be doubled in size when its expansion is completed in 1991. This project is necessary to ensure reliable electric service and to meet projected growth needs for businesses and homes in the coastal area north of the city of San Diego.

The Moreno natural gas compressor station expansion, estimated to be completed in November 1991, will maintain our ability to deliver gas supplies to residential and commercial customers during peak winter weather. This project also allows us to deliver more natural gas as fuel for our power plants and for industrial customers during off-peak conditions.

• The company completed a number of actions to encourage the development of natural gas vehicles. Natural gas is a lower-cost, lower-emission fuel than gasoline for cars, trucks and buses.

Vehicles powered by compressed natural gas (CNG) could help improve air quality in California and in the nation's major cities. In comparison with gasoline-powered vehicles, CNG vehicles would reduce carbon monoxide by 90 percent, hydrocarbons by 50 percent and nitrogen oxides by 33 percent.

Besides pursuing a merger, SDG&E and Southern California Edison Company worked on a transition plan to integrate the two companies. Below (left to right) are Ed Guiles, vice president of corporate planning, and Jack Thomas, executive vice president and chief operating officer. During 1990, these officers made several trips to Edison's headquarters in Rosemead, about 110 miles northeast of San Diego.

SDG&E coordinated an effort by a coalition of California and Texas utilities to encourage the manufacture of compressed natural gas vehicles. Partially as a result of this effort, General Motors will produce 1,000 natural gas-powered pickup trucks in 1991.

In 1990, our company signed an agreement with Unocal Corporation for a joint demonstration project to make natural gas fuel available at two local service stations.

SDG&E also worked with school districts and local transit authorities on various projects to demonstrate and to use natural gas-powered buses in our service territory.

• We conducted research to discover new ways to cut expenses and to help customers use energy more efficiently. These efforts range from more effective and less expensive ways of reducing power plant emissions to developing battery storage systems. Battery storage systems would allow energy to be captured during the night, when energy demands and rates are lower, and stored for daytime use.

• SDG&E focused subsidiary operations more intensely on business opportunities linked to the worldwide emphasis on more effective environmental controls for power plants. A public stock offering by a subsidiary operation, Wahlco Environmental Systems, raised $38 million in capital that can be used in part to expand into additional business opportunities pertaining to environment-related products and services.

Power Plant Operations

The company's Encina and South Bay power plants, which can burn either fuel oil or natural gas, operated at 89 percent availability in 1990. Together they met 24 percent of customer power needs.

SDG&E also has a 20 percent ownership of the San Onofre Nuclear Generating Station, which continues to be one of the nation's safest and best-run nuclear plants. Power from San Onofre met 20 percent of the needs of our customers in 1990.

Power purchases enabled the company to meet 56 percent of customer electricity needs during 1990. The company's transmission links include its own 500,000-volt Southwest Powerlink, which extends into Arizona, as well as tramsmission access to the Pacific Intertie, which extends from California north to the Canadian border.

Managing Energy Supplies

For several years now, the company has been reaching far beyond its service boundaries to seek out economical, short-term purchases of electricity and natural gas in the energy marketplace.

The Peñasquitos substation will be doubled in size during 1991 to meet increasing customer energy demands in the coastal area north of San Diego. Pictured above are Margot Kyd, vice president of administrative services, and Gary Cotton, senior vice president of engineering and operations. The $19 million substation expansion project is the company's largest current construction effort.

Transmission links beyond our service area enable us to shop the energy marketplace aggressively, on an hourly basis, 24 hours each day, to seek out low-cost energy. This keeps our prices down, and allows us to minimize customer rates.

SDG&E purchases electricity from Mexico, from Canada and from throughout the Western U.S., and natural gas from Canada and from the West. We also are able to make short-term power sales throughout the western region and to Mexico.

In recent years, we've progressively become more skilled in our power purchases, both in terms of the prices we pay and the expansion of our transmission access.

In comparison with the average of the previous three years, during 1990 we doubled the savings we achieved for our customers through economical power purchases. During the past year, we also extended our ability to purchase power further eastward by completing a low-cost, short-term power purchase in Arkansas. Prior to that, our company had never made a power purchase beyond Texas.

On the gas side of the business, we've progressively increased our transmission access, enabling us to increase competition among suppliers when we solicit bids for supplies. During 1990, SDG&E purchased 95 percent of customer gas needs on the spot market. Prior to 1986, the company purchased all our customer gas needs from one supplier. Soliciting spot market bids enables us to obtain gas supplies at lower prices.

These skills in managing energy supplies will help the company to continue to search out the most economical supplies of electricity and natural gas to help meet future customer energy needs.

In the mid-1930s, the company made wide use of billboard advertising.

THE REGULATORY ENVIRONMENT

Collaboration Helps Achieve Regulatory Success

SDG&E's dealings with regulatory issues proved successful during 1990, marked by a stronger emphasis on collaboration with consumer and environmental groups. The company also continued to search for effective but economical methods of protecting the environment while still meeting customer energy needs.

Looking ahead, California Governor Pete Wilson is expected to streamline some of the state's regulatory processes concerning utilities, while maintaining California's leadership role in addressing energy issues.

Specific highlights for 1990 include:

- SDG&E began a $25-million package of new energy efficiency programs following a year-long, collaborative effort that involved consumer groups, environmental organizations and state agencies.
- We negotiated a $25-million settlement that will benefit SDG&E and its customers, pending regulatory approvals. The settlement is a positive end to a long dispute concerning our company's 1978 agreement to purchase power from Century Power Corporation.
- State and federal regulatory hearings on the proposed merger between our company and Southern California Edison were completed. Final regulatory decisions on the merger could occur during the first half of 1991.
- The California Public Utilities Commission made no disallowances during 1990 concerning our company's operations. Disallowances for utilities are common in California for expenditures, such as those concerning capital construction projects, power contracts and fuel expenses.
- The commission also approved plans for the California portion of the Pacific Gas Transmission Pipeline project, which will make available to SDG&E and its customers long-term access to Canadian natural gas supplies beginning in 1993.

These linemen used an electric truck in 1922.

Power Contracts

The $25-million settlement with Century Power reflects the company's continued efforts to seek power purchase contracts, and take legal action when necessary, to ensure economically priced energy for customers, according to the company's top legal officer.

"Over the past several years we brought actions to recover overcharges from Century for our customers," says Stephen Baum, senior vice president and general counsel. "When the conditions of this settlement have been met, including approval by the Federal Energy Regulatory Commission, and it has been reviewed by the California Public Utilities Commission, we'll pass on to customers their share of the settlement money through lower rates."

The settlement also gives SDG&E rights to purchase up to 217 megawatts of economically priced energy from Century during 1991, with other options to purchase power in the years 1992 through 1994.

During the latter part of 1990, the company signed power purchase contracts with Southern California Edison Company that enabled us to suspend plans and equipment orders for two major expansion projects, a 460-megawatt combined cycle power plant and a 140-megawatt addition to an existing power plant unit.

These power contracts take effect only if the merger does not occur, and if SDG&E chooses to implement them. The contracts are intended to cover any project delays caused by the suspensions. The contracts with Edison help us to achieve maximum savings for the merged company. At the same time, the contracts ensure that, if for some reason the merger does not occur, we can still meet customers' future energy needs.

Environmental Research and Innovation

The company has a solid record of complying with local, state and federal environmental regulations. In addition, the company searches for innovative ways to respond to environmental issues and problems.

Some examples:

- When an underground storage tank has a gasoline or oil leak, a common way of complying with environmental regulations is to haul the contaminated soil to an approved hazardous waste site. That's often an expensive solution.

During 1990, SDG&E's environmental research efforts achieved successful results in removing soil contaminants with an innovative approach involving microbes that occur naturally in soil. By injecting nutrients into the soil, our researchers stimulate the microbes' appetites for hydrocarbons. The microbes then consume the hydrocarbons, eliminating the hazardous waste. The cost? It's less than half that of the common landfill disposal method. This approach, called bioremediation, also eliminates the long-term liability the company would face in association with the disposal of contaminated soil at a hazardous waste site.

• California is facing its fifth year of drought. As a good corporate citizen, SDG&E has placed a stronger emphasis on water conservation projects in recent years. By using water chemistry monitoring and control techniques and the latest technologies for water reclamation, the company conserves several million gallons of water per year.

Power plant boilers require pure water, and sensitive instruments continuously test water quality. In the past, the water was tested in instruments and any water that did not meet certain quality standards was discharged. Now, instead of being discharged, the water passes through purification equipment so it can be recycled and returned to the boiler. This saves approximately five million gallons of water per year. The company also is researching other ways to conserve water and to reclaim waste water at its Encina and South Bay power plants.

Careful control of the chemical content of water at power plants has an important benefit besides water conservation: it leads to more economical power plant operation. Improving the quality of boiler feedwater reduces boiler tube failures, a common cause of unplanned power plant outages.

During 1990, the company established a joint energy and water conservation program with the San Diego County Water Authority. We worked together to provide and install low-flow showerheads in homes to conserve both water and the energy used to heat water.

• The company also carries out research projects which may yield environmental benefits, such as:

- research of a cost-effective chemical injection process for controlling nitrogen oxide emissions from power plants. In 1990, this research progressed to the stage where it is ready to be tested commercially. Once commercial tests of this process are completed, it can be used as a standard technique in power plants.

Shown here are (left to right) Ronald Fuller, vice president of governmental and regulatory services and Stephen Baum, senior vice president and general counsel. They often travel to San Francisco, the location of the California Public Utilities Commission's headquarters, to the state capital in Sacramento and to Washington, D.C. to protect the interests of SDG&E, its customers and its shareholders.

- the development and testing of fuel cells. SDG&E is taking a lead role in this cooperative effort with other utilities and manufacturers. Fuel cells convert natural gas fuel directly into electricity through a chemical reaction, a process that produces very few emissions. Fuel cells also would enable generating capacity to be added in small increments.

Regulatory Changes Ahead

"California's new governor wants to restructure the state agencies that regulate our business," observes Ronald Fuller, vice president for governmental and regulatory services. "The emphasis will be on looking for ways to streamline the regulatory process while still assuring adequate energy resources at a reasonable cost," says Fuller. "We plan to participate in any such review process, to speak out for the interests of our company, our customers and our shareholders."

In an October 1990 statement on energy matters, Pete Wilson said that as governor he will encourage energy conservation and "the widespread use of cleaner fuels for cars, trucks and buses."

SDG&E already places a strong emphasis on energy conservation, energy efficiency and the development of natural gas-powered vehicles.

"California leads the nation in imaginative energy programs," says Fuller, "and we expect that to continue under the new governor's administration."

THE EMPLOYEE ENVIRONMENT

Employees Improve Productivity, Cut Expenses

By every measure, our employees are more productive, more efficient and more capable than ever before. During 1990:

- They helped the company to complete a major reorganization of its largest division, which employs about half of our total work force. The changes in our Customer Services Division reduced the levels of management and gave many employees additional responsibilities. The results are improved efficiency for the company as a whole and better customer service.
- Employees improved service to our 1.1 million electric and 670,000 natural gas customers. Through surveys, our customers confirmed that employees are improving service. To accomplish this improved level of service, many of our front-line employees assumed more decision-making responsibilities.
- They also improved internal service between the company's various departments.

"Since our corporate goal is to provide quality service to customers," explains Margot Kyd, vice president of administrative services, "employees throughout our company must provide excellent service in support of those employees who deal directly with customers."

- Employees helped the company to further cut costs and improve revenues by their collective and individual efforts. Employee suggestions which were approved during 1990 will lead to $5 million in annual benefits to our company, a record one-year amount for our employee suggestion program.
- They enabled the company to provide services to a growing customer population with fewer employees. Five years ago, the company had 940,000 electric customers and 590,000 natural gas customers. At that time, the number of employees was 4,815. The company now serves 1.1 million electric customers and 670,000 gas customers and has 4,175 employees. That translates into a 33 percent increase in employee efficiency.

Management recognizes that employees comprise our greatest resource. To encourage and to reward superior employee performance:

- The company provided extensive new training to employees during 1990, which will continue in 1991. This training provides employees with the skills they need to become more service-oriented, to improve customer satisfaction, to meet the needs of both internal and external customers, and to manage change.
- The company continued to give employees an incentive for helping the company to achieve its goals. The Gain Sharing program, instituted in January 1988, provides employees with an annual incentive award if specific goals are reached in providing good service while cutting costs and improving safety. For 1990, nearly all employees received a $755 Gain Sharing award.

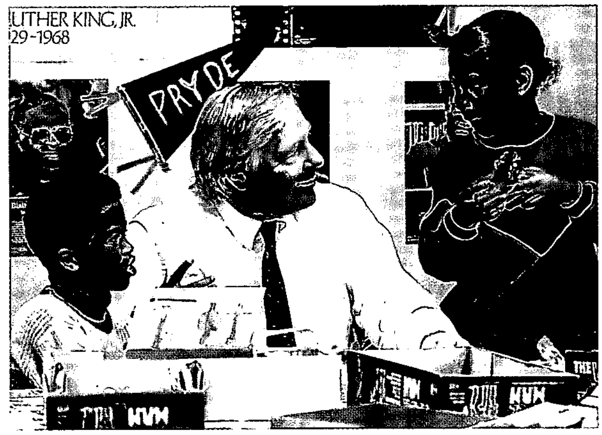
Extensive training programs help employees to improve service to customers. Leonard Viejo, corporate director of operations analysis and audit, discusses with employees the company's service management ethic.

SDG&E's management places a high priority on communicating openly about company issues with employees, the community and the news media. Below (at left) is Frank Ault, controller, with George Weida, vice president of human resources.

- We continued the flexCHOICE plan, begun in 1989, which delivers a full benefit package to employees while still controlling costs.
- Individual employees were rewarded for their suggestions on effective ways to reduce expenses and improve revenues. Under the company's "10% Solution" program, an employee receives 10 percent of the first year's savings for cost-cutting ideas, up to a maximum of $25,000.
- We maintained open and effective communication with employees to keep them informed of company-related issues, including ones concerning the pending merger with Edison. These communications included group meetings and question and answer sessions with officers, news bulletins, fact sheets, an employee telephone news line, a daily news summary distributed by electronic mail, an employee newspaper and special-edition video reports.
- SDG&E participated with Southern California Edison Company in a culture study so employees can understand better the similarities and the differences between the two companies. This provided employees of both companies information that will give them greater opportunities for success in a merged company. (During the year, Edison also pledged a job offer for every SDG&E employee.)
- The company maintained good relations with its union, which resulted in improved productivity.

"Our employees deserve the credit for our company's success," says George Weida, vice president of human resources. "They've responded quite well to changes in our company and in our business. During the past four years, almost every department in our company has been reorganized, requiring a lot of effort on the part of our employees."

Employees, in turn, show more confidence in the company's management than in previous years. Results of an employee survey show that in 1990 the majority of employees believed that the company's management values individual employee input. Five years ago, a similar survey showed that only 13 percent of employees felt they were valued. Similarly, the survey showed that in 1990 the majority of employees believed that there was free and informal communication at all levels of the company. Only 16 percent of employees believed that in 1985.



SDG&E and its employees support a variety of community organizations. Dick Manning, vice president of public relations, is a board member for San Diego County's Young Men's Christian Association. He's shown here helping youngsters assemble models of the human body at San Diego's Jackie Robinson YMCA.

Community Involvement

SDG&E and its employees together support a variety of community organizations throughout the company's service territory.

In 1990, as in previous years, our contributions to United Way ranked among the highest of firms located in San Diego and Orange counties. United Way in turn supports hundreds of community groups, from those that provide medical services to the needy to those that offer sports activities for youth.

In addition, SDG&E and it employees contribute directly to individual arts, community service, educational and youth activity organizations. During 1990, this support became especially important because many community groups, particularly those in the arts, experienced cuts in government funding.

At all levels of the company, employees generously contribute their time as community volunteers, from serving as tutors for school children to heading fund-raising campaigns for medical clinics.

"There's a strong partnership between our company and the communities we serve," notes Dick Manning, vice president of public relations. "As a major corporation, we have a responsibility to be involved in the social concerns of the communities where we do business. Our efforts have gained SDG&E a solid reputation as a good corporate citizen. The youth programs we support help individuals who will be our customers, and possibly our employees, in future years."

◦ *In 1926–27, this boiler crew set installation records.*

SUBSIDIARY OPERATIONS

Subsidiary Markets Environmental Products Worldwide

Pacific Diversified Capital, SDG&E's wholly owned subsidiary, has been an independently operated holding company since 1986. PDC's objective is to increase our return on shareholders' equity through diversification into unregulated businesses. In 1990, PDC took actions to concentrate its investments in environment-related products and services. As a result, the company is better prepared to benefit from the worldwide emphasis on improving air quality.

PDC's consolidated net income for 1990 was approximately $12 million, contributing 22 cents in per-share earnings for SDG&E common stock shareholders. By comparison, 1989 net income was about $4 million, or seven cents a share.

The increased net income for 1990 was due to a public stock offering involving a PDC subsidiary, Wahlco Environmental Systems. The WES gain was partially offset by losses from the sale of Mock Resources, Inc., a fuel distribution company, and from the real estate investment activities of Phase One Development.

Following is a summary of PDC's most significant activities during 1990:

• On April 25, a public stock offering of 20 percent of the ownership of WES raised an approximate net $38 million in capital. The company is now listed on the New York Stock Exchange under the ticker symbol WAL.

Some of the money raised by the WES public stock offering was used to repay existing debt and to replenish working capital, and some was set aside for possible acquisitions.

"We're building on Wahlco Environmental Systems' two main strengths: its excellent worldwide sales network and its highly skilled engineering staff," says Henry Huta, president and chief executive officer of both PDC and WES. "We are expanding and diversifying Wahlco's line of air pollution control technologies and services."

WES primarily sells flue gas conditioning systems to coal-fired power plants operated by utilities. These systems help reduce air emissions, using an approach that also improves the operating efficiency and the useful life of precipitators, expensive equipment that captures emission particles.

PDC continues to own 80 percent of WES; so, in effect, SDG&E shareholders retain 80 percent ownership of WES. The total after-tax gain to SDG&E from the WES offering was $13.5 million, or 24 cents per share of SDG&E common stock.

• PDC sold its fuel oil and natural gas distribution subsidiary, Mock Resources, Inc., in June 1990 at a loss of about $2.7 million, or five cents per share of SDG&E common stock. The sale enabled PDC to focus more intently on environment-related businesses. PDC also remains on a long-range program of reducing its investment in commercial real estate.

Wahlco Environmental Systems, Inc. (WES)
Wahlco Environmental Systems, Inc. expanded its products and services during 1990.

WES has designed, engineered and built about 90 percent of the flue gas conditioning systems installed in North America and 75 percent of those installed in other parts of the world.

Officers

Pacific Diversified Capital Company

Thomas A. Page, 57
Chairman of the Board

Henry N. Huta, 43
President and Chief Executive Officer

A. Noel DeWinter, 51
Vice President and Chief Financial Officer

Wahlco Environmental Systems, Inc.

Thomas A. Page, 57
Chairman of the Board

Henry N. Huta, 43
President and Chief Executive Officer

A. Noel DeWinter, 51
Vice President, Finance and Secretary

Fred C. Johnson, 39
Vice President and Treasurer

Wahlco, Inc.

W. Clay Matthews, 61
President and Chief Executive Officer

R. J. Mudd, 44
Vice President—Operations and Secretary of Corporation

Gary A. Skarphol, 41
Controller

Bachmann Companies, Inc.

Lothar Bachmann, 49
President and Chief Executive Officer

Rick W. MacMillan, 46
Vice President and Chief Financial Officer

John T. Guffre, 42
Vice President and General Manager

Ekkehard Bachmann, 45
President—Bachmann Industries Canada, Inc.

Alberto I. Salvato, 50
President—Bachmann Industries Australia Ptd., Ltd.

The federal Clean Air Act Amendments of 1990, and possible expansion of government regulations about air quality in Eastern and Western Europe and in Asia, are expected to increase significantly the sales of a variety of types of pollution control equipment in the coming years.

Highlights for WES in 1990 were:

• WES acquired all of the capital stock of Bachmann Companies on March 30, for $9.6 million in cash. Bachmann designs, manufactures and sells dampers and other products used by electric utilities, chemical plants, refineries, cement plants, paper and steel mills, and other industrial firms.

Bachmann has manufacturing facilities in the U.S., Canada, Australia and India. Since the acquisition by WES, Bachmann's sales backlog has increased from $11 million in March 1990 to approximately $20 million in December 1990. The company is expanding manufacturing capacity to meet increased product demand.

Since Bachmann products are components of systems used to help control air emissions, sales may increase as a result of the approval of new federal clean air standards.

• On November 15, President George Bush signed the Clean Air Act Amendments of 1990. This comprehensive revision of existing federal air quality regulations is intended to reduce toxic air pollutants and deal with the issue of acid rain.

The new regulations will require utilities to reduce levels of a number of types of air emissions, including sulfur dioxide. WES is the world leader in the manufacture and sale of flue gas conditioning systems, a comparatively low-cost option to help utilities comply with the federal air quality rules.

Utilities that burn high-sulfur coal basically have three options for meeting the new sulfur dioxide emission rules:

SDG&E's subsidiary, Pacific Diversified Capital, concentrated its efforts more intently on environmental products and services during 1990. PDC's Wahlco Environmental Systems sells air pollution control equipment to power plants throughout the world. Henry Huta, shown here in front of a utility power plant, serves as president and chief executive officer of both PDC and Wahlco Environmental Systems.

– Install complex "scrubbers" that capture emission particles, an option that costs about $80 million to $120 million per boiler. There are 111 power plants in the U.S. that have been targeted by the Environmental Protection Agency. A large power plant can have as many as four boilers.

– Switch to lower-sulfur coal and enlarge existing precipitators. This alternative can cost from $20 million to $50 million for each precipitator.

– Convert to lower-sulfur coal in conjunction with a flue gas conditioning system. These systems cost between $1.5 million and $3.5 million per boiler to install, creating a potential market of approximately $400 million in the U.S. alone.

• Wahlco Power Products, a division of WES, opened a new 65,000-square-foot manufacturing facility in Fairmont, West Virginia. The facility produces heater baskets, used mainly by utilities to help power plants conserve and transfer heat as they generate electricity.

WES plans to continue leading the flue gas conditioning market, says Huta, and to market these systems to utilities and to industrial firms as a method for reducing air emissions. "At the same time, we want to expand the company's line of pollution control products and services," he emphasizes.

"Our own research scientists and engineers are developing new products, and we're pursuing both acquisitions and joint ventures," says Huta.

WES already does business in the U.S., Canada, the United Kingdom, France, Germany, Italy, Hungary, Poland, Australia, Korea, Taiwan, and Hong Kong. The company hopes to expand soon to other countries in Eastern Europe and to the Soviet Union.

Wahlco Power Products, Inc.

William H. Pollock, 42
President and Chief Executive Officer

Rick W. MacMillan, 46
Vice President and Chief Financial Officer

Phase One Development, Inc.

Henry N. Huta, 43
President and Chief Executive Officer

Michael J. Lowell, 32
Vice President—Chief Financial Officer

∘ In 1887, the Station A complex housed a power plant and a gas manufacturing facility.

1880 1885 1890 1895 1900 1905

1881 San Diego Gas Company

1887 San Diego Gas & Electric Light Company

1905 San Diego Consolidated Gas & Electric Company

1887 Coronado Gas & Electric Company

1892 Electric Rapid Transit Street Car Company

MORE THAN A CENTURY OF SERVICE

Since April 18, 1881, our company has provided vital energy services to customers. This brief glimpse of highlights during SDG&E's more than a century of service is dedicated to company employees. ○ *The top portion of the timeline above displays the company's name changes over the years. The bottom portion of the timeline lists some of the companies and facilities our company acquired over the years. Photos illustrate our progress as we expanded from a gas company with 89 customers to a company with 1.1 million electric service customers and 670,000 gas service customers.*

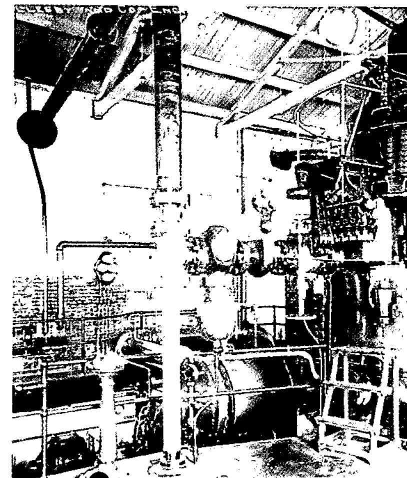
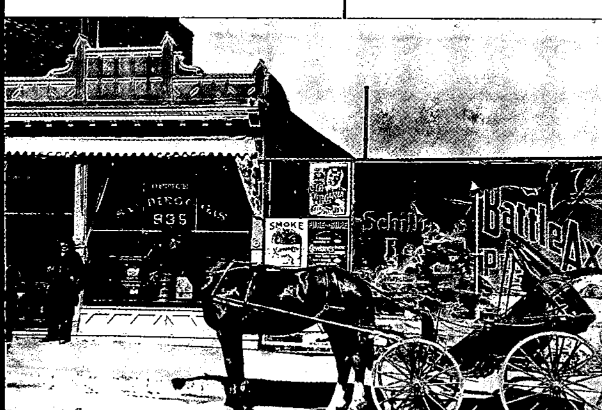
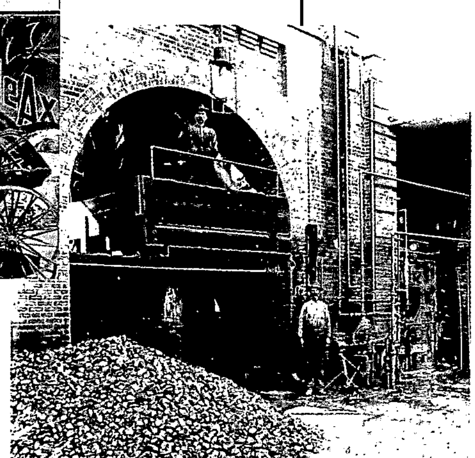


Photo courtesy San Diego Historical Society





1886 • This two-room building was the company's first office.

1886 • Electric arc street light tower at Fifth Avenue and F Street, downtown San Diego.

1887 • Employees stand in front of new plant that manufactured gas.

1906 • The Hotel del Coronado, opened in 1888, was the world's first electrically lighted hotel.

1906 • The first turbine-generator was installed at Station A power plant.

1908 • Electric linemen pose in front of Station A power plant.

1910 1915 1920 1925 1930 1935

1916 Oceanside Electric & Gas Company

1917 Escondido Utilities Company

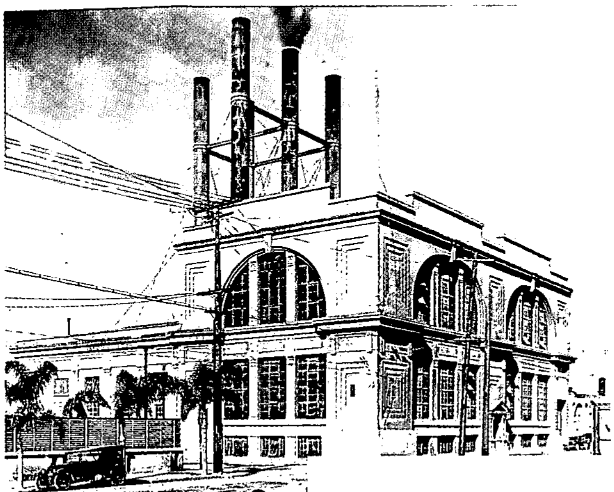
1918 Del Mar W. L. & P. Company

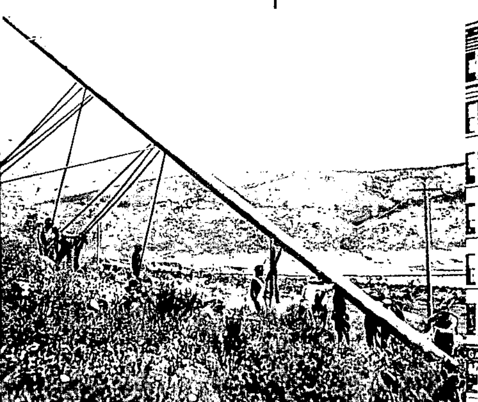
1921 S. D. Electric Railway Company (Station B)

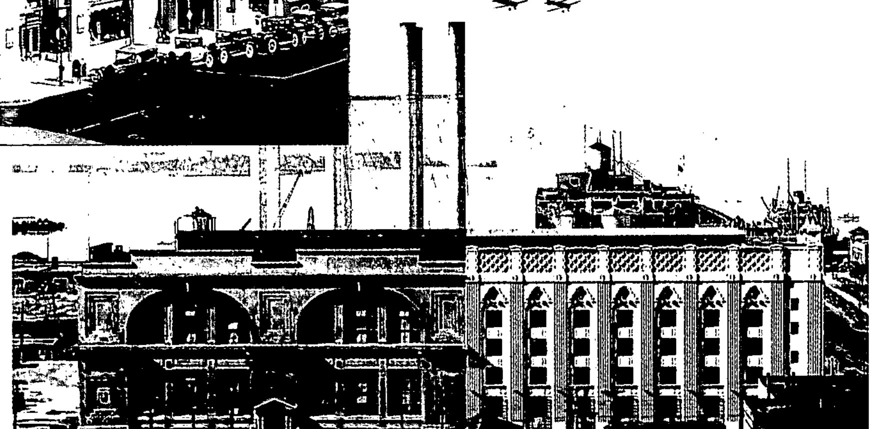
1923 Electric Building

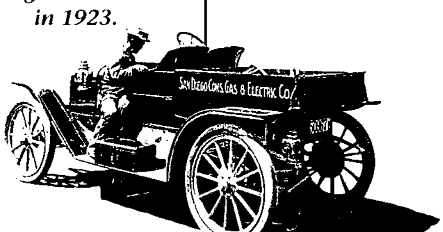
1928 San Juan Capistrano Substation

1930 South Coast Gas Company









◦ Stanley Steamers serviced residential gas customers in 1923.

1916 • Raising a power pole required muscle power.

1921 • Station B power plant was acquired.

1923 • This building was purchased. It remained our headquarters until 1968.

1928 • Station B power plant was expanded.

1929 • Members of Women's Committee formed a first aid team.

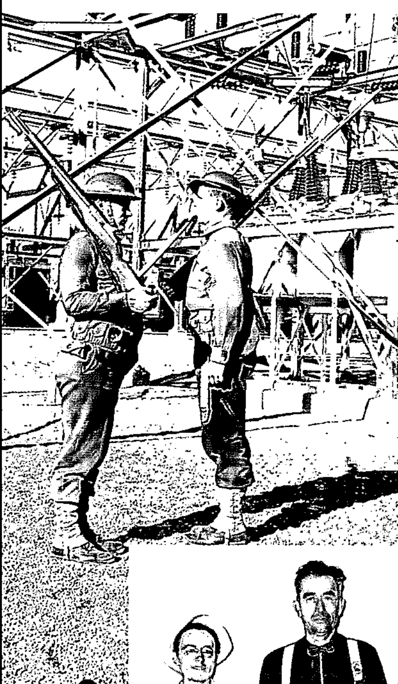
1937 • This kitchen display promoted gas and electric appliances.

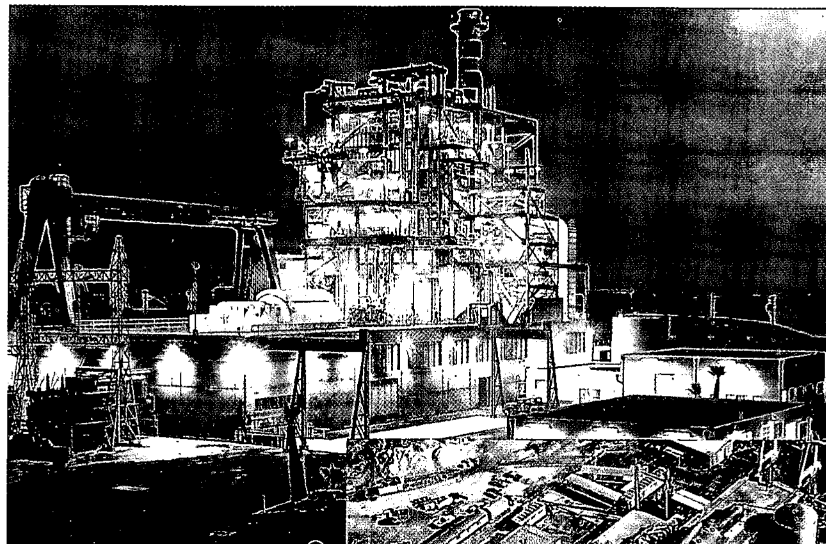
1940 | 1945 | 1950 | 1955 | 1960 | 1965

1940 San Diego Gas & Electric Company

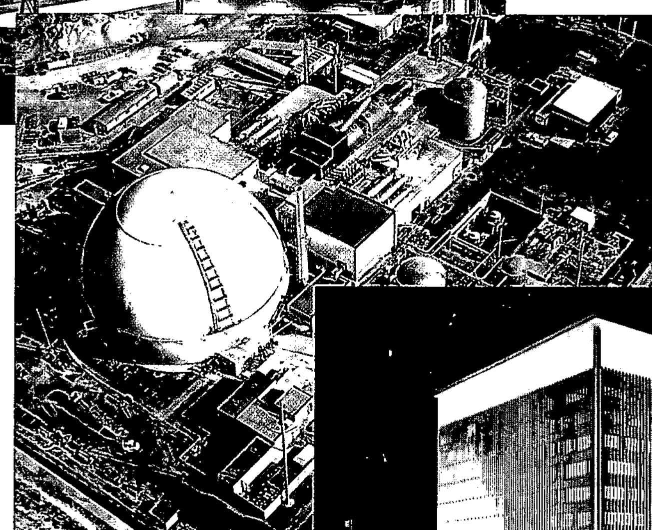
1948 Rincon Substation

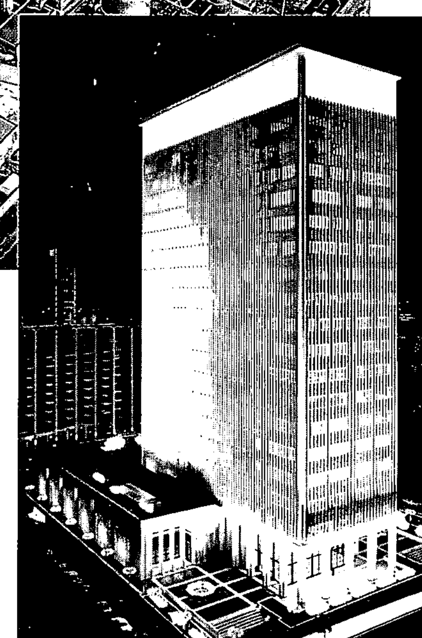
1954 Escondido Mutual Water Company

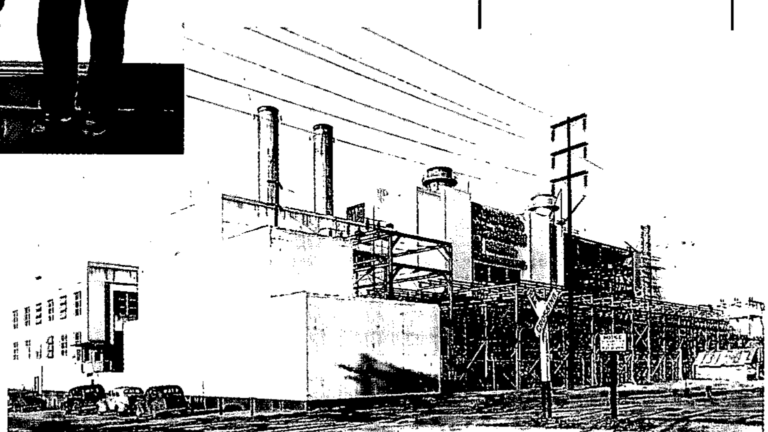




◦ Reddy Kilowatt, an electric power industry symbol, was featured on '50s traffic warning flags for poles.







1941 • Guards protected company facilities during wartime.

1943 • Women meter readers joined SDG&E for the first time.

1950 • Silver Gate power plant was expanded during the post-war population boom.

1960 • The first unit of South Bay power plant began operation.

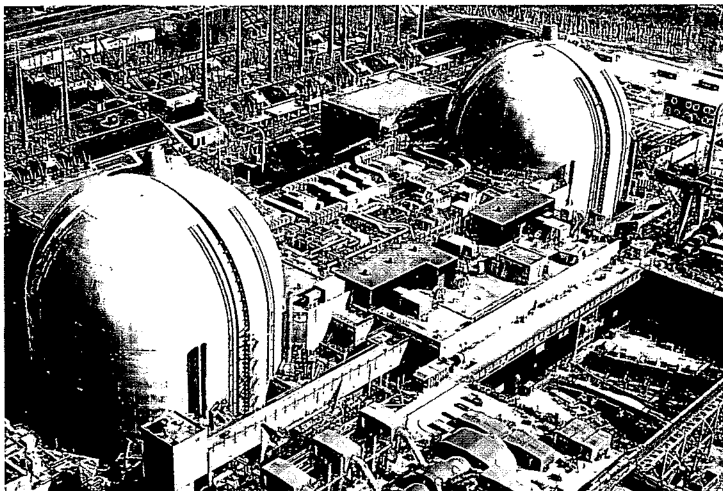
1967 • San Onofre Nuclear Generating Station Unit 1 went on line.

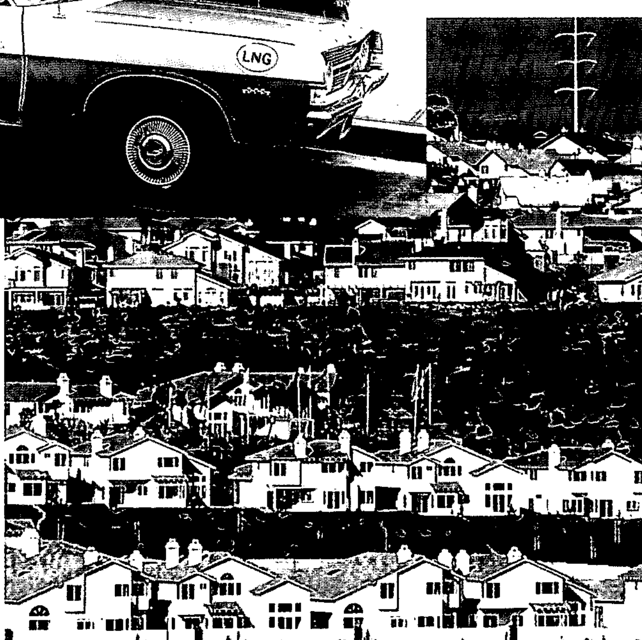
1968 • "Electric Building" headquarters opened.

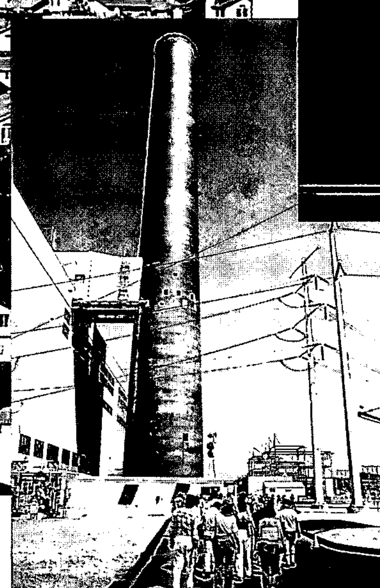
1970 1975 1980 1985 1990

1970 Mountain Empire Electric Co-op

1988 Merger Agreement with Southern California Edison







1968 • This natural gas-powered vehicle went on a national tour.

1970s • Construction continued on Unit 2 at San Onofre Nuclear Generating Station.

1970s and '80s • Construction and the influx of new residents increased the demands for energy services.

1978 • Unit 5 at Encina power plant began operation.

1983 • Southwest Powerlink was dedicated. The 280-mile line was built to bring power from Arizona.

1988 • SDG&E Chairman Tom Page and Edison Chairman Howard Allen signed merger agreement.

Six-Year Summary

In millions of dollars except per share amounts

For the years ended December 31	1990	1989	1988	1987	1986	1985
Operating revenues	**$1,771.9**	$1,669.5	$1,620.5	$1,562.2	$1,634.2	$1,738.7
Operating income	**301.1**	284.8	274.6	261.1	282.4	287.9
Net income (before preferred dividend requirements)	**207.8**	187.1	189.4	196.8*	167.3	202.7
Earnings per common share before cumulative effect of change in accounting principle	**3.52**	3.15	3.18	2.96	2.59	3.25
Earnings per common share	**3.52**	3.15	3.18	3.28	2.59	3.25
Dividends declared per common share	**2.70**	2.70	2.60	2.50	2.345	2.205
At December 31						
Total assets	**3,656.6**	3,546.5	3,532.7	3,551.5	3,409.2	3,332.6
Long-term debt and preferred stock subject to mandatory redemption (excludes current portion)	**1,337.1**	1,287.2	1,357.0	1,388.4	1,333.2	1,354.1

*Includes $17.7 million from the cumulative effect of change in accounting principle.

The Six-Year Summary should be read in conjunction with the consolidated financial statements, notes to consolidated financial statements and statistical data contained elsewhere in this report.

Quarterly Financial Data (Unaudited)

In thousands of dollars except per share amounts

Quarter ended	March 31	June 30	September 30	December 31
1989				
Operating revenues	$420,204	$390,593	$423,892	$434,782
Operating expenses	358,348	323,702	346,317	356,340
Operating income	61,856	66,891	77,575	78,442
Other income (expense)	1,663	1,553	(1,177)	1,776
Net interest charges	27,600	25,210	22,964	25,679
Net income (before preferred dividend requirements)	35,919	43,234	53,434	54,539
Preferred dividend requirements	2,840	2,815	2,774	2,773
Earnings applicable to common shares	$ 33,079	$ 40,419	$ 50,660	$ 51,766
Average common shares outstanding	55,894	55,893	55,893	55,900
Earnings per common share	$ 0.59	$ 0.72	$ 0.91	$ 0.93
1990				
Operating revenues	$445,749	$403,285	$452,127	$470,707
Operating expenses	366,643	337,477	373,407	393,192
Operating income	79,106	65,808	78,720	77,515
Other income (expense)	2,345	11,122	3,382	(1,415)
Net interest charges	25,310	27,942	27,429	28,061
Net income (before preferred dividend requirements)	56,141	48,988	54,673	48,039
Preferred dividend requirements	2,774	2,743	2,673	2,673
Earnings applicable to common shares	$ 53,367	$ 46,245	$ 52,000	$ 45,366
Average common shares outstanding	55,919	55,918	55,918	55,929
Earnings per common share	$ 0.95	$ 0.83	$ 0.93	$ 0.81

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

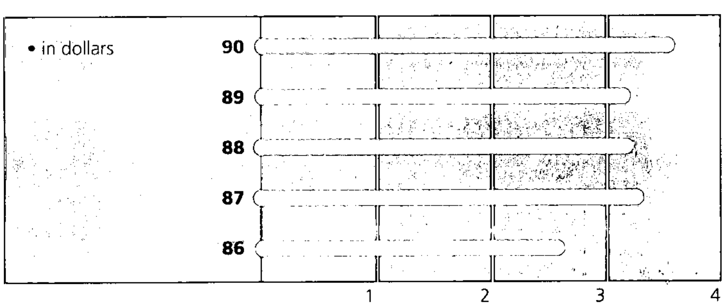
FINANCIAL REVIEW

Results of Operations

Earnings Earnings for 1990 increased 37 cents over 1989 to $3.52 per share. The increase was primarily due to the gain from the public offering of 20 percent of Wahlco Environmental Systems, Inc., previously a wholly owned subsidiary, and the California Public Utilities Commission's 1989 Southwest Powerlink regulatory disallowance, partly offset by expenses related to the pending merger with Southern California Edison Company. The total after-tax gain to the company from the WES offering was $13.5 million. As described below, the Southwest Powerlink regulatory disallowance reduced 1989 pretax income by approximately $20 million. Absent these unusual items, earnings were up slightly, due primarily to the increase in the company's authorized return and to increased conservation awards from the CPUC.

1989 earnings of $3.15 per share were three cents less than the $3.18 in 1988, due to numerous factors. The primary factors were the 1989 Southwest Powerlink regulatory disallowance, offset by increased sales not subject to regulatory balancing accounts, improved earnings of subsidiaries and a conservation award from the CPUC.

Earnings Per Share



Subsidiary Operations and Activities In 1990, the company's nonutility subsidiaries contributed approximately $12 million, or 22 cents per SDG&E common share, to consolidated earnings. In 1989, the subsidiaries achieved a consolidated net income of approximately $4 million, or seven cents per SDG&E common share. The increase in earnings is primarily due to the Wahlco Environmental Systems public offering, offset by losses on the sale of Mock Resources, Inc. and by the real estate investment activities of Phase One Development, Inc. The WES offering and the sale of Mock are described in Note 2 of the notes to consolidated financial statements. There are no plans for further offerings of WES stock.

In March 1990 WES purchased Bachmann Companies, Inc. for $9.6 million in cash. Bachmann is a manufacturer of gas- and fluid-flow control products. WES's expansion and diversification plans for the 1990s include additional acquisitions and product development. This could include joint ventures, licensing agreements and strategic alliances in foreign countries. The company plans to continue its focus of diversification in environment-related businesses.

Purchased Power As discussed in Note 8 of the notes to consolidated financial statements, the CPUC issued a 1989 decision that disallowed certain costs of power transported over the Southwest Powerlink transmission line. The principal accounting effects of the disallowance were recorded in the first quarter of 1989, reducing pretax income by approximately $25 million, or 28 cents per share after tax. This was partially offset in the third quarter of 1989 when the company filed for a credit of $5 million.

During the third quarter of 1989, the CPUC Division of Ratepayer Advocates issued a report on the reasonableness of the company's entering into its 75-megawatt long-term purchased power contract with Portland General Electric. Power deliveries at issue under that contract began on January 1, 1989. The DRA has recommended comparing the annual costs of the contract with the cost of alternative sources of power, with the excess costs being subject to disallowance in those years in which the contract costs are higher than the cost of the alternative sources. The potential disallowances identified by the DRA have a present value of $28 million, based on the DRA's assertions regarding the value of the benefits of the contract to SDG&E's customers during the contract's first 10 years.

The company has participated with PGE in negotiating new contracts with the coal company and the railroad supplying coal to PGE's Boardman power plant. This plant is associated with the company's power contract with PGE. The new contracts will enable PGE to resume normal operations of the plant, which had operated only briefly during the last seven years.

Because of the new contracts, energy costs from PGE will be reduced. The company hopes that the new contracts will reduce or eliminate the DRA's concerns about the cost effectiveness of the PGE contract. The CPUC has reopened the record to consider the reduced annual costs. The additional hearings are scheduled for April 1991.

Power Plant Construction The company's philosophy of providing adequate energy at the lowest possible cost has been based on a combination of production from its own plants and purchases from other producers. The company has been in the early stages of developing new generating facilities. Southern California Edison, with which the company is proposing to merge, has a surplus of power. Therefore, work has been suspended on two power plant projects and the construction of the projects may be postponed if the proposed merger is consummated. SDG&E has signed two firm power contracts with Edison that enable the company economically to defer capital expenditures for the projects. The Edison contracts insure the availability of future additional power that may be necessary due to delaying the start of the projects.

One project was to expand by 140 megawatts the output of the South Bay power plant. The second project was the construction of a two-unit, 460-megawatt combined-cycle power plant at an undetermined site. Combined-cycle plants use both a gas turbine generator and a heat recovery steam generator, a process that is more fuel-efficient than conventional fossil-fueled power plants.

Energy under the Edison contract related to the South Bay project would be available from June 1993 to the earlier of the completion of the South Bay project or May 1995. Energy under the Edison contract related to the combined-cycle project would be available from June 1995 to either May 1996 or May 1997 at SDG&E's option. The company also has the option to terminate the Edison contracts within 180 days of the termination of the merger. Therefore, if energy can be acquired from other utilities or independent producers at a lower cost, the company can obtain the lower market prices.

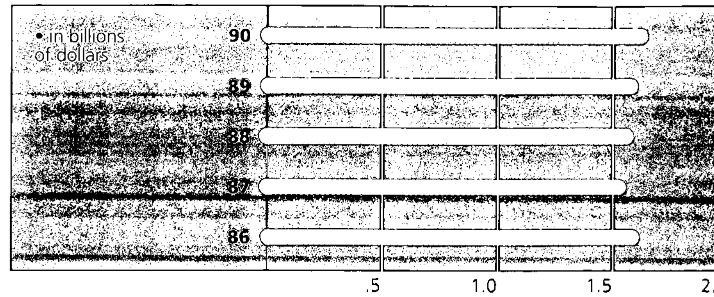
Revenues The CPUC controls the company's prices, and thereby its revenues, generally by two mechanisms: base rates and balancing accounts.

Base rates provide a return on capital and compensate the company for operating and maintenance costs, taxes and depreciation. Base rates are set in a general rate case every three years. Between rate cases, the commission makes annual adjustments for inflation, system growth and rate of return. The current three-year cycle started January 1, 1989.

The company uses balancing accounts for fuel costs, both electric and gas. The commission sets balancing account rates based on estimated costs. Differences between actual and estimated costs are accumulated in the balancing accounts and, periodically, blended into future rates. The company also uses balancing accounts to compensate for the differences between actual and estimated sales volumes except for gas sales to certain large customers.

Electric revenue increased 2 percent in 1990 and in 1989. The 1990 increase was due to increased volume, the 1989 Southwest Powerlink regulatory disallowance and slightly higher authorized costs, partially offset by decreases in rates for electric fuel and purchased power. The 1989 increase was due to increased volume, partially offset by the Southwest Powerlink regulatory disallowance and a decrease in total authorized costs. Gas revenue was up 18 percent in 1990 and 5 percent in 1989. The 1990 increase was due to increases in total authorized costs and in sales to cogenerators. The 1989 increase was due to higher authorized costs.

Operating Revenues



Revenues in 1990 also increased due to an increase in the company's authorized return. The increase was due to the CPUC's increase of the company's common equity component from 48 percent to 49.5 percent. The change in the equity ratio was partially offset by the authorized return on equity decreasing from 13 percent in 1989 to 12.9 percent in 1990. The net effect of the changes in the rate of return and in the equity component was that the overall authorized return to common shareholders for 1990 exceeded that for 1989 by 0.2 percent of equity.

1989 revenues were adversely affected by a change in authorized return. Although the rate of return was increased from 12.75 percent to 13 percent, this was more than offset by a change in the CPUC-authorized equity to debt ratio. The CPUC established a capital structure based on a hypothetical 48 percent common equity component, which was below the company's actual percentage. The net effect of the two factors was an authorized return to common shareholders for 1989 lower than that authorized for 1988 by 0.3 percent of equity.

Most of the revenues from diversified operations arise from Wahlco Environmental Systems, Inc., a nonutility subsidiary. WES's revenues increased in 1990 due to the sales of Wahlco Power Products, Inc., formed in September 1989, and of Bachmann, acquired in March 1990.

Costs The total cost of electric fuel and purchased power decreased in 1990 due primarily to lower costs for natural gas and purchased power, partially offset by increases in volume. In 1989, the cost of electric fuel and purchased power increased because of increased volume and higher costs for natural gas.

Income taxes increased in 1990 and in 1989 because of the increase in operating income and tax adjustments related to various regulatory issues.

The company earns an allowance for funds used during construction on the construction funds held by the trustee as well as on construction in progress. The total allowance for construction funds, both debt and equity, decreased in 1989 due to the total drawdown of the funds held by the trustee and remained relatively constant in 1990. The allowance is not a current source of cash but will result in increased future cash flows as its amortization is included in rates.

Liquidity and Capital Resources

Utility operations are a major source of liquidity for the company. Since 1984, tax-exempt industrial development bonds and pollution control bonds have been the major external sources of liquidity. Until 1989, funds from operations and tax-exempt bonds were more than adequate to cover construction of utility plant, payment of dividends and maturing long-term debt. However, by late 1989 the situation had changed. In 1989, the company issued short-term debt to fund that portion of construction expenditures not covered by cash flow from operations. In 1990, the company issued $100 million of taxable 30-year first mortgage bonds to pay off short-term borrowings.

It is anticipated that only short-term borrowings will be used to fulfill external capital requirements in 1991. For the years 1992–1995, external sources are expected to consist of stock and debt issuances.

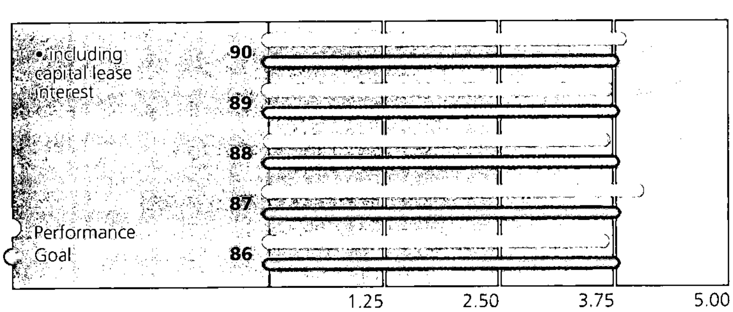
The company conducts a continuing review of its construction and financing programs in response to changes in system growth, inflation, rate relief, environmental and regulatory requirements, and availability and cost of capital.

The utility's capital structure is one factor that has enabled it to obtain long-term financing at attractive rates. The following table shows the percentages of capital represented by the various components.

	1986	1987	1988	1989	1990	Goal
Common equity	42%	44%	46%	45%	45%	45–48%
Preferred stock	7	6	6	6	6	5–7
Debt and leases	51	50	48	49	49	46-49
Total	100%	100%	100%	100%	100%	100%

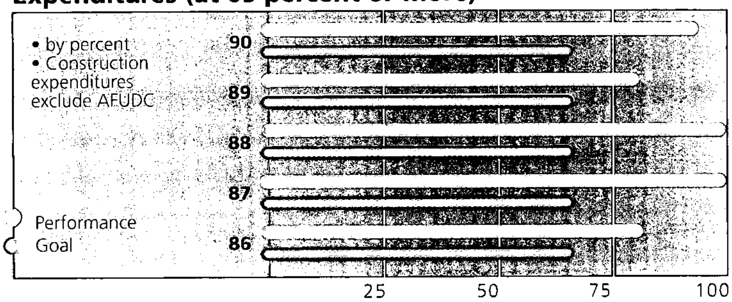
The percentage of funds for construction that the company generates internally is another good measure of liquidity provided by operations. The company's goal is to exceed 65 percent. The following chart shows the company's success in achieving that goal.

Maintain 3.75x Pretax Interest Coverage



Another measure of the company's ability to obtain financing is pretax interest coverage. The company's goal is to exceed 3.75. The chart shows the company's results.

Maintain Internal Generation of Construction Expenditures (at 65 percent or more)



The major changes in operational cash flows in 1990 compared to 1989 have been related to inventories and liabilities. The change in cash flow related to inventories was due primarily to increased purchases and reduced usage of fuel oil and the increased natural gas storage capability. The 1990 increase in accounts payable and other current liabilities was due primarily to the December receipt of a $25 million supplier refund, the majority of which will be refunded to the company's customers.

In financing activities, the cash flow related to issuances of long-term debt was higher in 1990 due to the issuance of $100 million of 30-year first mortgage bonds. The repayment of long-term debt increased in 1990 due primarily to the retirement of $30 million of 30-year first mortgage bonds. The high level of short-term borrowings in 1989 was due primarily to the issuance of short-term debt to fund capital expenditures, pending the $100 million bond issue.

The major changes in operational cash flows in 1989 compared to 1988 were changes in regulatory balancing accounts, partly offset by changes in income taxes. In 1988, the balancing accounts were a source of cash, as the amounts collected in prices temporarily exceeded the related costs, primarily because sales volumes were significantly higher than anticipated. In 1989, the balancing accounts were a larger cash use than in 1988, because in 1989 the previous overcollections were returned to customers by means of prices lower than the related costs. The major cause of the 1989 change in the cash flow effect of income taxes was the timing of tax deductions arising from balancing account activity.

Additions to utility plant, excluding nuclear fuel and the allowance for funds used during construction, were $235 million in 1990 and are expected to total approximately $260 million in 1991. Management believes ample external sources of long-term and short-term financing will continue to be available.

The Future

Several pending events, trends and factors are expected to affect future operating results and liquidity.

- The company plans to merge with Southern California Edison Company.
- Public and regulatory concern regarding environmental issues is increasing.
- New federal clean air regulations and recent political events in Europe may help expand the company's nonutility operations in the environment-related industry.
- San Diego's population growth is slowing, but sales and peak demand levels continue to grow.
- New energy efficiency and conservation programs will affect rates, system requirements and future earnings.
- Partial deregulation and competition are continuing.
- Oil costs may increase due to the war in the Middle East.
- Significant capital expenditures are necessary to upgrade San Onofre Nuclear Generating Station Unit 1.

A short description of each of these follows.

Planned Merger In November 1988, the company signed a merger agreement with SCEcorp and its utility subsidiary, Southern California Edison Company, under which the company will be merged into Edison. Favorable votes of the companies' shareholders were received at annual meetings held in April 1989.

Hearings before the Federal Energy Regulatory Commission ended in May 1990. In November 1990, the administrative law judge presiding at the FERC proceedings issued a proposed decision that the merger not be approved. SDG&E believes that the FERC, consistent with its decision in the Utah Power-PacifiCorp merger, should reject the proposed decision. However, there can be no assurance in this regard.

The CPUC's evidentiary hearings ended in August 1990. In February 1991, the administrative law judges presiding at the CPUC hearings issued a proposed decision that the merger not be approved. The proposed decision was based on a finding that the merger does not meet the legal requirement of not adversely affecting competition. The ALJs believe the merger has anti-competitive effects that cannot be mitigated. That finding is in contradiction to the U.S. Department of Justice's finding that, with certain mitigation measures already accepted by Edison, the merger poses no competitive problems. In addition, the judges agreed that the merger would provide more than $1 billion in customer savings and that all significant environmental concerns related to the merger can be mitigated. In their response to the proposed decision, SDG&E and Edison have recommended that the CPUC set aside the proposed decision and approve the merger. The response also stated that the proposed decision contained conditions that, if not modified in the final CPUC decision, may cause Edison to not consummate the merger, even if it is approved by the CPUC.

The merger remains dependent upon regulatory approvals, which could be received in the first half of 1991. Both the CPUC and FERC decisions are subject to possible appeal for rehearing by the applicable commission and then to possible judicial review by the appropriate state and federal courts.

SDG&E continues to seek approval of the merger, believing it is in the best interests of shareholders and customers.

Environmental Concerns There is increasing public concern over a variety of environmental issues related to the company's operations. These issues include hazardous wastes, air quality, water quality, and the possibility that electric and magnetic fields cause adverse health effects.

The company has taken pride in being a leader in the utility industry in its efforts to protect the environment. Compliance programs necessary to meet future environmental laws and regulations will increase the cost of electric and gas service by requiring changes to the company's operations or facilities.

The company owns three sites upon which manufactured gas had been produced. The company is cleaning up one site and is studying the other two sites. The cleanup that is underway will cost $1–$3 million. Cleanup costs for the other sites, if required, are not known.

Although research conducted to date has found no conclusive evidence that electric and magnetic fields cause health effects, a few studies have suggested a possible connection with cancer. The company and the utility industry are funding additional studies. The ultimate impact of this issue on the company and the utility industry is impossible to predict.

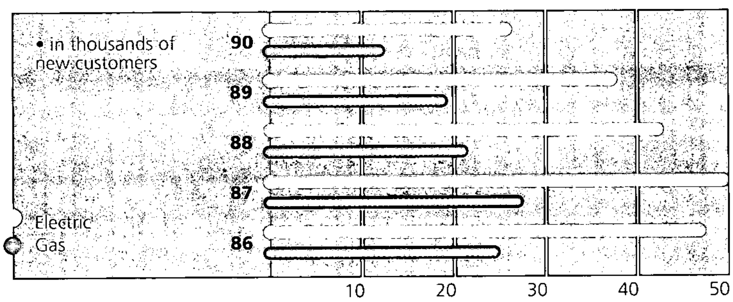
Clean Air Regulations In November 1990, President Bush signed the Clean Air Act Amendments of 1990. This revision of existing federal air quality regulations will require utilities to reduce further the level of several types of air emissions. Since the new law is less stringent than California law, it should not result in any major capital expenditures for the company.

The company's subsidiary, Wahlco Environmental Systems, Inc., is the world leader in the manufacture and sale of flue gas conditioning systems, which is a comparatively low-cost option for utilities to help comply with the new federal regulations. WES is already doing business in many foreign countries and is actively pursuing sales in Eastern Europe and the Soviet Union. Also, the European Economic Community is designing environmental requirements similar to those of the U.S.

Sales and Customer Growth The company's rate of new customer additions continues to decline due to the current economic recession. In 1989, the customer growth rate was 4 percent for electric and 3 percent for gas. For 1990, the rate of growth was 2 percent for both electric and gas customers. Yet, 1990 electric and gas sales volumes increased at 7 and 5 percent, respectively. In 1989, electric sales volumes increased 6 percent and gas sales volumes were unchanged.

In 1990, electric sales volumes increased more than customer additions due to higher consumption per customer. The higher consumption is primarily attributable to mild weather in 1989 and customer response to electric price reductions in 1988 and 1989. The company's system peak demand increased by 7 percent over the company's previous record system peak, which occurred in 1988. The 1990 gas sales volumes increase was primarily due to increased gas usage by cogenerators.

Customer Growth



Energy Efficiency and Conservation The company recently received approval from the CPUC for a $25 million energy efficiency and conservation package for 1991. The demand-side management programs are much larger than the 1989 and 1990 programs and were developed as a result of a year-long collaborative process that involved California utilities, consumer groups, environmental organizations and state regulatory agencies.

Customers who participate in the programs can reduce their bills and gain long-term energy savings. All customers benefit because conservation enables the company to control rates by reducing its need to build new power plants. The company has the potential to earn up to a 13.5 percent share of the savings from certain programs, if specific goals are met. However, the company faces a financial penalty if program goals are not met.

Partial Deregulation and Competition The electric and natural gas utility industries are experiencing partial deregulation and competition. Deregulation could result in increased volatility in electric rates. In the future, customers may be able to purchase power from other sources and transmit it over the company's transmission lines. This could result in higher rates to remaining customers and increased cost recovery risk to the company.

Since January 1, 1991, the company's electric rates have averaged 9.4 cents per kilowatt-hour and may be increased slightly in May 1991. While still higher than many other utilities, the company's average electric rate has decreased from a peak of 12.7 cents in 1985 and for the latest three years has been lower than those of the other major, investor-owned California utilities. The lower prices have made the company more competitive with the alternative sources of electricity available to its customers and reduced the amount of bypass of the company's electric system.

The company continues to pursue methods to lower rates. However, the company recently has been required to increase its rates. The increases are due to inflation, higher taxes and the fact that previous overcollections have now been completely refunded. Price competition in the western market is expected to remain intense due to the availability of surplus energy from other utilities. Due to the current economic recession and lower customer growth rates in the Southwest, the availability of surplus energy will probably continue into at least the mid-1990s. Still, the company believes that, due to increasing energy requirements, the supply of surplus energy in the Southwest will diminish, resulting in upward pressure on long-term wholesale power prices. Therefore, despite cost-reduction efforts, prices are expected to increase.

The company has signed letters of intent with seven Canadian natural gas suppliers to purchase a total of 100 million cubic feet of gas per day. This amount represents more than a quarter of the company's anticipated natural gas needs for a typical day in the mid-1990s. The letters of intent are contingent upon a final gas commodity agreement to be worked out with each supplier, U.S. and Canadian regulatory approvals, and completion of planned pipeline expansion projects.

Oil Prices and the Middle East War The long-term effects of the war in the Middle East are very difficult to predict. The company does not anticipate any major change in resource availability or customer rates due to the current situation. This is due to the company's efforts to significantly reduce its dependence on oil since the 1970s. In 1977, for example, about 73 percent of the company's total electrical output depended on fuel oil. In 1990, that percentage was reduced to about 4 percent.

Due to the significant gas competition, natural gas prices have remained relatively low despite the recent hikes in oil prices. And, there are abundant supplies of natural gas available, both domestically and in Canada. However, due to pipeline capacity restrictions in bringing the gas to California, some additional oil may have to be burned. It is expected that planned pipeline expansion projects will reduce future gas curtailments caused by pipeline restrictions.

In August 1990, the CPUC issued an order suspending the incentive mechanism that otherwise rewards or penalizes the utilities to the extent of 8 percent of the actual cost of their electric fuel compared to the forecasted cost. The suspension was ordered in anticipation of higher prices due to the Middle East situation. The incentive mechanism was adopted by the CPUC in 1980 to encourage the utilities to manage effectively their electric fuel and purchased power expenses. The suspension is not expected to have any significant effect on the company's 1991 earnings. The CPUC plans to investigate the effectiveness of this incentive mechanism and will consider alternative incentive systems.

San Onofre Nuclear Generating Station Unit 1 Unit 1 at San Onofre, in which the company has a 20 percent interest, has been out of service since June 30, 1990. The unit is expected to return to service in March 1991. The outage was originally intended to repair damage to the thermal shield and to perform a normal refueling. However, it was decided to extend the outage further in order to perform some additional procedures previously scheduled for a subsequent mid-cycle outage, in order to comply with mandates of the Nuclear Regulatory Commission. The mid-cycle outage has now been cancelled.

Also, in revenue requests filed with the CPUC, the company and Southern California Edison Company, the majority owner of the three San Onofre units, indicated that an additional $375 million will have to be spent during the unit's remaining life to comply with other NRC requirements. The company's share of these expenditures would be $75 million and would be expended over the years 1992 to 2004. The CPUC decision may be issued in late 1991. If the CPUC finds that the additional expenditures are not cost effective, it could order the utilities to remove Unit 1 from rate base. In such event, the company's ability to earn a normal return on its undepreciated investment in the unit would be uncertain.

RESPONSIBILITY REPORT FOR THE CONSOLIDATED FINANCIAL STATEMENTS

The company is responsible for the consolidated financial statements and other data in this annual report. To meet its responsibility for the reliability of the consolidated financial statements, the company has developed a system of internal accounting controls and engages a firm of independent auditors. The board of directors of the company carries out its responsibility for the consolidated financial statements through its audit committee, composed of directors who are not officers or employees of the company.

Management maintains the system of internal accounting controls, which it believes is adequate to provide reasonable, but not absolute, assurance that its assets are safeguarded, transactions are executed in accordance with its objectives, and the financial records and reports are reliable for preparing the consolidated financial statements in accordance with generally accepted accounting principles.

The concept of reasonable assurance recognizes that the cost of a system of internal accounting controls should not exceed the benefits derived and that management makes estimates and judgments of these cost/benefit factors. The system of internal accounting controls is supported by an extensive program of internal audits, selection and training of qualified personnel, and written policies and procedures.

The company's independent auditors, Deloitte & Touche, are engaged to audit the company's consolidated financial statements in accordance with generally accepted auditing standards for the purpose of expressing their opinion as to whether the company's consolidated financial statements are presented fairly, in all material respects, in accordance with generally accepted accounting principles.

The audit committee discusses with the company's internal auditors and the independent auditors the overall scope and specific plans for their respective audits. The committee also discusses the company's consolidated financial statements and the adequacy of the company's internal controls. The committee met twice during the fiscal year with the internal auditors and the independent auditors without management present, to discuss the results of their examinations, their evaluations of the company's internal controls, and the overall quality of the company's financial reporting. The internal auditors and the independent auditors have full and free access to the committee throughout the year.

Company management has prepared the consolidated financial statements and other data in this annual report. In the opinion of the company, the consolidated financial statements, which include amounts based on estimates and judgments of management, have been prepared in conformity with generally accepted accounting principles.

Frank H. Ault, Controller

Statements of Consolidated Income

In thousands except per share amounts
For the years ended December 31

		1990	1989	1988
Operating Revenues				
Electric	*a*	$1,356,448	$1,324,891	$1,299,995
Gas	*b*	355,069	300,397	285,430
Diversified operations	*c*	60,351	44,183	35,076
Total operating revenues		1,771,868	1,669,471	1,620,501
Operating Expenses				
Electric fuel and purchased power		483,019	509,720	482,333
Gas purchased for resale		199,040	155,400	164,120
Maintenance		62,868	67,645	66,509
Depreciation and decommissioning		185,901	175,867	171,809
Property and other taxes		42,827	40,440	41,776
Other	*d*	350,635	299,891	305,400
Income taxes (Note 7)		146,429	135,744	113,987
Total operating expenses		1,470,719	1,384,707	1,345,934
Operating Income		301,149	284,764	274,567
Other Income and (Deductions)				
Allowance for equity funds used during construction		5,098	7,386	12,398
Gain on subsidiary sale of stock	*e*	22,559	—	—
Taxes on nonoperating income (Note 7)		(10,488)	822	314
Other—net		(1,735)	(4,393)	4,148
Total other income		15,434	3,815	16,860
Income Before Interest Charges	*f*	316,583	288,579	291,427
Interest Charges				
Long-term debt		97,894	87,962	89,166
Short-term debt and other		14,766	16,404	13,704
Allowance for borrowed funds used during construction		(3,918)	(2,913)	(808)
Net interest charges		108,742	101,453	102,062
Net Income (before preferred dividend requirements)	*g*	207,841	187,126	189,365
Preferred Dividend Requirements		10,863	11,202	11,716
Earnings Applicable to Common Shares		$ 196,978	$ 175,924	$ 177,649
Average Common Shares Outstanding		55,921	55,895	55,875
Earnings Per Common Share		$ 3.52	$ 3.15	$ 3.18
Dividends Declared Per Common Share		$ 2.70	$ 2.70	$ 2.60

See notes to consolidated financial statements.

Excerpts from the Financial Review

a. *1989 revenues and earnings were reduced by the Southwest Powerlink regulatory disallowance.*

b. *Part of the 1990 increase in gas revenues was due to increased sales to cogenerators.*

c. *Wahlco Environmental Systems, Inc. increased its revenues in 1990 by the formation of Wahlco Power Products, Inc. and its acquisition of Bachmann Companies, Inc.*

d. *Merger expenses reduced 1990 earnings.*

e. *1990 earnings included the gain from a public offering of 20 percent of Wahlco Environmental Systems, Inc.*

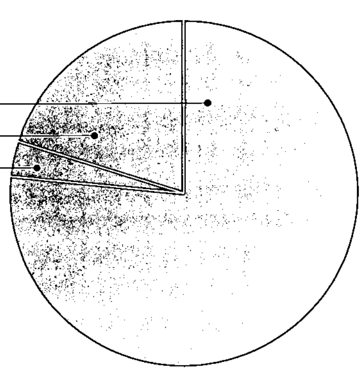
f. *The company's authorized return was increased for 1990.*

g. *The sale of Mock Resources, Inc. reduced subsidiary earnings. Consolidated Income Statements have been restated to exclude Mock's operations.*

1990 Revenue Dollar

Source

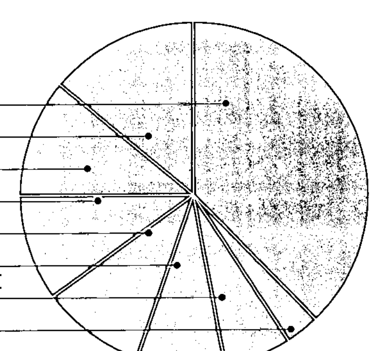
76.6¢ ∘ Electric Sales
20.0¢ ∘ Gas Sales
3.4¢ ∘ Diversified Operations



Diversified operations consist primarily of sales by Wahlco Environmental Systems, Inc.

Disposition

38.5¢ ∘ Fuel and Purchased Energy
13.9¢ ∘ Other Operating Expenses
11.3¢ ∘ Total Taxes
10.5¢ ∘ Depreciation
9.1¢ ∘ Dividends to Shareholders
8.3¢ ∘ Salaries and Benefits
5.8¢ ∘ Cost of Money—net of AFUDC
2.6¢ ∘ Reinvested in Business



Consolidated Balance Sheets

In thousands of dollars

Balance at December 31		1990	1989
Assets			
Utility plant — at original cost		$ 4,594,253	$ 4,383,771
Accumulated depreciation		(1,606,438)	(1,433,791)
Utility plant — net (Notes 3 and 5)		2,987,815	2,949,980
Investments and other property (Note 5)		188,284	157,852
Current assets			
Cash and temporary investments		11,529	20,033
Receivables		166,067	175,616
Inventories	*a*	101,164	76,533
Regulatory balancing accounts undercollected — net	*b*	40,765	—
Other		15,969	26,971
Total current assets		335,494	299,153
Goodwill		47,979	41,028
Deferred charges and other assets		97,065	98,483
Total		$ 3,656,637	$ 3,546,496
Capitalization and Liabilities			
Capitalization (see Statements of Consolidated Capital Stock and Long-Term Debt)			
Common equity		$ 1,303,307	$ 1,256,113
Preferred stock		142,493	146,993
Long-term debt (Note 3)	*c*	1,167,089	1,112,743
Total capitalization		2,612,889	2,515,849
Current liabilities			
Short-term borrowings (Note 4)		63,729	72,474
Long-term debt redeemable within one year (Note 3)		115,000	115,000
Current portion of long-term debt (Note 3)	*d*	18,064	50,372
Accounts payable		131,594	159,382
Dividends payable		40,439	40,519
Taxes accrued		56,993	28,962
Interest accrued		26,650	27,504
Regulatory balancing accounts overcollected — net	*b*	—	8,393
Other		83,067	52,595
Total current liabilities		535,536	555,201
Customer advances for construction		67,088	71,993
Accumulated deferred income taxes — net (Note 7)		226,676	206,101
Accumulated deferred investment tax credits (Note 7)		129,367	134,588
Deferred credits and other liabilities		85,081	62,764
Contingencies and commitments (Notes 8 and 9)		—	—
Total		$ 3,656,637	$ 3,546,496

See notes to consolidated financial statements.

Excerpts from the Financial Review

a. Inventories grew due to increased fuel oil and natural gas storage capabilities.

b. Differences between actual and estimated sales volumes and fuel costs are accumulated in balancing accounts.

c. The company issued $100 million of 30-year first mortgage bonds in 1990.

d. $30 million of 30-year first mortgage bonds were retired in 1990.

Statements of Consolidated Cash Flows

In thousands of dollars

For the years ended December 31		1990	1989	1988
Cash Flows from Operating Activities				
Net income		$207,841	$187,126	$189,365
Adjustments to reconcile net income to net cash provided by operating activities				
Depreciation and decommissioning		185,901	175,867	171,809
Amortization of deferred charges and other assets		1,554	1,251	1,267
Allowance for funds used during construction	*a*	(9,016)	(10,299)	(13,206)
Deferred income taxes and investment tax credits		26,773	24,471	(14,222)
Deferred merger costs		11,083	(3,709)	(7,374)
Gain on subsidiary sale of stock	*b*	(22,559)	—	—
Other — net		11,842	8,723	6,508
Changes in working capital components net of effects from sale of subsidiary				
Receivables		(8,259)	11,380	2,024
Regulatory balancing accounts		(49,158)	(62,891)	12,401
Inventories		(24,631)	673	(28,344)
Prepayments and other current assets		6,903	(1,603)	(3,307)
Accrued interest and taxes		15,758	5,289	(6,933)
Accounts payable and other current liabilities		21,334	(13,104)	(9,530)
Net cash provided by operating activities		375,366	323,174	300,458
Cash Flows from Financing Activities				
Dividends paid		(161,874)	(160,777)	(155,761)
Sale of common stock		137	116	129
Issuances of long-term debt		107,185	1,615	9,071
Repayment of long-term debt		(66,064)	(10,337)	(38,399)
Redemption of preferred stock		(4,500)	(3,000)	(7,564)
Short-term borrowings — net		(8,745)	72,474	4,598
Proceeds from subsidiary sale of stock	*b*	38,120	—	—
Net cash used by financing activities		(95,741)	(99,909)	(187,926)
Cash Flows from Investing Activities				
Construction expenditures	*c*	(235,356)	(236,738)	(201,629)
Contributions to decommissioning funds		(22,038)	(25,640)	(30,268)
Purchases of assets and subsidiaries	*d*	(18,644)	(20,054)	(33,592)
Sales of assets and subsidiaries		(2,151)	2,269	13,811
Other — net		(9,940)	2,578	(1,625)
Net cash used by investing activities		(288,129)	(277,585)	(253,303)
Net decrease		(8,504)	(54,320)	(140,771)
Cash and temporary investments, beginning of period		20,033	74,353	215,124
Cash and temporary investments, end of period		$ 11,529	$ 20,033	$ 74,353
Supplemental Information				
Noncash investing and financing activities				
Real estate disposed		$ —	$ 24,624	$ —
Debt discharged		—	(21,300)	—
Noncash proceeds		$ —	$ 3,324	$ —

See notes to consolidated financial statements.

Excerpts from the Financial Review

a. The allowance for funds used during construction is not a current source of cash but results in future cash flows.

b. 1990 earnings included the gain from a public offering of 20 percent of Wahlco Environmental Systems, Inc.

c. Additions to utility plant are expected to total approximately $260 million in 1991.

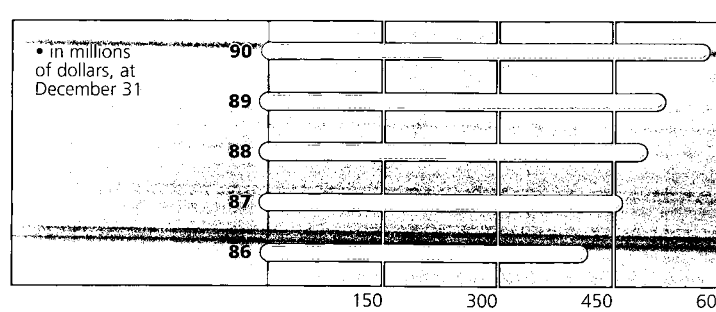
d. In March 1990 Bachmann Companies, Inc. was acquired for $9.6 million in cash.

Statements of Consolidated Changes in Capital Stock and Retained Earnings

In thousands of dollars For the years ended December 31, 1988, 1989, 1990	Preferred Stock Not Subject to Mandatory Redemption	Preferred Stock Subject to Mandatory Redemption	Common Stock	Premium on Capital Stock	Retained Earnings
Balance, December 31, 1987	$87,493	$68,814	$279,363	$467,618	$450,419
Net Income					189,365
Common stock sold (25,740 shares)			129		
Preferred stock retired (25,640 shares)		(1,314)		(8)	
Current sinking fund requirement		(5,000)			
Dividends declared					
Preferred stock					(11,681)
Common stock					(145,268)
Balance, December 31, 1988	87,493	62,500	279,492	467,610	482,835
Net Income					187,126
Common stock sold (23,163 shares)			116		
Vesting of previously restricted shares				1,071	
Current sinking fund requirement		(3,000)			
Dividends declared					
Preferred stock					(11,192)
Common stock					(150,945)
Balance, December 31, 1989	87,493	59,500	279,608	468,681	507,824
Net Income					207,841
Common stock sold (27,417 shares)			137		
Vesting of previously restricted shares				1,062	
Preferred stock retired (15,000 shares)		(1,500)			
Current sinking fund requirement		(3,000)			
Dividends declared					
Preferred stock					(10,847)
Common stock					(150,999)
Balance, December 31, 1990	$87,493	$55,000	$279,745	$469,743	$553,819

See notes to consolidated financial statements.

Retained Earnings



Statements of Consolidated Capital Stock

In thousands of dollars except voluntary redemption price

Balance at December 31	Voluntary Redemption Price	1990	1989
Common Equity			
Common stock, without par value, authorized 170,000,000 shares, outstanding: 1990, 55,948,922 shares; 1989, 55,921,505 shares		$ 279,745	$ 279,608
Premium on capital stock		469,743	468,681
Retained earnings		553,819	507,824
Total common equity		$1,303,307	$1,256,113
Preferred Stock			
Not subject to mandatory redemption			
$20 par value, authorized 1,375,000 shares			
5% Series, 375,000 shares outstanding	$ 24.00	$ 7,500	$ 7,500
4½% Series, 300,000 shares outstanding	21.20	6,000	6,000
4.40% Series, 325,000 shares outstanding	21.00	6,500	6,500
4.60% Series, 374,650 shares outstanding	20.25	7,493	7,493
Without par value*			
$7.80 Series, 200,000 shares outstanding	101.00	20,000	20,000
$7.20 Series, 150,000 shares outstanding	101.00	15,000	15,000
$2.475 Series, 1,000,000 shares outstanding	28.35	25,000	25,000
Total not subject to mandatory redemption		$87,493	$87,493
Subject to mandatory redemption			
Without par value*			
$8.25 Series, outstanding: 1990, 65,000 shares; 1989, 75,000 shares	$103.85	$ 6,500	$ 7,500
$9.125 Series, outstanding: 1990, 65,000 shares; 1989, 100,000 shares	103.65	6,500	10,000
$7.05 Series, 450,000 shares outstanding	107.05	45,000	45,000
Current sinking fund requirement**		(3,000)	(3,000)
Total subject to mandatory redemption		$55,000	$59,500

*Authorized 10,000,000 shares total (both subject to and not subject to mandatory redemption).

**Future sinking fund requirements include $3 million in 1992, $4.8 million in 1993, $3.3 million in 1994 and $2.8 million in 1995.

See notes to consolidated financial statements.

Statements of Consolidated Long-Term Debt

In thousands of dollars

Balance at December 31	1990	1989
First mortgage bonds (Note 3)		
4⅝% Series H, due October 1, 1990	$ —	$ 30,000
5½% Series I, due March 1, 1997	25,000	25,000
7% Series J, due December 1, 1998	35,000	35,000
8¾% Series K, due February 1, 2000	40,000	40,000
8% Series L, due September 1, 2001	45,000	45,000
8⅜% Series M, due January 15, 2004	75,000	75,000
8¾% Series Q, due March 15, 2007	50,000	50,000
9¾% Series R, due May 1, 2008	50,000	50,000
5½% Series U-2, due September 1, 1994	9,668	10,068
10% Series AA, due June 1, 2018	150,000	150,000
10% Series BB, due September 1, 2018	150,000	150,000
6% Series CC, due May 1, 2008	53,000	53,000
6.2% Series DD, due December 1, 2008	27,000	27,000
9¼% Series EE, due September 1, 2020	100,000	100,000
5.9% Series FF, due December 1, 2007	35,000	35,000
7⅝% Series GG, due July 1, 2021	44,250	44,250
7⅜% Series HH, due December 1, 2021	81,350	81,350
8¾% Series II, due March 1, 2023	25,000	25,000
9⅝% Series JJ, due April 15, 2020	100,000	—
Total	1,095,268	1,025,668
Capitalized leases (Note 9)		
Nuclear fuel	56,085	71,767
Generating facility	89,390	93,695
Other	21,168	21,776
Total	166,643	187,238
Other long-term debt (Note 3)	54,410	80,451
Unamortized discount on long-term debt	(16,168)	(15,242)
Long-term debt redeemable within one year (Note 3)	(115,000)	(115,000)
Current portion of long-term debt (Note 3)	(18,064)	(50,372)
Total	$1,167,089	$1,112,743

See notes to consolidated financial statements.

Schedules of Consolidated Financial Information by Segments of Business

In thousands of dollars

At December 31 or for the years then ended	1990	1989	1988
Operating revenues*	$1,771,868	$1,669,471	$1,620,501
Operating Income			
Electric operations	$ 255,636	$ 242,064	$ 245,377
Gas operations	37,371	36,093	26,083
Diversified operations	8,142	6,607	3,107
Total	$ 301,149	$ 284,764	$ 274,567
Depreciation and Decommissioning			
Electric operations	$ 156,606	$ 149,400	$ 147,029
Gas operations	25,183	23,188	21,164
Diversified operations	4,112	3,279	3,616
Total	$ 185,901	$ 175,867	$ 171,809
Utility Plant Additions**			
Electric operations	$ 190,794	$ 194,637	$ 165,517
Gas operations	44,562	42,101	36,112
Total	$ 235,356	$ 236,738	$ 201,629
Identifiable Assets			
Utility plant — net			
Electric operations	$2,667,923	$2,652,349	$2,626,159
Gas operations	319,892	297,631	275,929
Total	2,987,815	2,949,980	2,902,088
Inventories			
Electric operations	68,416	58,554	60,368
Gas operations	22,229	17,979	16,838
Diversified operations	10,519	—	—
Total	101,164	76,533	77,206
Other identifiable assets			
Electric operations	282,333	209,037	225,219
Gas operations	52,802	36,641	52,863
Diversified operations	146,873	161,621	169,810
Total	482,008	407,299	447,892
Other Assets	85,650	112,684	105,506
Total Assets	$3,656,637	$3,546,496	$3,532,692

*The detail to operating revenues is provided in the Statements of Consolidated Income. The gas operating revenues shown therein include $6 million in 1990, $5 million in 1989 and $8 million in 1988, representing the gross margin on sales to the electric segment. These margins arose from interdepartmental transfers of $112 million in 1990, $150 million in 1989 and $129 million in 1988, based on transfer pricing allowed by the California Public Utilities Commission in tariff rates.

**Excluding allowance for funds used during construction.

See notes to consolidated financial statements.

The company is an operating public utility engaged principally in the generation, purchase, distribution and sale of electrical energy and the purchase, distribution and sale of natural gas. Income taxes and corporate expenses are allocated to departments in accordance with regulatory accounting requirements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1 Merger Agreement with Southern California Edison Company

In November 1988, SDG&E, SCEcorp and Southern California Edison Company, a subsidiary of SCEcorp, executed an agreement to merge SDG&E into Edison. Under the terms of the agreement, SCEcorp will exchange 1.3 shares of its newly issued common stock for each SDG&E common share. SDG&E preferred and preference stock will be exchanged for SCEcorp preferred and preference stock with similar provisions, except that dividends on each series will be increased between 10 percent and 20 percent. During April 1989, the shareholders of SDG&E, SCEcorp and Edison approved the agreement. Completion of the merger remains subject to approval by regulatory agencies, including the California Public Utilities Commission and the Federal Energy Regulatory Commission. The agreement describes various company actions, including dividend increases and debt issues, that cannot be done without SCEcorp's consent.

The proposed merger will be treated as a "pooling of interests" for accounting and financial reporting purposes. Under this method of accounting, the assets and liabilities of SDG&E and Edison would be carried forward at their recorded amounts as of the effective time of the merger. Income of the combined corporation would include income of the constituent corporations for the entire year in which the combination occurs and reported income of the separate corporations for the prior periods would be combined and restated as income of the combined corporation.

Combined pro forma financial information of the two companies as of December 31, 1990, and for each of the three years in the period ended December 31, 1990, will be included in SDG&E's annual report to the Securities and Exchange Commission on Form 10-K to be filed in March 1991.

In February 1990, the California Attorney General indicated that he would challenge the merger before the regulatory authorities and, possibly, in the courts. In May 1990, he issued a formal advisory opinion to the CPUC recommending that the merger not be approved. Under California law the CPUC cannot approve a utility merger without first obtaining the attorney general's advisory opinion on its effect on competition.

Also in February 1990, the CPUC's Division of Ratepayer Advocates recommended that the CPUC not approve the merger unless various, stringent conditions are imposed. The CPUC's evidentiary hearings began in May 1990 and ended in August 1990. In February 1991, the administrative law judges presiding at the CPUC hearings issued a proposed decision that the merger not be approved. The proposed decision was based on a finding that the merger does not meet the legal requirement of not adversely affecting competition. The ALJs believe the merger has anti-competitive effects that cannot be mitigated. That finding is in contradiction to the U.S. Department of Justice's finding that, with certain mitigation measures already accepted by Edison, the merger poses no competitive problems. In their response to the proposed decision, SDG&E and Edison have recommended that the CPUC set aside the proposed decision and approve the merger. The response also stated that the proposed decision contained conditions that, if not modified in the final CPUC decision, may cause Edison to not consummate the merger, even if it is approved by the CPUC.

In October 1990, the CPUC issued its Final Environmental Impact Report. The report concludes that, if the merger is approved, all significant environmental impacts can be mitigated.

Hearings before the FERC commenced in February 1990 and ended in May 1990. After the hearings, the FERC staff stated that most of the objections to the merger are without merit and concluded that the merger is consistent with the public interest and should be approved. In November 1990, the administrative law judge presiding at the FERC proceedings issued a proposed decision not to approve the merger.

An Environmental Assessment will be issued in early 1991. The FERC will review the results of this Environmental Assessment before making its merger decision.

Regulatory decisions on the merger could be received in the first half of 1991. Both the CPUC and FERC decisions are subject to possible appeal for rehearing by the applicable commission and then to possible judicial review by the appropriate state and federal courts.

In June 1990, SDG&E and Edison reached settlement with the U.S. Department of Justice on conditions that resolve the DOJ's previous concerns about the merger's impact on competition. Under the commitments made to the DOJ, SDG&E and Edison agreed to extend the period of transmission commitments they had made previously in the merger case, and agreed to propose to FERC a system that will allow third parties to bid for transmission capacity the merger will make available. In addition, the merged utility agreed to obtain prior approval of the CPUC before entering any contracts to purchase power from an affiliate.

In April 1990, the City Attorney for the City of San Diego amended its February 1990 complaint filed in the San Diego County Superior Court against SDG&E, SCEcorp and Edison, asking for a determination of the rights of the City under its franchises with SDG&E. In June 1990, the San Diego County Superior Court granted Edison's motion to transfer the case to a neutral county. The court ordered the case transferred to Monterey County. In September 1990, SDG&E and Edison filed answers and cross-complaints opposing the lawsuit filed by the City. The City's response stated that SDG&E/SCE cross-complaints didn't state facts sufficient to constitute a cause of action and that the City had properly exercised its powers related to SDG&E's franchise agreement. Pretrial discovery has not yet commenced in the case and the case is not set for trial.

In September 1990, Tucson Electric Power Company filed a lawsuit in San Diego County Superior Court against SCEcorp and Edison. The lawsuit alleges intentional and negligent interference by SCEcorp and Edison with the proposed merger of Tucson and SDG&E in 1988. The lawsuit seeks actual damages in an amount to be determined at trial and punitive damages and exemplary damages of $6.7 billion. The lawsuit was subsequently amended, naming as an additional plaintiff a shareholder who requests the case be certified as a class action. SCEcorp and Edison believe their merger with SDG&E was made within the terms of the SDG&E/Tucson merger agreement and deny Tucson's allegations.

2 Summary of Accounting Policies

Consolidation The consolidated financial statements include the accounts of San Diego Gas & Electric and its subsidiary, Pacific Diversified Capital Company, the holding company for the nonutility subsidiaries. The nonutility subsidiaries are Wahlco Environmental Systems, Inc. and Phase One Development, Inc. WES was formed in February 1990 and provides products and services in the pollution control and utility services industries. In the second quarter of 1990, PDC sold 20 percent of WES in an initial common stock offering, resulting in an after-tax gain of $13.5 million ($0.24 per SDG&E common share).

In June 1990 PDC sold its 51 percent interest in Mock Resources, Inc. The Mock sale resulted in an after-tax loss of $2.7 million ($0.05 per SDG&E common share). The loss is reflected in the Statements of Consolidated Income under the caption "Other Income and (Deductions), Other — Net." The results of the operations of Mock through June 29, 1990 are included in the Statements of Consolidated Income under the same caption. Revenues related to the Mock operations were $197 million in 1990, $413 million in 1989, and $456 million in 1988. Prior year operating results have been restated to reclassify the net operating results of Mock into "Other — net."

Utility Plant and Depreciation Utility plant represents the buildings, equipment and other facilities used to provide electric and gas service. The cost of utility plant includes labor, material, contract services and other related items and an allowance for funds used during construction. The cost of depreciable retired utility plant, plus removal expenses minus salvage value is charged to accumulated depreciation.

Depreciation expense reflects the straight-line remaining useful life method. The provisions for depreciation approximated 3.97 percent of average depreciable utility plant in 1990, 3.96 percent in 1989, and 4.07 percent in 1988.

Inventories At December 31,1990, inventories include $54 million of materials and supplies ($43 million in 1989), and $47 million of fuel oil and natural gas ($34 million in 1989). Materials and supplies are valued at average cost, and fuel oil and natural gas are valued by the last-in first-out, or LIFO, method.

Allowance for Funds Used During Construction The allowance represents the cost of funds used to finance the construction of utility plant and is added to the cost of utility plant. AFUDC also increases income, partly as an offset to financing costs shown in the Statements of Consolidated Income, although it is not a current source of cash.

Revenues and Regulatory Balancing Accounts Revenues from utility customers consist of deliveries to customers and the changes in regulatory balancing accounts. Earnings fluctuations from changes in the costs of fuel oil, purchased energy and gas, and consumption levels for electricity and the majority of gas are eliminated by balancing accounts authorized by the California Public Utilities Commission. The balances of these accounts represent amounts that will be recovered from, or repaid to, customers by adjustments to future prices. The CPUC reviews the reasonableness of the amounts in these accounts.

Goodwill Goodwill arose from the acquisition of certain businesses by Pacific Diversified Capital. It is being amortized on a straight-line basis over 40 years.

Other Certain prior year amounts have been reclassified for comparability.

3 Long-Term Debt

Due dates of long-term debt are shown on the Statements of Consolidated Long-Term Debt. Excluding capital leases, which are described in Note 9, combined aggregate maturities and sinking fund requirements of long-term debt are $8 million for 1991, $8 million for 1992, $3 million for 1993, $11 million for 1994, and $0.4 million for 1995.

First mortgage bonds are secured by a lien on substantially all utility plant. Additional first mortgage bonds may be issued upon compliance with the provisions of the bond indenture.

Certain first mortgage bonds have variable interest rate provisions. Bondholders may elect to redeem their bonds at the interest adjustment dates. The interest rate adjustment dates are August 1 for Series FF and September 1 for Series CC and DD. In February 1990, the company received CPUC authorization to issue $200 million in debt over a two-year period. In April 1990, the company issued $100 million of first mortgage bonds.

Interest payments, including those applicable to short-term borrowings, amounted to $114 million in 1990, $102 million in 1989, and $104 million in 1988.

4 Short-Term Borrowings

At December 31, 1990 and 1989, short-term borrowings and weighted average interest rates for the balances outstanding were:

In millions of dollars	1990		1989	
	Balance	Interest Rate	Balance	Interest Rate
Commercial paper	$53.0	8.1%	$57.8	8.7%
Subsidiaries' bank credit line	10.7	10.0%	14.7	10.5%
Total	$63.7		$72.5	

As of December 31, 1990, SDG&E had various bank lines aggregating $100 million, all of which were available to support commercial paper. SDG&E's subsidiaries had a bank credit line that provided for borrowings up to $21.5 million at the prime rate. A commitment fee was paid on the unused portion of the lines. There were no requirements for compensating balances.

5 Facilities Under Joint Ownership

The Southwest Powerlink transmission line and the San Onofre nuclear power plant are owned jointly with other utilities. The company's interests at December 31, 1990 were:

In millions of dollars

Project	Southwest Powerlink	San Onofre
Ownership interest (%)	89	20
Utility plant in service	$209	$1,179
Accumulated depreciation	$ 45	$ 287
Construction work in progress	$ —	$ 20

Each participant in the projects must provide its own financing.

The company's share of operating expenses is included in its Statements of Consolidated Income.

The company's share of future dismantling and decontamination costs for the San Onofre units is estimated to be $187 million. These costs are considered in setting rates and are expected to be fully recovered in rates over the estimated lives of the plants. In December 1987, the company began placing in externally managed trust funds the amounts collected in rates. At December 31, 1990, the trust funds had a balance of $86 million, which is included in "Investments and Other Property" on the Consolidated Balance Sheets.

6 Employee Benefit Plans

The company-funded pension plan covers substantially all employees. Benefits are related to the employees' compensation. Plan assets consist primarily of common stocks and bonds.

The company funds the plan based on the aggregate cost actuarial method, subject to full-funding limitations. Net pension cost consists of the following:

In thousands of dollars	1990	1989	1988
Cost related to current service	$14,221	$13,370	$13,695
Interest on projected benefit obligation	21,589	18,670	21,231
(Return)/loss on plan assets	12,342	(50,703)	(48,936)
Other	(45,362)	20,008	19,405
Total Cost	$ 2,790	$ 1,345	$ 5,395

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

In thousands of dollars	1990	1989
Accumulated benefit obligation:		
Vested	$203,422	$163,929
Nonvested	5,441	6,055
Total	$208,863	$169,984
Plan assets at fair value	$319,865	$338,224
Projected benefit obligation	315,580	263,317
Excess of plan assets over projected benefit obligation	4,285	74,907
Unrecognized effect of accounting change	(2,522)	(2,751)
Unrecognized actuarial gains and losses	(1,763)	(72 ,156)
Amount recognized as an asset	$ —	$ —

The projected benefit obligation assumes an 8 percent actuarial discount rate and a 6 percent average annual salary increase. The expected long-term rate of return on plan assets is 8.5 percent.

Eligible employees may make a contribution of 1 to 11 percent of their base pay to the company's Savings Plan for investment in mutual funds or in common stock of the company. The company contributes up to three percent of a participant's base compensation for investment in the company's common stock. The company contributed approximately $6 million in 1990, $4 million in 1989 and $8 million in 1988 to these plans.

The company has a long-term incentive stock compensation plan that provides for aggregate awards of up to 1,350,000 shares of common stock over a 10-year period ending in 1996. In each of the last five years the company issued approximately 25,000 to 31,000 shares of stock to officers for $5 per share. These shares were issued subject to buy-back if certain corporate goals are not met.

The company partially provides health and life insurance benefits to retired employees. The benefits paid and expensed amounted to $3 million in 1990, $3 million in 1989 and $2 million in 1988. In December 1990, the Financial Accounting Standards Board issued a rule that would require a major change in the way retiree benefits other than pensions will be accounted for beginning in 1993.

The company's current expense for retiree health and life insurance premiums represents premiums paid during the year for existing retirees. The new rule will require an accrual of all current and future health and life insurance premiums for the life of each employee. This projected benefit will be expensed over each employee's years of service, up to the first year of benefit eligibility. The present value of these projected premiums is expected to be about $45 million. This accounting change is not expected to affect company profit or net worth significantly because most employee benefits are recovered in rates.

7 Income Taxes

Deferred income taxes arise from including income or deductions in the company's income tax returns in a year different from the year they are reported in the financial statements. However, deferred taxes are not provided for those timing differences that are reflected in customer rates. At December 31, 1990, the cumulative net amounts of timing differences for which deferred taxes have not been provided were approximately $300 million for federal purposes and $700 million for state purposes. In addition, tax reductions that arose from investment tax credits had been deferred and are recognized over the useful lives of the related property.

In December 1987, the Financial Accounting Standards Board issued a rule that would require a major change in the way tax expense will be computed in future years. Implementation of the new rule is expected to be required by the first quarter of 1993.

Deferred taxes included in the income statement essentially are taxes on current year income that will be paid in future years. Under existing rules, deferred taxes are computed using tax rates in effect at the time the deferred taxes arise, despite actual or anticipated changes in tax rates. The new rule will require an adjustment of deferred taxes for changes in tax rates.

This new rule is not expected to affect the company's profits or net worth significantly because most tax increases or reductions are reflected in rates. However, deferred taxes on the balance sheet will increase by a substantial, but not yet quantified, amount and a new regulatory asset will be reported for the estimated amount collectible from customers.

Income tax payments totaled $104 million in 1990, $108 million in 1989 and $129 million in 1988.

Components of Income Tax Expense

In thousands of dollars	1990	1989	1988
Current federal income tax	$102,683	$ 86,017	$101,397
Current state franchise tax	27,461	24,434	26,498
Total current taxes	130,144	110,451	127,895
Deferred — federal and state taxes			
Construction projects	(15,765)	(8,929)	(31,205)
Tax over book depreciation	24,189	32,247	27,355
State franchise tax	5,247	—	8,901
Regulatory balancing accounts	15,992	27,334	(7,136)
Unbilled revenue	(7,487)	(10,267)	(6,284)
Gain on subsidiary sale of stock	9,024	—	—
Other — net	794	(3,154)	2,547
Total deferred taxes	31,994	37,231	(5,822)
Deferred investment tax credits — net	(5,221)	(12,760)	(8,400)
Total income tax expense	$156,917	$134,922	$113,673

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

Reconciliation of Statutory Federal Income Tax Rate to Effective Rate

In thousands of dollars	1990	1989	1988
Income before federal taxes	$331,739	$295,394	$279,734
Statutory federal income tax rate	34.0%	34.0%	34.0%
Depreciation	1.9	4.6	3.6
Deferred investment tax credits — net	(1.8)	(4.3)	(3.0)
Other — net	3.2	2.2	(2.1)
Effective federal income tax rate	37.3%	36.5%	32.5%

8 Regulatory Proceedings and Litigation

Southwest Powerlink In February 1989, the California Public Utilities Commission issued a decision ordering a disallowance of approximately $25 million of costs associated with long-term purchased power contracts using the Southwest Powerlink. This decision had the effect of reducing pretax income for the first quarter of 1989 by $25 million, or $0.28 per share after tax. The decision also provided for a possible reduction of the disallowance through an energy credit based on cost savings from energy purchased under these contracts. In September 1989, SDG&E filed for this credit, increasing pretax income for the third quarter by $5 million, or $0.05 per share after tax. In 1990, the CPUC approved the credit.

In March 1989, seeking to reduce the disallowance, SDG&E filed an application for rehearing with the CPUC. The application challenged the CPUC's authority to disallow expenses resulting from paying rates approved by the Federal Energy Regulatory Commission. The application also challenged various premises supporting the CPUC's decision. In September 1989, the CPUC denied the application for rehearing. Also in September 1989, SDG&E challenged the CPUC's rejection of its application in U.S. District Court in San Francisco. SDG&E requested an injunction from the court reversing the CPUC's action.

Management cannot predict the ultimate outcome of this matter or when a decision will be reached.

Portland General Electric In July 1989, the CPUC Division of Ratepayer Advocates issued a report on the reasonableness of the company's entering into its purchased power contract with Portland General Electric, contending that the power was uneconomic to the ratepayers during part of the contract term. Power deliveries under that contract began on January 1, 1989. The DRA has recommended that the annual costs of the contract be compared with the cost of alternative sources of power, with the excess costs being subject to disallowance in those years in which the contract costs are higher than the cost of the alternative sources. The potential disallowances identified by the DRA have a present value of $28 million, based on the DRA's assertions as to what constitutes the cost of alternative sources of power.

In 1989 and 1990, SDG&E participated with PGE in negotiating new contracts with the coal company and the railroad supplying coal to PGE's Boardman power plant. This plant is associated with SDG&E's 75-megawatt long-term power contract with PGE. As a result of these new contracts, energy costs from PGE will be reduced.

The company hopes that the new contracts will reduce or eliminate the DRA's concern about the cost effectiveness of the PGE contract. The CPUC granted SDG&E's request to reopen the record in this proceeding to consider the reduced annual costs. The additional hearings are scheduled for April 1991.

Management cannot predict the ultimate outcome of this matter or when a decision will be reached.

Springerville Litigation On December 28, 1990, Philip Morris Capital Corporation filed a lawsuit against SDG&E, Century Power Corporation and two other defendants alleging liability for unspecified compensatory damages, including the loss of tax benefits and losses sustained from the adverse tax consequences of defendants' alleged acts, and punitive damages for various improprieties relating to the sale and leaseback of Springerville Unit 1. SDG&E faces the exposure of joint and several liability with the other defendants.

A portion of the electricity generated by Unit 1 was purchased by SDG&E. The sale and leaseback transaction was entered into between Century and six investors, including Philip Morris.

Philip Morris asserts that SDG&E unlawfully agreed to delay its claim that it was entitled to rate relief as a result of the sale and leaseback transaction until after the transaction was completed in December 1986. According to the lawsuit, SDG&E allegedly participated in a plan with the other defendants to conceal the expected rate relief.

According to the lawsuit, Philip Morris' investment in the Springerville unit is $90 million. Philip Morris does not specify that the $90 million represents a loss or damage. Since the Federal Energy Regulatory Commission has not ruled that SDG&E is entitled to the expected rate relief, it is SDG&E's position that the Plaintiff has not been damaged by SDG&E's alleged actions.

On February 19, 1991, SDG&E moved to dismiss the complaint against it on various grounds. SDG&E believes it has meritorious defenses against the claims and intends to defend the lawsuit vigorously. Management cannot predict the ultimate outcome.

Subsidiary Shareholder Litigation In June 1990, an action was instituted against Wahlco Environmental Systems, Inc., certain directors and officers as well as the underwriters for WES's initial public offering. In November 1990, a substantially similar action was filed, naming SDG&E as an additional defendant. The complaints, which seek unspecified compensatory and punitive damages, allege various violations of federal and state securities laws and various state law claims based upon alleged misrepresentations and material omissions made in connection with WES's initial public offering, first quarter 10-Q filing, press releases and other documents and statements.

SDG&E and WES believe they have meritorious defenses to the claims and intend to defend the suits vigorously. Management cannot predict the ultimate outcome of the litigation.

Other Litigation The company is involved in various legal matters arising out of the ordinary course of business. Management believes that these matters will not have a material adverse effect on the company's financial position.

9 Other Contingencies and Commitments

Nuclear Insurance Public liability claims that could arise from a nuclear incident are limited by the Price-Anderson Amendments Act of 1988 to a maximum amount of $7.8 billion for each licensed nuclear facility. The company and the co-owners of the San Onofre units have purchased primary insurance of $200 million for this exposure, the maximum amount available in 1990. The remaining $7.6 billion is provided by secondary financial protection required by the Nuclear Regulatory Commission. This secondary coverage provides for loss sharing among utilities owning nuclear reactors if a costly accident occurs. The company could be assessed retroactive premium adjustments of up to $40 million in the event of a nuclear incident involving any of the licensed, commercial reactors in the United States, if the amount of the loss exceeds $200 million.

In addition to public liability insurance, coverage is provided for property damage and replacement power costs at San Onofre. Primary property damage coverage is provided for losses of up to $500 million. Additional decontamination liability and excess property damage insurance coverage of $1.7 billion at December 31, 1990 is provided. Replacement power insurance provides weekly indemnity payments for up to two years, commencing after a waiting period of 21 weeks. These three insurance coverages are provided primarily through mutual insurance companies owned by utilities with nuclear facilities. If losses at any of the nuclear facilities covered by the risk-sharing arrangements were to exceed the accumulated funds available for these insurance programs, SDG&E could be assessed retroactive premium adjustments of up to $7.4 million per year.

Termination Agreement If the SCEcorp merger is consummated, the merged company would be obligated, among other things, to pay Tucson Electric Power Co. $25 million under the Termination and Settlement Agreement that terminated the pending merger with Tucson.

Construction Approximately $260 million, excluding nuclear fuel and AFUDC, is planned to be spent for utility plant construction in 1991.

Environmental Issues The company's operations are guided by federal, state and local environmental laws and regulations governing hazardous wastes, air quality, water quality, land use and solid waste disposal. Compliance programs necessary to meet existing and future environmental laws and regulations will increase the cost of electric and gas service by requiring changes to the company's operations or facilities. The costs of compliance with environmental laws and regulations are normally included in rates.

Leases Nuclear fuel, an office building and a generating facility are financed by long-term capital leases. Utility plant includes $285 million at December 31, 1990 and $298 million at December 31, 1989 related to these leases.

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

In millions of dollars	Operating Leases	Capitalized Leases
1991	$12	$ 38
1992	11	38
1993	9	20
1994	6	12
1995	5	12
Thereafter	11	106
Total future rental commitments	$54	226
Imputed interest (6 percent to 9 percent)		(59)
Net commitment		$167

Rental payments totaled $57 million in 1990, $61 million in 1989 and $59 million in 1988.

Purchased Power Contracts The company buys electric power under several long-term contracts. The contracts expire on various dates between 1992 and 2013.

At December 31, 1990, the future minimum payments under the contracts were:

In millions of dollars	
1991	$ 117
1992	117
1993	119
1994	122
1995	123
Thereafter	1,039
Total minimum payments	$1,637

These payments are fixed charges. The company is required to pay additional amounts for actual deliveries of energy under the contracts.

Total payments, including energy payments, under the contracts were $236 million in 1990, $247 million in 1989 and $253 million in 1988.

The company has exercisable options to extend two long-term contracts. The company also has two contracts for future years that it can terminate. Because the payments under these contracts are not firm commitments, they are not included in the above table.

Concentration of Credit Risk In March 1990, the Financial Accounting Standards Board issued a rule that requires companies to disclose all significant concentrations of credit risk. The company grants credit to its customers, substantially all of whom are located in its service territory, which covers all of San Diego County and the southern portion of Orange County.

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying consolidated balance sheets and the consolidated statements of capital stock and long-term debt of San Diego Gas & Electric Company and its subsidiaries as of December 31, 1990 and 1989, and the related consolidated statements of income, changes in capital stock and retained earnings, and cash flows for each of the three years in the period ended December 31, 1990. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of San Diego Gas and Electric Company and its subsidiaries as of December 31, 1990 and 1989, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1990 in conformity with generally accepted accounting principles.

Deloitte & Touche

DELOITTE & TOUCHE
San Diego, California
February 22, 1991

BOARD OF DIRECTORS

The seven-person board of directors consists of six outside directors and the chief executive officer of SDG&E, who serves as its chairman. The directors provide a broad perspective because of their diverse business, professional and civic backgrounds.

Board members include (left to right): Fred C. Stalder, Malin Burnham, Ralph R. Ocampo, Thomas A. Page, Daniel W. Derbes, Catherine Fitzgerald Wiggs and Clair W. Burgener.

Thomas A. Page*
Mr. Page has been chairman, president and chief executive officer of the company since February 1983. Mr. Page is the chairman and a director of both Pacific Diversified Capital Company and Wahlco Environmental Systems, Inc. He is 57 years old and has been a director of SDG&E since 1979. Committee memberships: chairman of the Executive Committee and a member of the Nominating Committee.

Clair W. Burgener
Mr. Burgener has been president of Burgener Properties, Inc., a real estate and property development firm, since January 1958. He is a former member of Congress, U.S. House of Representatives, 43rd District (California), 1973–1983. Mr. Burgener is a director of San Diego Trust and Savings Bank, TCS Enterprises, and Blue Shield of California. He serves on the California State Personnel Board, the Board of Management Analysis Co. and the Board of Regents of the University of California. He is 69 years old and has been a director of SDG&E since 1983. Committee memberships: chairman of the Nominating Committee and a member of the Finance and the Executive Compensation committees.

Malin Burnham*
Mr. Burnham is chairman of John Burnham & Co., a mortgage loan, real estate and insurance firm. He is chairman and a director of Burnham Pacific Properties, Inc. He is chairman of the board and a director of First National Corp. of San Diego and a director of BMA Corp. and of both Pacific Diversified Capital Company and Wahlco Environmental Systems, Inc., subsidiaries of the company. He is 63 years old and has been a director of SDG&E since 1967. Committee memberships: chairman of the Audit Committee and a member of the Executive Committee.

Daniel W. Derbes*
Mr. Derbes is president of Signal Ventures. He is chairman of the Executive Committee and a director of Oak Industries, Inc. From November 1985 until December 31, 1988, he was president of Allied-Signal International, Inc. and executive vice president of Allied-Signal, Inc., a multi-national advanced technologies company. He was president of Signal Advanced Technology Group and executive vice president of The Signal Companies, Inc. from February 1983 until November 1985. He is a director of WD-40 Co. and of both Pacific Diversified Capital Company and Wahlco Environmental Systems, Inc. He is 60 years old and has been a director of SDG&E since 1983. Committee memberships: Executive and Finance committees.

Ralph R. Ocampo
Dr. Ocampo is a San Diego physician and surgeon. He is 59 years old and has been a director of SDG&E since 1983. Committee memberships: chairman of the Finance Committee and a member of the Audit Committee.

Fred C. Stalder
Mr. Stalder is a private investor. He formerly was president, chairman of the board and chief executive officer of Central Savings and Loan Association. He is 70 years old and has been a director of SDG&E since 1969. Committee memberships: Audit, Executive Compensation and Nominating committees.

Catherine Fitzgerald Wiggs
Mrs. Wiggs is vice president, human resources development and a member of the Management Executive Committee of The Security Life of Denver, a wholly owned subsidiary of Nationale-Nederlanden N. V. She has been a management consultant in the fields of human resources and organizational effectiveness. She formerly was executive vice president, human resources, and a member of the management executive committee of The Broadway Stores, Inc., Division of Carter Hawley Hale Stores, Inc., a retail department store chain. She is 57 years old and has been a director of SDG&E since 1979. Committee memberships: chairwoman of the Executive Compensation Committee and a member of the Audit Committee.

*Member of the Executive Committee

Committees of the Board

Audit *This committee selects an independent auditor and reviews the overall plan of the audit, financial statements, audit results, scope of internal audit procedures and the auditors' evaluation of internal controls.*

Executive *This committee is empowered to act in place of the full board, except in certain transactions for various board responsibilities that are reserved for the board.*

Executive Compensation *This committee reviews the salaries and other forms of compensation of company officers and makes compensation recommendations to the board.*

Finance *This committee counsels management; helps plan the company's capital requirements, proposed financing programs and capital risk exposure analyses, and reviews the general investment policy performance for the Pension Plan and the Savings Plan.*

Nominating *This committee considers and recommends nominees to the board, criteria for board and committee composition and member-*

CORPORATE PROFILE— SAN DIEGO GAS & ELECTRIC

San Diego Gas & Electric is an investor-owned energy management company founded in 1881. Nearly all of the company's revenues are generated from its utility businesses.

SDG&E purchases, generates and distributes energy to about 1.1 million customers in San Diego County and the southern portion of Orange County. The electric service area has a population of approximately 2.7 million.

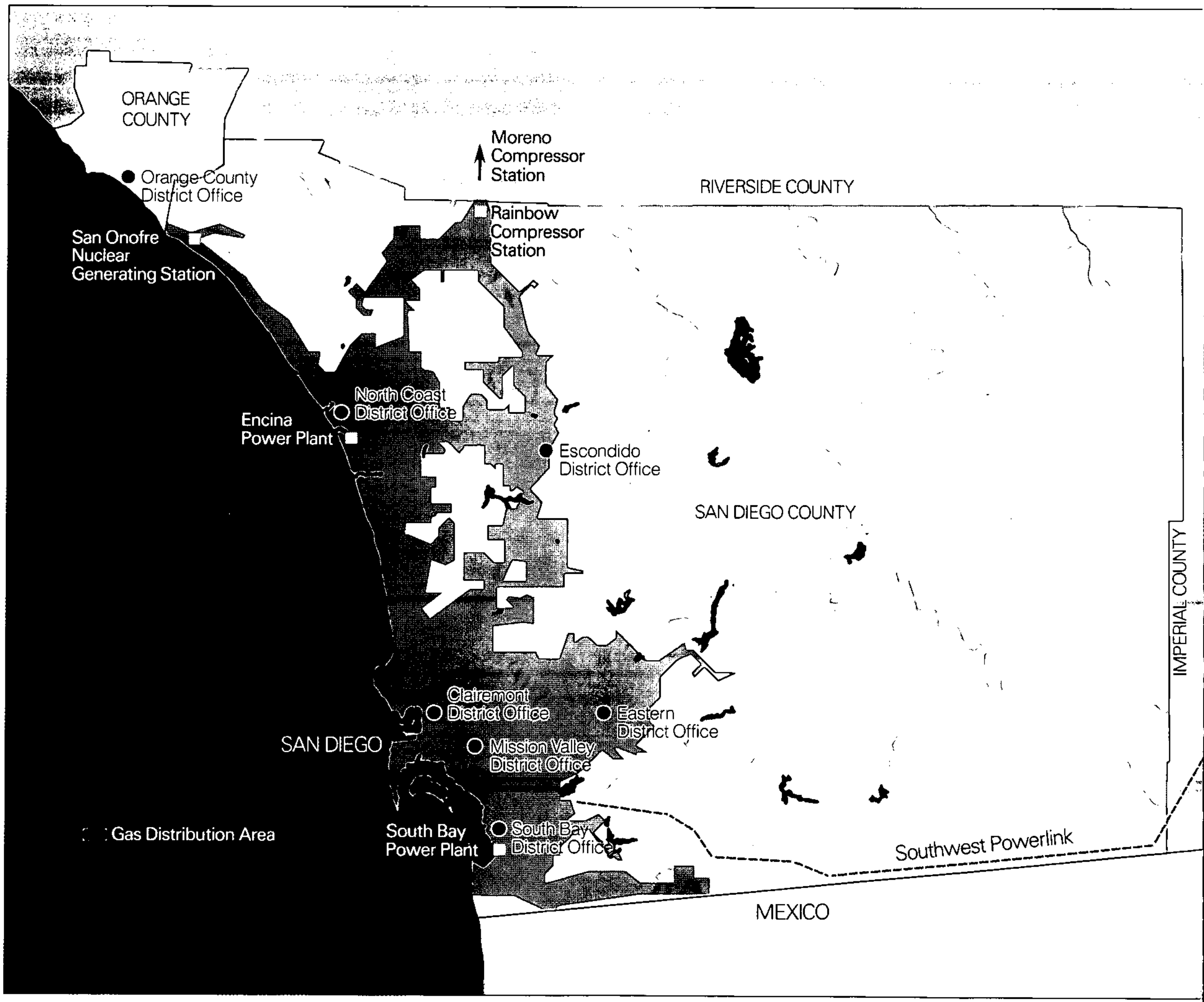
The company also purchases and distributes natural gas to about 670,000 customers in San Diego County. Gas service is not available in all locations, but the company's gas service area is being expanded.

Among SDG&E's major assets are the Encina and South Bay power plants, which can burn either fuel oil or natural gas; a 20 percent interest in three units at the San Onofre Nuclear Generating Station in northwest San Diego County; the Southwest Powerlink, a 500,000-volt transmission line which connects San Diego and Phoenix; and a natural gas pipeline system within the company's gas service area. Within its service territory, the company has seven operating and maintenance centers, two business centers, seven district offices and five branch offices.

As of December 31, 1990, there were about 4,175 people employed in SDG&E's utility operations.

SDG&E owns two subsidiaries: Pacific Diversified Capital, an independently operated holding company that owns companies serving utility, environmental and real estate markets; and Califia Company, a subsidiary used for general corporate purposes such as holding real estate.

SDG&E's electric service area covers all of San Diego County and the southern portion of Orange County. The natural gas service area is shown in color. The Moreno gas compressor station is located in Riverside County, 35 miles north of the San Diego county line.



Officers

Thomas A. Page, 57
Chairman, President and Chief Executive Officer

Thomas Page was elected chairman in 1983. He has been president and chief executive officer since 1981. He joined SDG&E in 1978 as a senior officer.

Jack E. Thomas, 58
Executive Vice President and Chief Operating Officer

Jack Thomas was elected executive vice president in 1985 and chief operating officer in 1986, after serving as a group vice president since 1980 and as a vice president since 1972. He joined SDG&E as an engineer in 1957.

Stephen L. Baum, 50
Senior Vice President and General Counsel

Stephen Baum was elected senior vice president in 1987 after serving as a vice president since 1985, when he joined SDG&E as a vice president and general counsel. He formerly was senior vice president and general counsel for the Power Authority of the State of New York.

Gary D. Cotton, 50
Senior Vice President—Engineering and Operations

Gary Cotton was elected senior vice president in 1985 after serving as a vice president since 1979. He was appointed to his current position in November 1986. Cotton joined SDG&E in 1975.

Alton T. Davis, 53
Senior Vice President—Customer Services

Alton Davis was elected senior vice president in 1985 after serving as a group vice president since 1981 and as a vice president since 1976. He was appointed to his current position in November 1986. Davis joined SDG&E in 1968.

R. Lee Haney, 51
Senior Vice President—Finance and Chief Financial Officer

Lee Haney was elected senior vice president—finance in January 1990. He was elected a vice president in 1983 after serving as treasurer for two years. He was elected vice president—finance in April 1986 and became chief financial officer in July 1988. He joined SDG&E in 1972.

Donald E. Felsinger, 43
Vice President—Marketing and Resource Development

Donald Felsinger was elected a vice president in 1983 and was appointed vice president of marketing in November 1986. Resource development was added to the division in February 1989. Felsinger joined SDG&E in 1972.

Ronald K. Fuller, 53
Vice President—Governmental and Regulatory Services

Ronald Fuller was elected vice president of regulatory services in 1983. Governmental services was added to the division in 1984. He joined the company in 1974. Prior to that he served in the executive office of the president of the United States.

Edwin A. Guiles, 41
Vice President—Corporate Planning

Edwin Guiles was elected vice president—corporate planning in January 1990 after serving as director—merger transition since January 1989 and as director—business planning since 1987. He joined SDG&E as an engineer in 1972.

Margot A. Kyd, 37
Vice President—Administrative Services

Margot Kyd was elected vice president—administrative services in December 1988 after serving as treasurer since 1986. She served as manager— financial services and assistant treasurer the previous year. Kyd joined the company in 1980.

Richard L. Manning, 59
Vice President—Public Relations

Richard Manning has been vice president—public relations since he joined SDG&E in 1981.

George A. F. Weida, 54
Vice President—Human Resources

George Weida joined SDG&E in 1983 as a vice president and was named head of the human resources division in 1984. Previously, he was head of human resources for other major U.S. corporations.

Frank H. Ault, 46
Controller

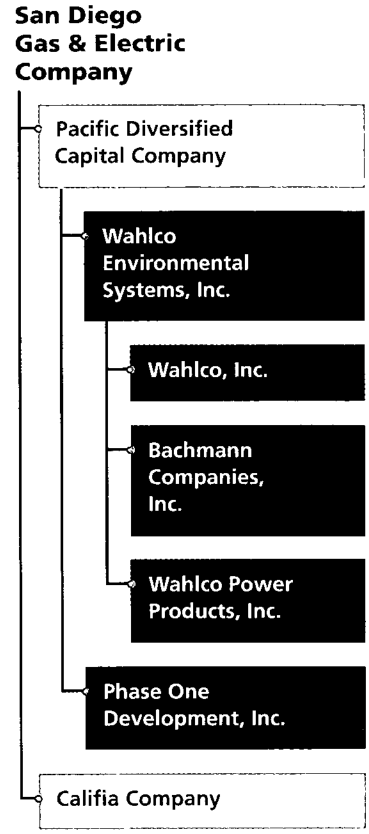
Frank Ault was elected controller in May 1986 after serving as director—internal auditing since 1981. Ault joined SDG&E in 1969.

Malyn K. Malquist, 38
Treasurer

Malyn Malquist was elected treasurer in January 1990 after serving as director—finance and assistant treasurer since 1988. He was named director— information services during 1987 following service as manager—financial services. He joined the company in 1978.

Delroy M. Richardson, 52
Corporate Secretary

Delroy Richardson was elected secretary in December 1986 after serving as assistant secretary since 1983. He joined SDG&E as an attorney in 1971 .



Selected Financial Data

At December 31	1990	1989	1988	1987	1986	1985
Current assets*	$ 335.5	$ 299.2	$ 319.9	$ 336.4	$ 299.7	$ 366.2
Current liabilities*	$ 535.5	$ 555.2	$ 510.1	$ 533.7	$ 450.2	$ 404.8
Working capital*	$ (200.0)	$ (256.0)	$ (190.2)	$ (197.3)	$ (150.5)	$ (38.6
Working capital ratio	.6	.5	.6	.6	.7	.9
Long-term debt*	$ 1,167.1	$ 1,112.7	$ 1,179.5	$ 1,204.6	$ 1,193.9	$ 1,208.6
Common shareholders' equity*	$ 1,303.3	$ 1,256.1	$ 1,229.9	$ 1,197.4	$ 1,159.9	$ 1,153.0
Number of utility customers†	1,095.2	1,069.6	1,032.6	990.4	940.7	893.9
Number of utility employees	4,175	4,209	4,420	4,612	4,815	4,860
Common shares outstanding	55,948,922	55,921,505	55,898,342	55,872,602	55,847,822	55,822,762
Book value per common share	$ 23.29	$ 22.46	$ 22.00	$ 21.43	$ 20.77	$ 20.65
Price/Earnings ratio	12.7	14.3	12.0	9.1	9.9	8.3

For year ended December 31						
Operating Revenues*						
Electric	$ 1,356.4	$ 1,324.9	$ 1,300.0	$ 1,261.3	$ 1,333.5	$ 1,395.7
Gas	$ 355.1	$ 300.4	$ 285.4	$ 293.8	$ 299.2	$ 343.0
Diversified operations	$ 60.4	$ 44.2	$ 35.1	$ 7.1	$ 1.5	—
Pretax income/revenue	20.6%	19.3%	18.7%	21.7%	21.6%	22.7
Return on equity	15.4%	14.2%	14.6%	15.6%	12.3%	16.2
Effective federal tax rate	37.3%	36.5%	32.5%	39.1%	47.8%	44.5
Earnings per common share	$ 3.52	$ 3.15	$ 3.18	$ 3.28††	$ 2.59	$ 3.25
Dividends declared per common share	$ 2.70	$ 2.70	$ 2.60	$ 2.50	$ 2.345	$ 2.205
Dividend payout ratio (declared)	76.7%	85.7%	81.8%	76.3%	90.4%	68.1
Price range of common shares	$ 46¼–$39	$45⅝–$36⅜	$ 39½–$30	$37⅞–$28¼	$42½–$26¾	$28⅜–$21½

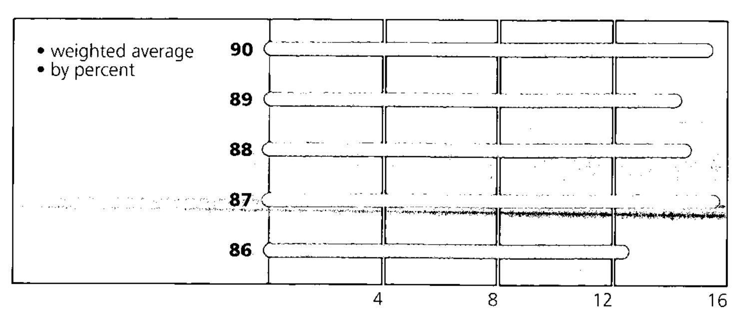
*In millions of dollars.

†In thousands.

††Including $0.32 for cumulative effect of change in accounting principle.

Financial Return on equity is measured by earnings applicable to common shares divided by average common equity.

Financial Return on Equity



Compound Annual Growth Rate 5 Years	1984	1983	1982	1981	1980	Compound Annual Growth Rate 10 Years
(1.7)%	$ 393.8	$ 267.3	$ 303.9	$ 302.4	$ 308.8	0.8%
5.8%	$ 352.2	$ 429.7	$ 443.6	$ 453.4	$ 382.3	3.4%
—	$ 41.6	$ (162.4)	$ (139.7)	$ (151.0)	$ (73.5)	—
—	1.1	.6	.7	.7	.8	—
(0.7)%	$ 1,277.5	$ 1,275.4	$ 1,007.2	$ 925.0	$ 918.5	2.4%
2.5%	$ 1,052.9	$ 957.6	$ 817.4	$ 672.4	$ 585.8	8.3%
4.1%	853.6	823.2	804.5	792.4	772.9	3.5%
(3.0)%	4,841	4,917	5,084	4,909	4,776	(1.3)%
—	54,063,592	51,693,662	48,266,144	41,499,034	36,469,483	4.4%
2.4%	$ 19.48	$ 18.52	$ 16.94	$ 16.20	$ 16.06	3.8%
—	7.6	6.1	5.9	5.3	11.6	—

(0.6)%	$ 1,292.8	$ 1,207.1	$ 1,137.9	$ 948.6	$ 770.9	5.8%
0.7%	$ 327.9	$ 323.1	$ 293.0	$ 211.0	$ 189.5	6.5%
—	—	—	—	—	—	—
—	19.8%	18.7%	15.3%	10.2%	4.5%	—
—	15.8%	18.2%	17.5%	14.5%	6.0%	—
—	38.7%	31.2%	24.0%	4.7%	(13.1)%	—
1.6%	$ 3.01	$ 3.20	$ 2.90	$ 2.34	$ 1.01	13.3%
4.1%	$ 2.065	$ 1.925	$ 1.785	$ 1.64	$ 1.56	5.6%
—	68.8%	60.7%	62.4%	71.1%	156.8%	—
—	$23¾–$17⅝	$ 22–$17	$17⅞–$11¾	$ 14–$11	$ 15¼–$10	—

Quarterly Common Stock Data

	1990				1989			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Market price								
High	45⅜	43¾	44⅜	46¼	39¼	41½	42⅞	45⅝
Low	40¾	39½	39	39¾	36⅜	37⅛	40	39½
Dividends declared	67.5¢	67.5¢	67.5¢	67.5¢	67.5¢	67.5¢	67.5¢	67.5¢

SHAREHOLDER REFERENCE GUIDE

Stock Listing and Trading Information

Common stock: Listed on the New York and Pacific stock exchanges under the ticker symbol SDO. Shareholders can find the previous day's closing price in the New York Stock Exchange listing table of daily newspapers under the symbol SDieGs.

Preferred and preference stocks: Listed on the American and Pacific stock exchanges under the ticker symbol SDO. Previous day closing prices are listed in the American Stock Exchange listing table under the symbol SDGO. The 4.60% preferred series and the $7.05, $8.25 and $9.125 preference series are not listed.

Where to buy and sell stock: You can purchase the listed common, preferred and preference stocks through any brokerage firm. Some firms specialize in selling the unlisted series, and they can be located through your broker.

Del Richardson, corporate secretary, has responsibility for the company's board of directors' meetings, shareholder relations and records management.

Common Stock Investment Plan: Please call or write for a prospectus on how SDG&E common stock shareholders can purchase additional shares by investing all or a portion of their quarterly dividends in additional shares. The plan also allows optional cash investments of as little as $25 per investment up to a maximum of $5,000 per calendar quarter. Shares purchased under this plan are free of any brokerage fees.

Dividend Deposit Service: If you wish to have your dividend check mailed directly to your bank for deposit, send signed instructions containing your bank account number and the complete mailing address of the bank to the Office of the Secretary, SDG&E. If the checks are being deposited to a joint account, all owners of the account and all shareholders should sign the letter.

Transfer Agents and Registrars

The company's transfer agents and not the company have primary responsibility for stock transfers and the cancellation and issuance of stock certificates. You should contact the agents directly.

Transfer agents:

Union Bank (formerly California First Bank)
8155 Mercury Court
Post Office Box 2529
San Diego, California 92112 (619) 230-4487

Union Bank is the registrar for common stock in San Diego.

Union Bank is also transfer agent and registrar for the preferred and preference stocks.

First Interstate Bank of California
c/o First Interstate Bank
120 Broadway, 33rd Floor
New York, New York 10271

First Interstate Bank is the registrar for common stock in New York.

First Interstate Bank is also the transfer agent and registrar for the preference stocks, except the $8.25 and the $9.125 series.

How to transfer stock: A transfer of stock is required whenever there is a change in the name or names in which the stock certificate is registered. This can happen when you sell the stock, make a gift of stock, or add or delete owners of the certificate. The transfer can be made by filling in the stock assignment form on the back of the stock certificate and signing it exactly as the name or names appear on the front of the certificate. The signatures of the individuals transferring the stock must be guaranteed by either a commercial bank or a brokerage firm that is a member of a major stock exchange. The certificate can then be sent to the transfer agent for transfer. It is recommended that certificates be sent registered or certified mail.

Annual Meeting

The annual meeting of shareholders will be held on Tuesday, April 23 at 11 a.m. at the U.S. Grant Hotel, Grand Ballroom, 326 Broadway, San Diego, California 92101-4812.

The record date for shareholders eligible to vote at the annual meeting is February 25, 1991.

Shareholder Profile

As of December 31,1990, there were 62,431 common stock shareholders of record and 4,808 preferred and preference stock shareholders. There are thousands of other stock holders whose shares are held in street name by securities brokers and nominees.

Common Stock Shareholders

By account registration:	
Joint accounts	19,452
Women	18,283
Men	13,181
Fiduciaries	10,673
Securities brokers, nominees, others	842
By geographic area:	
United States, except California	31,838
California, except SDG&E service area	19,047
SDG&E service area, including employees	11,433
Foreign countries	113
By shares owned:	
1-99	13,394
100-300	29,616
301-500	8,484
501-1000	6,705
1001 or more	4,232

Publications Available to Shareholders

Annual Report: Inquiries about this annual report should be directed to Tom Murnane, Corporate Communications, Post Office Box 1831, San Diego, California 92112.

Investors Report: Reports of current activities, recent results and features of interest to shareholders are issued periodically during the year.

Form 10-K: The annual report to the Securities and Exchange Commission.

Shareholder Information Handbook: Answers many questions commonly asked by shareholders.

Where to Call for Information

Shareholders may call every business day, between 8:00 a.m. and 4:45 p.m. (Pacific time), to inquire about stock holdings:

Within California	(800) 826-5942
Outside California	(800) 243-5454

To hear a tape recorded corporate news report and stock update:

Within California	(800) 443-SDGE
Outside California	(800) 521-NEWS

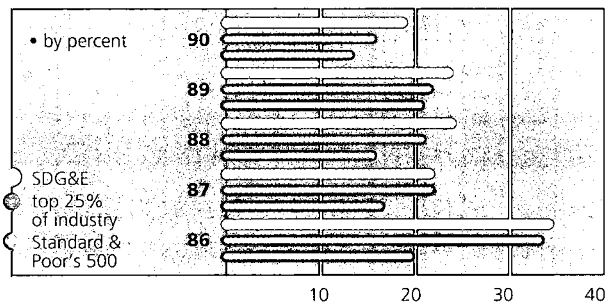
Inquiries from the financial community should be directed to:

Roberta DeTata	(619) 696-4488

Executive Offices

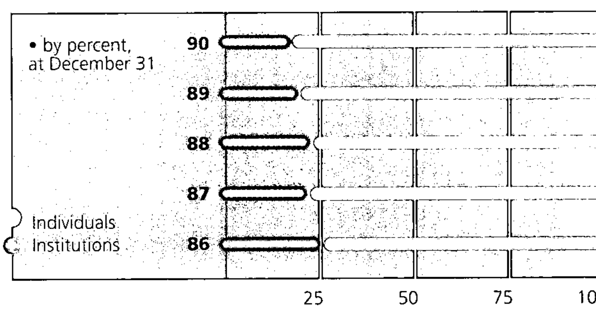
San Diego Gas & Electric
101 Ash Street
Post Office Box 1831
San Diego, California 92112
(619) 696-2000

Total Annual Return to Shareholders

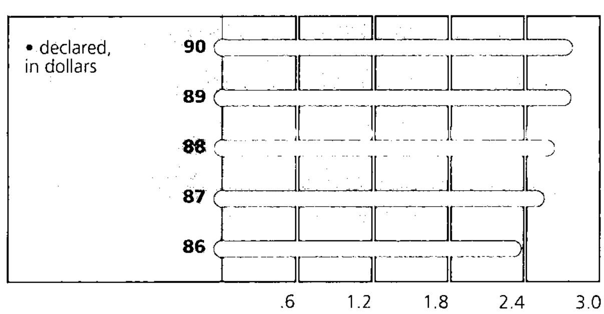


The company remained in the top 25 percent, meeting its goal. Stock price appreciation and dividends are the components of average total return, measured over five years.

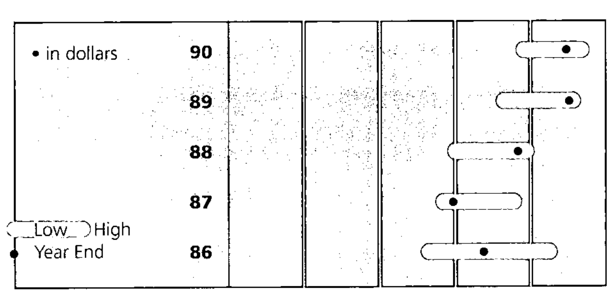
Investor Profile



Dividends Per Share



Common Stock Price Trend



The 1989 and 1990 price increases are due to the proposed merger with Southern California Edison and lower interest rates.

San Diego Gas & Electric
• Post Office Box 1831
• San Diego, California 92112