MICROSOFT CORP
Form DEFA14A
September 29, 2004

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934 (Amendment No. __)

Filed by the Registrant x

Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement

¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

¨ Definitive Proxy Statement

x Definitive Additional Materials

¨ Soliciting Material Pursuant to §240.14a-12

Microsoft Corporation

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

(1) Title of each class of securities to which transaction applies:

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(2) Aggregate number of securities to which transaction applies:

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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(4) Proposed maximum aggregate value of transaction:

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(5) Total fee paid:

¨ Fee paid previously with preliminary materials.

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

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(3) Filing Party:

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(4) Date Filed:

Persons who are to respond to the collection of information contained in this form are not

required to respond unless the form displays a currently valid OMB control number.

[The following is the text of an email sent by John G. Connors, Microsoft s Senior Vice President and Chief Financial Officer, to all employees on September 29, 2004]

Every year at this time shareholders are given the opportunity to participate directly in the governance of the Company through the proxy voting process. Over the next few weeks, shareholders will receive a proxy statement from the Company and will be asked to vote on a number of key items that affect the Company. The proxy statement is a document that Microsoft is required to file with the Securities and Exchange Commission (SEC), and contains information that must be provided to shareholders before they vote - by proxy - on company matters.

If you own Microsoft shares, your involvement in the proxy voting process is important and I would encourage you to vote your proxy and take an active role in the overall governance of our company.

This year, shareholders are asked to consider and vote on the following matters:

1. **Election of directors.**

2. **Proposed amendments to the 2001 Stock Plan and the 1991 Stock Option Plan.**

3. **Proposed amendments to the 1999 Stock Plan for Non-Employee Directors, the Stock Option Plan for Non-Employee Directors, and the Stock Option Plan for Consultants and Advisors.**

4. **A proposal for approval of the material terms of the performance criteria for awards under the 2001 Stock Plan.**

5. **Ratification of the selection of Deloitte & Touche LLP as the Company s independent auditor.**

I would like to highlight two particularly important items that appear on this years proxy: the amendments to the Microsoft 2001 Stock Plan and 1991 Stock Option Plan, and the amendments to the Microsoft 1999 Stock Plan and Stock Option Plan for Non-Employee Directors.

Since stock options and stock awards are not eligible to receive dividends, our Board has approved plan amendments and award adjustments that would ensure that employees, directors, consultants, and advisors that hold awards are not disadvantaged by our planned $3 per share special dividend. The Board and management determined that it would be appropriate to present the amendments to the shareholders for their approval.

By voting in favor of these proposals (#2 and #3), you are voting for amendments to the stock plans that will allow the adjustment of vested and unvested stock options and unvested stock awards to maintain their economic value after the special dividend equivalent to the pre-dividend value.

Please take a moment to review the proxy materials you will receive and vote on these important matters. Details on how you will be able to vote your proxy are explained below.

You may review the 2004 Proxy Statement in its entirety at:

http://www.microsoft.com/msft/SEC/FY04/proxy2004.mspx

Along with a copy of the proxy statement, shareholders will also receive our 2004 Annual Report, which can be reviewed at:

http://www.microsoft.com/msft/ar.mspx

Thank you,

John Connors

HOW WILL I RECEIVE THE PROXY MATERIALS?

You will receive your proxy materials via an electronic link (sent to you via email) or in the mail, depending on where your Microsoft shares are held.

If you are holding shares through a Microsoft-sponsored employee plan*, you will soon receive an email with proxy voting instructions from our transfer agent, Mellon Investor Services.

The email message will come directly from **vdirect@melloninvestor.com**, and will contain a link to a ***secure*** website where you will be able to vote your proxy on-line. Microsoft Investor Relations has authorized Mellon Investor Services to send this email to you.

Offering this on-line voting capability streamlines proxy voting and reduces the expense of printing and mailing the proxy package.

* Employee holdings at **Fidelity** (401(k), ESPP and, vested stock awards) and/or **Salomon Smith Barney** (shares from exercised options, vested stock awards) have been consolidated along with any registered holdings at Mellon Investor Services. If you have shares at any of these institutions as of the **September 10th annual meeting record date** you will receive an email with links to your proxy ballot. You will not receive a hard copy mailing.

If you hold shares through a private broker or bank, including the listed brokers above, outside of these programs, you should receive the hard copy edition of the proxy statement and the annual report in the mail. Look for the instructions in your package on how to vote your proxy on-line and consent to receive email notifications in the future.

WHAT IF I DIDN T RECEIVE THE PROXY MATERIALS ON-LINE?

Some possible reasons for not receiving an on-line proxy:

1. Employee stock options are not eligible for voting on proxy issues.

2. Unvested stock awards are not eligible for voting on proxy issues.

3. The matching process done by Mellon sometimes includes social security numbers: most international employees do not have social security numbers.

4. Fidelity or Salomon Smith Barney do not have the shareholder coded as an employee on their system, and therefore do not pass on the name to Mellon for the on-line proxy matching program.

If you fall into category 3 or 4 above, you should receive the proxy statement and annual report in the mail. If you wish to vote your proxy on-line, review the instructions provided in the mailed package.

If you did not receive the proxy materials (on-line or hard copy) and believe that you should have, or if you have questions on this program, please send an email to **denniem@microsoft.com.**

9pt;">January 2018 application, pursuant to SB 350, to make investments to support medium-duty and high-duty electric vehicles with an estimated implementation cost of $7 million of O&M.

$
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§
Application pending; draft decision expected in the first quarter of 2019.
Energy Storage Projects

§
April 2017 application to procure up to 70 MW of utility-owned energy storage to provide local capacity.
Not
disclosed
§
Final decision issued in May 2018 approving the project.
§
February 2018 application, pursuant to AB 2868, to make investments to accelerate the widespread deployment of distributed energy storage systems. SDG&E's application requests approval of 100 MW of utility-owned energy storage.

$
161

§
Application pending; draft decision expected in the first half of 2019.
Utility Billing and Customer Information Systems
Software

§
April 2017 application to replace the software, with an estimated implementation cost of $76 million of O&M.

$
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§
Application pending; joint party settlement filed January 2018; draft decision issued in July 2018 approving the project.

Risks Associated with Wildfires

With respect to claims related to the 2007 wildfires, based on the trial court's ruling that inverse condemnation claims would apply, we were subject to a strict liability standard. However, we were denied recovery by the CPUC of our non-FERC related wildfire costs. SDG&E applied to the CPUC for rehearing of its decision on January 2, 2018. On July 12, 2018, the CPUC adopted a decision denying the rehearing requests filed by SDG&E and other parties. We will appeal the decision with the California Courts of Appeal seeking to reverse the CPUC's decision. Insurance coverage for wildfires has significantly increased in cost and may become prohibitively expensive, may be disputed by the insurers, or may become unavailable. Moreover, any insurance proceeds we receive for wildfire events may be insufficient to cover our losses or liabilities due to the inability to procure a sufficient amount of insurance and/or the existence of limitations, exclusions, high deductibles, failure to comply with procedural requirements, and other factors, which could materially adversely affect SDG&E's and Sempra Energy's business, financial condition, results of operations, cash flows and/or prospects.

Other SDG&E Matters

See "Item 7. MD&A – Factors Influencing Future Performance" in the Annual Report for a discussion about:

Electric Rate Reform – California Assembly Bill
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Potential Impacts of Community Choice Aggregation and Direct Access
Renewable Energy Procurement
Clean Energy and Pollution Reduction Act – California SB 350
SONGS

SOCALGAS

Capital Project Update

We summarize below an update regarding a capital project at SoCalGas.

CAPITAL PROJECT – SOCALGAS

Project description	Estimated capital cost (in millions)	Status
San Joaquin Valley OIR		
§ In 2014, AB 2672 was signed into law providing increased access to energy for disadvantaged communities in the San Joaquin Valley.	$ 85	§ Decision expected in the third quarter of 2018.
§ In January 2018, submitted pilot proposals for seven communities to extend existing pipelines, install gas service to each household, and replace existing propane appliances with new, energy efficient natural gas appliances, with an estimated implementation cost of $14 million of O&M.		

Aliso Canyon Natural Gas Storage Facility Gas Leak

In October 2015, SoCalGas discovered a leak at one of its injection-and-withdrawal wells, SS25, at its Aliso Canyon natural gas storage facility (the Leak) located in Los Angeles County, which SoCalGas has operated as a natural gas storage facility since 1972. SoCalGas worked closely with several of the world’s leading experts to stop the Leak. In February 2016, DOGGR confirmed that the well was permanently sealed.

See Note 11 of the Notes to Condensed Consolidated Financial Statements herein for discussions of the following related to the Leak:

Local Community Mitigation Efforts
Insurance
Governmental Investigations and Civil and Criminal Litigation
Regulatory Proceedings
Governmental Orders and Additional Regulation

The costs incurred to remediate and stop the Leak and to mitigate local community impacts have been significant and may increase, and we may be subject to potential significant damages, restitution, and civil, administrative and criminal fines, penalties and other costs. In addition, the costs of defending against civil and criminal lawsuits, cooperating with investigations, and any damages, restitution, and civil, administrative and criminal fines, penalties and other costs, if awarded or imposed, as well as the costs of mitigating the actual natural gas released, could be significant. To the extent any of these costs are not covered by insurance (including any costs in excess of applicable policy limits), if there were to be significant delays in receiving insurance recoveries, or if the insurance recoveries are subject to income taxes, such amounts could have a material adverse effect on SoCalGas’ and Sempra Energy’s cash flows, financial condition and results of operations.

Cost Estimates and Accounting Impact

At June 30, 2018, SoCalGas estimates that its costs related to the Leak are $1,014 million, which includes $987 million of costs recovered or probable of recovery from insurance. Of the $1,014 million of estimated costs, approximately 55 percent is for the temporary relocation program (including cleaning costs and certain labor costs). The remaining portion of the $1,014 million includes legal costs incurred to defend litigation, the estimated costs to settle certain actions, the estimated costs of the root cause analysis being conducted by an independent third party, efforts to control the well, the costs to mitigate the actual natural gas released, the value of lost gas, and other costs. SoCalGas adjusts its estimated total liability associated with the Leak as additional information becomes available. The $1,014 million represents management’s best estimate of these costs related to the Leak. Of these costs, a substantial portion has been paid and $160 million is accrued as Reserve for Aliso Canyon Costs as of June 30, 2018 on SoCalGas’ and Sempra Energy’s Condensed Consolidated Balance Sheets for amounts expected to be paid after

June 30, 2018.

As of June 30, 2018, we recorded the expected recovery of the costs described in the immediately preceding paragraph related to the Leak of $502 million as Insurance Receivable for Aliso Canyon Costs on SoCalGas' and Sempra Energy's Condensed Consolidated Balance Sheets. This amount is net of insurance retentions and $485 million of insurance proceeds we received

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through June 30, 2018 related to costs described above, including temporary relocation costs, control-of-well expenses, legal costs and lost gas. If we were to conclude that this receivable or a portion of it was no longer probable of recovery from insurers, some or all of this receivable would be charged against earnings, which could have a material adverse effect on SoCalGas' and Sempra Energy's cash flows, financial condition and results of operations.
As described in "Governmental Investigations and Civil and Criminal Litigation" in Note 11 of the Notes to Condensed Consolidated Financial Statements herein, the actions seek compensatory, statutory and punitive damages, restitution, and civil, administrative and criminal fines, penalties and other costs, which except for the amounts paid or estimated to settle certain actions, are not included in the above amounts as it is not possible at this time to predict the outcome of these actions or reasonably estimate the amount of damages, restitution or civil, administrative or criminal fines, penalties or other costs that may be imposed. The recorded amounts above also do not include the costs to clean additional homes pursuant to the directive issued by DPH, future legal costs necessary to defend litigation, and other potential costs that we currently do not anticipate incurring or that we cannot reasonably estimate. Furthermore, the cost estimate of $1,014 million does not include certain other costs expensed by Sempra Energy through June 30, 2018 associated with defending against shareholder derivative lawsuits.

Natural Gas Storage Operations and Reliability

Natural gas withdrawn from storage is important for service reliability during peak demand periods, including peak electric generation needs in the summer and heating needs in the winter. The Aliso Canyon natural gas storage facility, with a storage capacity of 86 Bcf (which represents 63 percent of SoCalGas' natural gas storage inventory capacity), is the largest SoCalGas storage facility and an important element of SoCalGas' delivery system. Beginning October 25, 2015, pursuant to orders by DOGGR and the Governor of the State of California, and in accordance with SB 380, SoCalGas suspended injection of natural gas into the Aliso Canyon natural gas storage facility.
Having completed the steps outlined by state agencies to safely begin injections at the Aliso Canyon natural gas storage facility, as of July 31, 2017, SoCalGas resumed limited injections.
The CPUC has issued a series of directives to SoCalGas establishing the range of working gas to be maintained in the Aliso Canyon natural gas storage facility to help ensure safety and reliability for the region and just and reasonable rates in California, the most recent of which, issued July 2, 2018, directed SoCalGas to maintain up to 34 Bcf of working gas.
Section 455.5 of the California Public Utilities Code, among other things, directs regulated utilities to notify the CPUC if all or any portion of a major facility has been out of service for nine consecutive months. Although SoCalGas does not believe the Aliso Canyon natural gas storage facility or any portion of the facility was out of service (as that term is meant in section 455.5) for nine consecutive months, SoCalGas provided notification out of an abundance of caution to demonstrate its commitment to regulatory compliance and transparency, and because obtaining authorization to resume injection operations at the facility required more time than initially contemplated. In response, and as required by section 455.5, the CPUC issued an OII to address whether the Aliso Canyon natural gas storage facility or any portion of the facility was out of service for nine consecutive months under section 455.5, and if so, whether the CPUC should disallow costs for such period from SoCalGas' rates.
If the Aliso Canyon natural gas storage facility were determined to have been out of service for any meaningful period of time or permanently closed, or if future cash flows were otherwise insufficient to recover its carrying value, it could result in an impairment of the facility and significantly higher than expected operating costs and/or additional capital expenditures, and natural gas reliability and electric generation could be jeopardized. At June 30, 2018, the Aliso Canyon natural gas storage facility has a net book value of $678 million, including $286 million for the recently completed construction of a new compressor station. Any significant impairment of this asset could have a material adverse effect on SoCalGas' and Sempra Energy's results of operations for the period in which it is recorded. Higher operating costs and additional capital expenditures incurred by SoCalGas may not be recoverable in customer rates, and could have a material adverse effect on SoCalGas' and Sempra Energy's cash flows, financial condition and results of operations.

Increased Regulation

PHMSA, DOGGR, SCAQMD, EPA and CARB each commenced separate rulemaking proceedings to adopt further regulations covering natural gas storage facilities and injection wells. See "Item 7. MD&A – Factors Influencing Future

Performance” in the Annual Report for a discussion of the following regulations:
SB 380
SB 888
Additional Safety Enhancements

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PIPES Act of 2016

In June 2016, the "Protecting our Infrastructure of Pipelines and Enhancing Safety Act of 2016" or the "PIPES Act of 2016" was enacted. In December 2016, PHMSA published an interim final rule pursuant to the PIPES Act of 2016 that revises the federal pipeline safety regulations relating to underground natural gas storage facilities. The interim final rule incorporates consensus safety measures for the construction, maintenance, risk-management, and integrity-management procedures for natural gas storage. SoCalGas has developed and implemented policies and procedures to demonstrate compliance with the standards.

Higher operating costs and additional capital expenditures incurred by SoCalGas as a result of new laws, orders, rules and regulations arising out of the Aliso Canyon natural gas storage facility incident or our responses thereto could be significant and may not be recoverable in customer rates, and SoCalGas' and Sempra Energy's cash flows, financial condition and results of operations may be materially adversely affected by any such new laws, orders, rules and regulations.

CALIFORNIA UTILITIES – JOINT MATTERS

Capital Project Update

We summarize below updates regarding joint capital projects of the California Utilities.

JOINT CAPITAL PROJECTS – CALIFORNIA UTILITIES

Project description	Estimated capital cost (in millions)	Status
Pipeline Safety & Reliability Project		
§ September 2015 application and March 2016 amended application seeking authority to recover the estimated $633 million cost of the project, involving construction of an approximately 47-mile, 36-inch natural gas transmission pipeline in San Diego County.	$ 633	§ PSRP is a PSEP project. Our investment in PSRP, totaling approximately $36 million at SDG&E as of June 30, 2018, represents costs incurred to evaluate test or replacement options for Line 1600, consistent with the PSEP decision tree previously approved by the CPUC.
§ Would implement pipeline safety requirements and modernize system; improve system reliability and resiliency by minimizing dependence on a single pipeline; and enhance operational flexibility to manage stress conditions by increasing system capacity.		§ In June 2018, the CPUC issued a final decision denying the application for a new 36-inch pipeline and

		instead directing SDG&E and SoCalGas to submit a hydrostatic test or replacement plan for the existing Line 1600 in its present corridor. We will submit the plan to the Commission's Safety & Enforcement Division by the end of September 2018. Our submittal will include a revised cost estimate.
Mobile Home Park Utility Upgrade Program		
§ May 2017 application filed with the CPUC to convert an additional 20 percent of eligible units to direct utility service, for a total of 30 percent of mobile homes.	$ 471 to $ 508	§ A CPUC OIR was opened to evaluate the Mobile Home Park Program and to adopt programmatic modifications. The OIR subsumes the issues put forth by SDG&E and SoCalGas in their pending applications filed in May 2017, which will be dismissed without prejudice.
§ Estimated implementation cost of $2 million of O&M at SDG&E and $3 million to $4 million of O&M at SoCalGas.		§ September 2017 resolution approved extension of pilot program through the earlier of 2019 or the issuance of a CPUC decision on

		pending applications, while also allowing an increase from 10 percent to 15 percent of mobile homes to be converted.
Leak Abatement Compliance Program		
§ CPUC OIR to implement new rules and procedures in response to SB 1371 to promote reductions in natural gas leakage and implement annual emissions reporting requirements and leak management practices.	$ 115	§ Advice letter submitted in March 2018 requesting authority to implement the first two years (2018-2019) of a 12-year leak abatement program. The advice letter outlined the recovery mechanism and the proposed activities for the Leak Abatement Compliance Program.
§ Estimated O&M implementation costs through 2020 of $124 million at SoCalGas and $7 million at SDG&E.		§ Supplemental filing submitted on July 31, 2018 to update the overall implementation cost estimate through 2020.
		§ Pending CPUC approval.

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Natural Gas Pipeline Operations Safety Assessments

As we discuss in "Item 7. MD&A – Factors Influencing Future Performance" in the Annual Report, since 2011, the California Utilities have incurred costs related to the implementation of the CPUC's directives to test or replace natural gas transmission pipelines that do not have sufficient documentation of a pressure test and to address retrofitting pipelines to allow for in-line inspection tools and, where appropriate, automated or remote controlled shut-off valves (referred to as PSEP).

As shown in the table below, SoCalGas and SDG&E have made significant pipeline safety investments under the PSEP program, and SoCalGas expects to continue making significant investments as approved through various regulatory proceedings. SDG&E's PSEP program was substantially completed in 2017, with the exception of the PSRP, which we discuss in the table above. Both utilities have filed joint applications or plan to file future applications with the CPUC for review of the PSEP project costs as follows:

PIPELINE SAFETY ENHANCEMENT PLAN
– REASONABLENESS REVIEW SUMMARY

(Dollars in millions)

	2011 through June 30, 2018			
	Total invested[1]	CPUC review completed[2]	CPUC review pending[3]	2018 and future applications[4][5]
Sempra Energy Consolidated:				
Capital	$1,586	$ 8	$ 147	$ 1,431
Operation and maintenance	191	25	63	103
Total	$1,777	$ 33	$ 210	$ 1,534
SoCalGas:				
Capital	$1,228	$ 8	$ 133	$ 1,087
Operation and maintenance	182	25	62	95
Total	$1,410	$ 33	$ 195	$ 1,182
SDG&E:				
Capital	$358	$ —	$ 14	$ 344
Operation and maintenance	9	—	1	8
Total	$367	$ —	$ 15	$ 352

(1) Excludes disallowed costs through June 30, 2018 of $7 million at SoCalGas and $4 million at SDG&E for pressure testing or replacing pipelines installed between January 1, 1956 and July 1, 1961. Also excludes $36 million of costs incurred for the PSRP.

(2) Approved in December 2016; excludes $2 million of PSEP-specific insurance costs for which SoCalGas and SDG&E are authorized to request recovery in a future filing.

(3) Reasonableness Review Application for completed projects totaling $195 million filed in September 2016. Also includes approximately $15 million of pre-engineering costs incurred to support projects under development and submitted as part of the Forecast Application filed in March 2017. Both decisions are expected in 2018.

(4) Authorized to recover in rates 50 percent of the balances recorded in the PSEP Phase 1 balancing accounts each year, subject to refund.

(5) Reasonableness Review Application to be filed in late 2018 and expected to include the majority of these costs. Remaining costs not the subject of prior applications are to be included for review in subsequent GRCs.

SEMPRA TEXAS UTILITY

On March 9, 2018, we completed the acquisition of an indirect, 100-percent interest in Oncor Holdings, which owns an 80.25-percent interest in Oncor, and other EFH assets and liabilities unrelated to Oncor. Due to ring-fencing measures, existing governance mechanisms and commitments in effect following the Merger, we are prevented from having the power to direct the significant activities of Oncor Holdings and Oncor. As a result, we account for our 100-percent ownership interest in Oncor Holdings as an equity method investment, which is included in our newly formed reportable segment, Sempra Texas Utility. Certain other assets and liabilities unrelated to Oncor acquired in connection with the Merger were subsumed within our parent organization. We discuss this Merger and the related financing in Notes 1, 5, 6 and 7 of the Notes to Condensed Consolidated Financial Statements herein, and above in "Item 2. MD&A – Capital Resources and Liquidity."

Oncor Performance

The success of the Merger will depend, in part, on the ability of Oncor to successfully execute its business strategy,

including several objectives that are capital intensive, and to respond to challenges in the electric utility industry. If Oncor is not able to achieve these objectives, is not able to achieve these objectives on a timely basis, or otherwise fails to perform in accordance with our expectations, the anticipated benefits of the Merger may not be realized fully or at all and the Merger may materially adversely affect the results of operations, financial condition and prospects of Sempra Energy.

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Absence of Control

In accordance with the ring-fencing measures, existing governance mechanisms and commitments we made in connection with the Merger, we are subject to the following restrictions, among others:

A majority of the independent directors of Oncor must approve any annual or multi-year budget if the aggregate amount of capital expenditures or O&M in such budget is more than a 10 percent increase or decrease from the corresponding amounts of such expenditures in the budget for the preceding fiscal year or multi-year period, as applicable;

Oncor will make minimum aggregate capital expenditures equal to at least $7.5 billion over the period from January 1, 2018 through December 31, 2022 (subject to certain possible adjustments);

Oncor may not pay any dividends or make any other distributions (except for contractual tax payments) if a majority of its independent directors or a minority member director determines that it is in the best interests of Oncor to retain such amounts to meet expected future requirements;

At all times, Oncor will remain in compliance with the debt-to-equity ratio established by the PUCT from time to time for ratemaking purposes, and Oncor will not pay dividends or other distributions (except for contractual tax payments), if that payment would cause its debt-to-equity ratio to exceed the debt-to-equity ratio approved by the PUCT;

If the credit rating on Oncor’s senior secured debt by any of the three major rating agencies falls below BBB (or the equivalent), Oncor will suspend dividends and other distributions (except for contractual tax payments), unless otherwise allowed by the PUCT;

Without the prior approval of the PUCT, neither Sempra Energy nor any of its affiliates (excluding Oncor) will incur, guarantee or pledge assets in respect of any indebtedness that is dependent on the revenues of Oncor in more than a proportionate degree than the other revenues of Sempra Energy or on the stock of Oncor, and there will be no debt at Sempra Texas Holdings Corp. or Sempra Texas Intermediate Holding Company LLC at any time;

Neither Oncor nor Oncor Holdings will lend money to or borrow money from Sempra Energy or any of its affiliates (other than Oncor subsidiaries), or any entity with a direct or indirect ownership interest in Oncor Holdings or Oncor, and neither Oncor Holdings nor Oncor will share credit facilities with Sempra Energy or any of its affiliates (other than Oncor subsidiaries), or any entity with a direct or indirect ownership interest in Oncor Holdings or Oncor;

Oncor will not seek recovery in rates of any expenses or liabilities related to EFH’s bankruptcy, or (1) any tax liabilities resulting from EFH’s spinoff of its former subsidiary Texas Competitive Electric Holdings Company LLC, (2) any asbestos claims relating to non-Oncor operations of EFH or (3) any make-whole claims by holders of debt securities issued by EFH or EFIH, and Sempra Energy was required to and has filed with the PUCT a plan providing for the extinguishment of the liabilities described in items (1) through (3) above, which protects Oncor from any harm;

There must be maintained certain “separateness measures” that reinforce the financial separation of Oncor from Sempra Energy, including a requirement that dealings between Oncor, Oncor Holdings and their subsidiaries and Sempra Energy, any of Sempra Energy’s other affiliates or any entity with a direct or indirect ownership interest in Oncor Holdings or Oncor, must be on an arm’s-length basis, limitations on affiliate transactions, separate recordkeeping requirements and a prohibition on pledging Oncor assets or stock for any entity other than Oncor;

No transaction costs or transition costs related to the Merger (excluding Oncor employee time) will be borne by Oncor’s customers nor included in Oncor’s rates;

Sempra Energy will continue to hold indirectly at least 51 percent of the ownership interests in Oncor Holdings and Oncor for at least five years following the closing of the Merger, unless otherwise specifically authorized by the PUCT; and

Oncor will provide bill credits to customers in an amount equal to 90 percent of any interest rate savings achieved due to any improvement in its credit ratings or market spreads compared to those as of June 30, 2017 until final rates are set in the next Oncor base rate case filed after PUCT Docket No. 46957 (except that savings will not be included in credits if already realized in rates); and one year after the Merger, Oncor will provide bill credits to its customers equal to 90 percent of any synergy savings until final rates are set in the next Oncor base rate proceeding after PUCT Docket No. 46957, at which time any total synergy savings shall

be reflected in Oncor’s rates.

As a result of these ring-fencing measures, governance mechanisms and commitments, we do not control Oncor Holdings or Oncor, and we have limited ability to direct the management, policies and operations of Oncor Holdings and Oncor, including the deployment or disposition of their assets, declarations of dividends, strategic planning and other important corporate issues and actions. We have limited representation on the Oncor Holdings and Oncor boards of directors, which are controlled by independent directors. In addition, we are not allowed to make loans to Oncor Holdings or Oncor. The existence of these ring-fencing measures and other limitations may increase our costs of financing. Further, the Oncor directors have considerable autonomy and, as described in our commitments, have a duty to act in the best interest of Oncor consistent with the approved ring-fence and Delaware law, which may be contrary to our best interests or be in opposition to our preferred strategic direction for Oncor. To the extent that they take actions that are not in our interests, the financial condition, results of operations and prospects of Sempra Energy may be materially adversely affected.

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Key Personnel at Oncor

If, despite efforts to retain certain key personnel at Oncor, any key personnel depart or fail to continue employment as a result of the Merger, the loss of the services of such personnel and their experience and knowledge could adversely affect Oncor's results of operations, financial condition and prospects and the successful ongoing operation of its business, which could also have a material adverse effect on the results of operations, financial condition and prospects of Sempra Energy.

SEMPRA SOUTH AMERICAN UTILITIES

Regulated Rates

Chilquinta Energía's most recent review process for zonal transmission rates was completed in September 2017 and we expect final approval in the second half of 2018. Upon approval, the transmission rates will cover the period from January 2018 through December 2019, which we do not expect to have a material impact on our results.

Luz del Sur - Potential Impact from Tolling Customers

Luz del Sur is an electric distribution utility that provides electric services, including the supply of electricity, to regulated and non-regulated customers. Non-regulated customers consist of free and tolling customers. Luz del Sur supplies electricity to its customers from power purchased from generators under long-term, take-or-pay PPAs. A free customer has the option of purchasing electricity directly from Luz del Sur, while paying fees to Luz del Sur for generation, transmission (primary and secondary) and distribution services, or choosing to become a tolling customer. A tolling customer purchases electricity from alternative suppliers and pays only a tolling fee to Luz del Sur for secondary transmission and distribution. To the extent customers have the right to and choose to become tolling customers, Luz del Sur may be exposed to stranded costs related to capacity charges under its long-term, take-or-pay PPAs. We discuss Luz del Sur's customers and demand in "Item 1. Business" in the Annual Report.

SEMPRA MEXICO

Capital Project Updates

We summarize below updates regarding major capital projects at Sempra Mexico.

CAPITAL PROJECTS – SEMPRA MEXICO

Project description	Estimated capital cost (in millions)	Status
Terminals at Port of Veracruz, Puebla and Mexico City		
§ Awarded a 20-year concession in July 2017 to build and operate a marine terminal in the Port of Veracruz in Mexico for the receipt, storage and delivery of liquid fuels.	$ 170	§ Expected completion of marine terminal: third quarter of 2019
§ Working capacity of 1.4 million barrels of gasoline, diesel and jet fuel to supply the central region of Mexico.		§ Planned storage capacity increased to 2.1 million barrels.
§ IEnova will also build and operate two storage terminals located near Puebla and Mexico City with storage capacities of 500,000 and 800,000 barrels, respectively.	$ 145	§ Expected completion of two inland storage terminals: third quarter of 2019
§ Entered into three, long-term, U.S. dollar-denominated terminal services agreements in July 2017 with Valero Energy for the full capacity of the marine terminal and the two inland storage terminals.		§ Storage capacities at the Puebla and Mexico City terminals have been reallocated to 650,000 barrels each.
§ Pursuant to these agreements, Valero Energy has the option to purchase a 50-percent interest in each of the three terminals after commencement of commercial operations, subject to approval by the Port of Veracruz, COFECE, the CRE and other regulatory bodies.		
Don Diego Solar Complex		
§ Plan to develop, construct and operate a 125-MW photovoltaic project located in Sonora, Mexico.	$ 130	§ Estimated completion: second half of 2019
§ In February 2018, entered into a 15-year, U.S. dollar-denominated PPA with various subsidiaries of El Puerto de Liverpool, S.A.B. de C.V. for a portion of the capacity.		

Baja Refinados Terminal

§ Plan to develop, construct and operate a liquid fuels marine storage terminal within the La Jovita Energy Center, located 23 km north of Ensenada, Baja California, Mexico.	$ 130	§ Estimated completion: second half of 2020
§ Capacity of 1 million barrels of hydrocarbons, primarily gasoline and diesel, to increase fuel supply capacity and reliability in Baja California.		
§ In April 2018, entered into two long-term contracts for the receipt, storage and delivery of hydrocarbons with Chevron Combustibles de México S. de R.L. de C.V. and another global oil company for 100 percent of the terminal's storage capacity. Both contracts contain an option for the customer to acquire 20 percent of the equity of the terminal after commercial operations begin.		

Topolobampo Port Administration Terminal

§ Plan to develop, construct and operate a marine terminal for the receipt and storage of hydrocarbons, petroleum, petrochemicals and other liquids.	$ 150	§ Estimated completion: fourth quarter of 2020
§ Storage capacity of 1 million barrels, mainly for diesel and gasoline, to increase fuel supply sources and reliability in Sinaloa.		
§ In July 2018, entered into 10-year and 15-year, U.S. dollar denominated contracts for the receipt, storage and delivery of hydrocarbons with two refining and fuel marketing companies for 100 percent of the capacity. Both contracts have the potential to be extended to 20 years.		

Energía Costa Azul LNG Terminal

As we discuss in "Item 7. MD&A – Factors Influencing Future Performance" in the Annual Report, Sempra LNG & Midstream and IEnova are developing a proposed natural gas liquefaction project at IEnova's existing regasification terminal at ECA. In 2015, Sempra LNG & Midstream and IEnova entered into a project development agreement with a subsidiary of PEMEX; however, PEMEX's cost sharing obligations under that agreement ended on December 31, 2017. In June 2018, we selected a

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TechnipFMC plc and Kiewit Corporation partnership as the EPC contractor for the proposed ECA LNG liquefaction facility project. The TechnipFMC-Kiewit partnership is to perform the engineering, planning and related activities necessary to prepare, negotiate and finalize a definitive EPC contract for the project. The proposed liquefaction facility project is being developed to provide buyers with direct access to west coast LNG supplies. The development of this project is subject to numerous risks and uncertainties, including the receipt of a number of permits and regulatory approvals; finding suitable partners and customers; obtaining financing; negotiating and completing suitable commercial agreements, including a definitive EPC contract, joint venture agreements, LNG sales agreements and gas supply and transportation agreements; reaching a final investment decision; and other factors associated with this potential investment. For a discussion of these risks, see “Item 1A. Risk Factors” in the Annual Report.

Termoeléctrica de Mexicali

On June 1, 2018, management formalized its decision not to sell TdM, and the assets and liabilities that were previously classified as held for sale were reclassified as held and used, as we discuss in Note 5 of the Notes to Condensed Consolidated Financial Statements herein.

SEMPRA RENEWABLES

As we discuss in Notes 5, 6 and 9 of the Notes to Condensed Consolidated Financial Statements herein, on June 25, 2018, our board of directors approved a plan to sell all our U.S. wind assets and U.S. solar assets, including our wholly and jointly owned operating facilities and projects in development, comprising our Sempra Renewables reportable segment (the Renewables Sale). These wholly and jointly owned assets include operating wind and solar facilities with a total generating capacity of 1,335 MW and 1,262 MW, respectively. As a result, in June 2018, we classified Sempra Renewables’ consolidated assets and liabilities as held for sale. Although Sempra Renewables’ wind and solar equity method investments are included in the plan of sale, we continue to classify them as Other Investments. Because of our expectation of a shorter holding period as a result of this plan of sale, we evaluated the recoverability of the carrying amounts of our wind and solar equity method investments and concluded there is an other-than-temporary impairment on certain of our wind equity method investments totaling $200 million ($145 million after tax), which we recorded in Equity (Losses) Earnings.

We are actively pursuing the Renewables Sale, which we expect to be completed in 2019. Successful completion of a sale and the timing of such sale is subject to a number of risks and uncertainties, including identifying one or more acceptable buyers, negotiating and entering into definitive agreements for the Renewables Sale that are expected to be subject to various customary closing conditions, and obtaining the necessary third-party approvals and consents.

Sempra Renewables’ financial performance is primarily a function of the solar and wind power generated by its assets. Power generation from these assets depends on solar and wind resource levels, weather conditions, and Sempra Renewables’ ability to maintain equipment performance. The demand for renewable energy is impacted by various market factors, most notably state mandated requirements for utilities to deliver a portion of total energy load from renewable energy sources. Additionally, the phase out or extension of U.S. federal income tax incentives, primarily investment tax credits and production tax credits, and grant programs could significantly impact future renewable energy resource availability and investment decisions. Imposition by the U.S. government of ad valorem tariffs, import quotas or other import restrictions related to solar panels could materially adversely affect Sempra Renewables’ business, investment decisions and the demand for renewable energy in the U.S. Any adverse impact on Sempra Renewables or its assets from the foregoing may also adversely impact the valuation of the assets pursuant to the Renewables Sale by potential buyers, which may in turn impair our ability to successfully complete our sale of those assets.

We may be unable to implement the Renewables Sale in whole or in part, in which case we would not realize the anticipated benefits. Alternatively, even if implemented, the Renewables Sale may not result in the anticipated benefits to our business, results of operations and financial condition in a timely manner or at all. Further, we could experience unexpected delays, business disruptions resulting from supporting this initiative during and following completion of these activities, decreased productivity, adverse effects on employee morale and employee turnover as a result of such initiative, any of which may impair our ability to achieve anticipated results or otherwise harm our business, results of operations and financial condition.

Capital Project Updates

We summarize below the completion of a solar project in 2018 at Sempra Renewables.

CAPITAL PROJECT COMPLETED IN 2018 – SEMPRA RENEWABLES

Project description	
Great Valley Solar Project	
§ Capable of producing up to 200 MW of solar power, located in Fresno County, California, acquired in July 2017. § Fully contracted under four PPAs with an average contract term of 18 years.	§ Commercial operation dates and corresponding contracted energy sales commenced in four phases. Three phases commenced in the fourth quarter of 2017 and the final phase commenced in April 2018.

SEMPRA LNG & MIDSTREAM

Cameron LNG JV Three-Train Liquefaction Project

Construction on the current three-train liquefaction project began in the second half of 2014 under an EPC contract with a joint venture between CB&I, LLC (as assignee of CB&I Shaw Constructors, Inc.), a wholly owned subsidiary of Chicago Bridge & Iron Company N.V., and Chiyoda International Corporation, a wholly owned subsidiary of Chiyoda Corporation.

The total cost of the integrated Cameron LNG JV facility, including the cost of the original facility that was contributed to the joint venture interest during construction, financing costs and required reserves, was estimated to be approximately $10 billion at the time of our final investment decision.

Sempra LNG & Midstream has agreements totaling 1.45 Bcf per day of firm natural gas transportation service to the Cameron LNG JV facilities on the Cameron Interstate Pipeline with TOTAL S.A. and affiliates of Mitsubishi Corporation and Mitsui & Co., Ltd. The terms of these agreements are concurrent with the liquefaction and regasification tolling capacity agreements.

Sempra Energy and the project partners executed project financing documents for senior secured debt in an aggregate principal amount up to $7.4 billion for the purpose of financing the cost of development and construction of the Cameron LNG JV liquefaction project. Sempra Energy has entered into guarantees under which it has severally guaranteed 50.2 percent of Cameron LNG JV's obligations under the project financing and financing-related agreements, for a maximum amount of up to $3.9 billion. The project financing and completion guarantees became effective on October 1, 2014, and the guarantees will terminate upon financial completion of the project, which will occur upon satisfaction of certain conditions, including all three trains achieving commercial operation and meeting certain operational performance tests. We expect the project to achieve financial completion and the completion guarantees to be terminated approximately nine months after all three trains achieve commercial operation.

Large-scale construction projects like the design, development and construction of the Cameron LNG JV liquefaction facility involve numerous risks and uncertainties, including among others, the potential for unforeseen engineering challenges, substantial construction delays and increased costs. Cameron LNG JV has a turnkey EPC contract, and if the contractor becomes unwilling or unable to perform according to the terms and timetable of the EPC contract, the project could face substantial construction delays and potentially significantly increased costs. If the contractor's delays or failures are serious enough to cause the contractor to default under the EPC contract, such default could result in Cameron LNG JV's engagement of a substitute contractor. In October 2016, the EPC contractor indicated that

the Cameron LNG project would not achieve its originally scheduled dates for completion and subsequently provided project schedules reflecting further delays to the Cameron LNG project.

During the course of construction of large projects like Cameron LNG, contractors often assert that they are owed additional compensation, schedule extensions, or both. Cameron LNG JV received information from the EPC contractor claiming it was owed additional amounts beyond the contract value and entitled to schedule extensions, including as a result of the impacts of Hurricane Harvey and other events impacting the project. In December 2017, Cameron LNG JV entered into a Settlement Agreement with the EPC contractor that settled claims by the EPC contractor that it was owed additional compensation beyond the original contract price and that it was entitled to schedule extensions under the EPC contract. The Settlement Agreement resolves all of the EPC contractor’s known and unknown claims prior to December 17, 2017 and became effective in January 2018.

Under the Settlement Agreement, Cameron LNG JV has agreed to additional contract and bonus payments. These payments are subject to the EPC contractor’s achievement of certain milestones, including milestones aligned to the completion of commissioning the LNG trains. In addition, the bonus payments become payable only if the EPC contractor satisfies certain

additional milestones. The Settlement Agreement waives schedule-related liquidated damages related to the original contract schedule and reestablishes the start dates for such liquidated damages according to the settlement schedule. Based on a number of factors, we continue to believe it is reasonable to expect that all three trains at the Cameron LNG JV liquefaction facility will begin producing LNG in 2019 and that Cameron LNG JV will start generating earnings in 2019. These factors include, among others, the terms of the Settlement Agreement, the project schedules received from the EPC contractor, Cameron LNG JV's own review of the project schedules, the assumptions underlying such schedules, the EPC contractor's progress to date, the remaining work to be performed, and the inherent risks in constructing and testing facilities such as the Cameron LNG JV liquefaction facility. For a discussion of the Cameron LNG JV and of these risks and other risks relating to the development of the Cameron LNG JV liquefaction project that could adversely affect our future performance, see Note 4 of the Notes to Consolidated Financial Statements and "Item 1A. Risk Factors" in the Annual Report.

These delays in the project and the terms of the Settlement Agreement increased the total estimated cost of the integrated Cameron LNG facility above the approximately $10 billion estimated cost; however, the estimated increase is expected to be within the project contingency established by the Cameron LNG JV at the time of the final investment decision for the project in August 2014 and is not expected to be material to Sempra Energy.

Proposed Additional Cameron Liquefaction Expansion

Cameron LNG JV has received the major permits and FTA and non-FTA approvals necessary to expand the current configuration of the Cameron LNG JV liquefaction project from the current three liquefaction trains under construction. The proposed expansion project includes up to two additional liquefaction trains, capable of increasing LNG production capacity by approximately 9 Mtpa to 10 Mtpa, and up to two additional full containment LNG storage tanks (one of which was permitted with the original three-train project).

Under the Cameron LNG JV financing agreements, expansion of the Cameron LNG JV facilities beyond the first three trains is subject to certain restrictions and conditions, including among others, timing restrictions on expansion of the project unless appropriate prior consent is obtained from lenders. Under the Cameron LNG JV equity agreements, the expansion of the project requires the unanimous consent of all the partners, including with respect to the equity investment obligation of each partner. Discussions among the partners have been taking place regarding how an expansion may be structured. On July 13, 2018, TOTAL S.A. acquired Engie S.A.'s interest in the Cameron LNG JV. We expect that discussions on the potential expansion will continue among the new Cameron LNG JV member group. There can be no assurance that a mutually agreeable expansion structure will be agreed upon among the Cameron LNG JV members, which if not accomplished in a timely manner, could materially and adversely impact the development of the expansion project. In light of this, we are unable to predict when we and/or Cameron LNG JV might be able to move forward on this expansion project.

The expansion of the Cameron LNG JV facilities beyond the first three trains is subject to a number of risks and uncertainties, including amending the Cameron LNG JV agreement among the partners, obtaining customer commitments, completing the required commercial agreements, securing and maintaining all necessary permits, approvals and consents, obtaining financing, reaching a final investment decision among the Cameron LNG JV partners, and other factors associated with the potential investment. See "Item 1A. Risk Factors" in the Annual Report.

Other LNG Liquefaction Development

Design, regulatory and commercial activities are ongoing for potential LNG liquefaction developments at our Port Arthur, Texas site and at Sempra Mexico's ECA facility. For these development projects, we have met with potential customers and determined there is an interest in long-term contracts for LNG supplies beginning in the 2022 to 2025 time frame.

Port Arthur

As we discuss in "Item 7. MD&A – Factors Influencing Future Performance" in the Annual Report, Sempra LNG & Midstream is currently seeking authorization to site, construct and operate the proposed Port Arthur LNG natural gas liquefaction and export facility in Port Arthur, Texas.

The proposed project is designed to include:

two natural gas liquefaction trains with a nameplate capacity of 13.5 Mtpa of LNG and an expected export capability of approximately 11 Mtpa of LNG or 1.6 Bcf per day;

up to three LNG storage tanks;
natural gas liquids and refrigerant storage;
feed gas pre-treatment facilities; and

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two berths and associated marine and loading facilities.
In February 2018, Sempra LNG & Midstream and Woodside Petroleum Ltd. entered into a project development agreement, which replaced a prior agreement between the parties, for the joint development of the proposed Port Arthur LNG liquefaction project. On July 19, 2018, the parties terminated the project development agreement. As a result, Woodside Petroleum Ltd. is no longer participating in the development of the Port Arthur LNG liquefaction project.
In June 2018, we selected Bechtel as the EPC contractor for the proposed Port Arthur LNG liquefaction project. Bechtel is to perform the engineering, execution planning and related activities necessary to prepare, negotiate and finalize a definitive EPC contract for the project. Additionally, on June 26, 2018, Polish Oil & Gas Company and Port Arthur LNG entered into a preliminary agreement relating to the terms of a potential 20-year contract for the sales and purchase of 2 Mtpa of LNG per year. The current arrangements with Bechtel and Polish Oil & Gas Company do not commit any party to enter into a definitive EPC contract or LNG sales and purchase agreement or otherwise participate in the project.
Development of the Port Arthur LNG liquefaction project is subject to a number of risks and uncertainties, including obtaining customer commitments, completing the required commercial agreements, such as joint venture agreements, LNG sales agreements, gas supply agreements and an EPC contract; completing construction contracts; securing all necessary permits and approvals; obtaining financing and incentives; reaching a final investment decision; and other factors associated with the potential investment. See "Item 1A. Risk Factors" in the Annual Report.

Energía Costa Azul

We further discuss Sempra LNG & Midstream's participation in potential LNG liquefaction development at Sempra Mexico's ECA facility above in "Sempra Mexico – Energía Costa Azul LNG Terminal."

Natural Gas Storage Assets

As we discuss in Notes 5 and 9 of the Notes to Condensed Consolidated Financial Statements herein, on June 25, 2018, our board of directors approved a plan to sell Mississippi Hub and our 90.9-percent ownership interest in Bay Gas. Because of the plan of sale, we classified these non-utility natural gas storage assets as held for sale and recorded them at the lower of their carrying values and fair values less costs to sell. We also own other U.S. midstream assets that are not included in the plan of sale, primarily comprised of our 75.4-percent interest in LA Storage, a salt cavern development project in Cameron Parish, Louisiana. The LA Storage project also includes an existing 23.3-mile pipeline header system that is not currently contracted. Our inability to secure customer contracts that would support further investment in L.A. Storage has led us to conclude that the full carrying value of these other U.S. midstream assets may not be recoverable. Because of these events, in June 2018, we recognized an impairment charge on the non-utility natural gas storage assets and other U.S. midstream assets totaling $1.3 billion ($755 million after tax and noncontrolling interests) in Impairment Losses.
We are actively pursuing the sale of Sempra LNG & Midstream's non-utility natural gas storage assets (the Midstream Sale), which we expect to be completed in 2019. Successful completion of a sale and the timing of such sale is subject to a number of risks and uncertainties, including identifying one or more acceptable buyers, negotiating and entering into definitive agreements for the Midstream Sale that are expected to be subject to various customary closing conditions, and obtaining the necessary third-party approvals and consents.
We may be unable to implement the Midstream Sale in whole or in part, in which case we would not realize the anticipated benefits. Alternatively, even if implemented, the Midstream Sale may not result in the anticipated benefits to our business, results of operations and financial condition in a timely manner or at all. Further, we could experience unexpected delays, business disruptions resulting from supporting this initiative during and following completion of these activities, decreased productivity, adverse effects on employee morale and employee turnover as a result of such initiative, any of which may impair our ability to achieve anticipated results or otherwise harm our business, results of operations and financial condition.

RBS SEMPRA COMMODITIES

For a discussion about RBS Sempra Commodities, see "Item 7. MD&A – Factors Influencing Future Performance" in the Annual Report and in Note 11 of the Notes to Condensed Consolidated Financial Statements herein.

OTHER SEMPRA ENERGY MATTERS

For a discussion about Other Sempra Energy Matters, see “Item 7. MD&A – Factors Influencing Future Performance” in the Annual Report.

LITIGATION

We describe legal proceedings that could adversely affect our future performance in Note 11 of the Notes to Condensed Consolidated Financial Statements herein.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We view certain accounting policies as critical because their application is the most relevant, judgmental, and/or material to our financial position and results of operations, and/or because they require the use of material judgments and estimates. We discuss these accounting policies in “Item 7. MD&A” in the Annual Report.

We describe our significant accounting policies in Note 1 of the Notes to Consolidated Financial Statements in the Annual Report. We follow the same accounting policies for interim reporting purposes.

NEW ACCOUNTING STANDARDS

We discuss the relevant pronouncements that have recently been issued or become effective and have had or may have an impact on our financial statements and/or disclosures in Note 2 of the Notes to Condensed Consolidated Financial Statements herein.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We provide disclosure regarding derivative activity in Note 8 of the Notes to Condensed Consolidated Financial Statements herein. We discuss our market risk and risk policies in detail in “Item 7A. Quantitative and Qualitative Disclosures about Market Risk” in the Annual Report.

INTEREST RATE RISK

The table below shows the nominal amount of long-term debt:

NOMINAL AMOUNT OF LONG-TERM DEBT[1]

(Dollars in millions)

	June 30, 2018			December 31, 2017		
	Sempra Energy Consolidated	SDG&E	SoCalGas	Sempra Energy Consolidated	SDG&E	SoCalGas
California Utilities fixed-rate	$8,154	$5,245	$ 2,909	$7,877	$4,868	$ 3,009
Other fixed-rate	11,543	—	—	8,367	—	—
Other variable-rate	2,105	—	—	907	—	—

(1) *After the effects of interest rate swaps. Before the effects of acquisition-related fair value adjustments, reductions/increases for unamortized discount/premium and reduction for debt issuance costs, and excluding capital lease obligations and build-to-suit lease.*

Interest rate risk sensitivity analysis measures interest rate risk by calculating the estimated changes in earnings that would result from a hypothetical change in market interest rates. If interest rates increased or decreased by 10 percent on all of Sempra Energy’s effective variable-rate, long-term debt at June 30, 2018, the change in earnings over the next 12-month period ended June 30, 2019 would be approximately $4 million. These hypothetical changes in earnings are based on our long-term debt position after the effect of interest rate swaps.

FOREIGN CURRENCY AND INFLATION RATE RISK

We discuss our foreign currency and inflation exposure in “Item 2. MD&A – Impact of Foreign Currency and Inflation Rates on Results of Operations” herein and in “Item 7. MD&A – Impact of Foreign Currency and Inflation Rates on Results of Operations” in the Annual Report. At June 30, 2018, there were no significant changes to our exposure to foreign currency rate risk since December 31, 2017.

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Sempra Energy, SDG&E and SoCalGas have designed and maintain disclosure controls and procedures to ensure that information required to be disclosed in their respective reports is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and is accumulated and communicated to the management of each company, including each respective principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure. In designing and evaluating these controls and procedures, the management of each company recognizes that any system of controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives; therefore, the management of each company applies judgment in evaluating the cost-benefit relationship of other possible controls and procedures.
Under the supervision and with the participation of management, including the principal executive officers and principal financial officers of Sempra Energy, SDG&E and SoCalGas, each company evaluated the effectiveness of the design and operation of its disclosure controls and procedures as of June 30, 2018, the end of the period covered by this report. Based on these evaluations, the principal executive officers and principal financial officers of Sempra Energy, SDG&E and SoCalGas concluded that their respective company’s disclosure controls and procedures were effective at the reasonable assurance level.

INTERNAL CONTROL OVER FINANCIAL REPORTING

There have been no changes in the companies’ internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the companies’ internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not party to, and our property is not the subject of, any material pending legal proceedings (other than ordinary routine litigation incidental to our businesses) except for the matters 1) described in Notes 10 and 11 of the Notes to Condensed Consolidated Financial Statements herein and in Notes 13 and 15 of the Notes to Consolidated Financial Statements in the Annual Report, or 2) referred to in “Item 2. MD&A” herein or in “Item 7. MD&A” in the Annual Report.

ITEM 1A. RISK FACTORS

When evaluating our company and its subsidiaries, we urge you to carefully consider the risks and other information in this Quarterly Report on Form 10-Q, including the factors discussed in “Item 2. MD&A – Factors Influencing Future Performance,” as well as the risk factors disclosed in “Item 1A. Risk Factors” in the Annual Report and the risk factors discussed below. Except as set forth below, there have been no material changes from the risk factors as previously disclosed in the Annual Report. Any of

the risks and other information discussed in this Quarterly Report on Form 10-Q or any of the risks disclosed in "Item 1A. Risk Factors" in the Annual Report, as well as additional risks and uncertainties not currently known to us or that we currently deem immaterial, could materially and adversely affect our businesses, cash flows, results of operations, financial condition, prospects and/or the trading prices of our securities or those of our subsidiaries.

Risks Related to Sempra Energy Subsidiaries

We may be unable to realize the anticipated benefits from our plan to divest certain of our assets as part of our capital rotation plan.

On June 28, 2018, we announced that our board of directors approved a plan to divest certain non-utility natural gas storage assets in the southeast U.S. and all our U.S. wind and U.S. solar assets (collectively, the Assets). Any potential sale will depend on a number of factors that may be beyond our control, including, but not limited to, market conditions, industry trends, consent rights or other rights granted to or held by third parties and the availability of financing to potential buyers on reasonable terms, and there can be no assurance that this plan will result in the identification or consummation of any sale or that any such sale, if completed, would be completed on terms that would result in additional value to our shareholders.

If we do not successfully manage our current capital rotation plan, or any other capital rotation plan that we may initiate in the future, any expected efficiencies and benefits might be delayed or not realized, and our operations and business could be disrupted. In addition, on June 29, 2018, Moody's indicated that a timely and efficient execution of the divestiture of the Assets has the potential to be credit supportive, but is subject to high execution risk. If we are unable to successfully complete the disposition of the Assets in a timely or efficient manner, this could be viewed negatively by Moody's or other credit ratings agencies.

In addition, as we discuss in Notes 5 and 9 of the Notes to Condensed Consolidated Financial Statements herein, we recorded impairment charges related to certain of the Assets totaling $1.5 billion ($900 million after tax and noncontrolling interests) in June 2018. These charges include $1.3 billion ($755 million after tax and noncontrolling interests) at Sempra LNG & Midstream and $200 million ($145 million after tax) at Sempra Renewables. These impairment charges result primarily from adjusting the related Assets' carrying values to estimated fair values, less costs to sell when applicable. Other than the costs to sell, we do not expect that any of the impairment charges will result in future cash expenditures. However, if we are unable to complete the plan of sale, or if the sale prices are lower or the costs to sell are higher than currently expected, additional impairment charges may be recorded, and/or the sale of the Assets could result in additional losses, which could be significant.

Our business could be negatively affected as a result of actions of activist shareholders.

As described under "MD&A – Factors Influencing Future Performance," on June 11, 2018, Elliott Associates, L.P. and Elliott International, L.P. (collectively, Elliott) and Bluescape Resources Company LLC (Bluescape), collectively holders of an approximately 4.9-percent economic interest in our outstanding common stock as of such date, delivered a letter and accompanying presentation to our board of directors seeking collaboration with them and management to nominate six new directors identified by Elliott and Bluescape and establish a committee of the board of directors to conduct portfolio and operational reviews of our business. Elliott and Bluescape have also proposed, among other things, that we dispose of our interests in our South American utility subsidiaries and IEnova, and that we spin off our interest in Cameron LNG JV and certain other pipeline assets.

While we strive to maintain constructive, ongoing communications with all of our shareholders, and welcome their views and opinions with the goal of enhancing value for all shareholders, activist shareholders may, from time to time, engage in proxy solicitations or advance shareholder proposals, or otherwise attempt to effect changes and assert influence on our board of directors and management. Responding to proposals by activist shareholders may, and responding to a proxy contest instituted by shareholders would, require us to incur significant legal and advisory fees, proxy solicitation expenses (in the case of a proxy contest) and administrative and associated costs and require significant time and attention by our board of directors and management, diverting their attention from the pursuit of our business strategy. Any perceived uncertainties as to our future direction and control, our ability to execute on our strategy, or changes to the composition of our board of directors or senior management team arising from proposals by activist shareholders or a proxy contest could lead to the perception of a change in the direction of our business or instability which may be exploited by our competitors, result in the loss of potential business opportunities, and make

it more difficult to pursue our strategic initiatives or attract and retain qualified personnel and business partners, any of which could have an adverse effect, which may be material, on our business and operating results. We may choose to initiate, or may become subject to, litigation as a result of proposals by activist shareholders or proxy contests or matters relating thereto, which would serve as a further distraction to our board of directors and management and could require us to incur significant additional costs.

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In addition, actions such as those described above could cause significant fluctuations in the trading prices of our common stock and our preferred stock, based on temporary or speculative market perceptions or other factors that do not necessarily reflect the underlying fundamentals and prospects of our business. As we continue to engage in discussions with Elliott and Bluescape, the trading prices of our common stock and our preferred stock may be subject to significant fluctuations, including as a result of actions taken by activist shareholders and our responses thereto, which may be material.

Likewise, to the extent that we implement any proposals made by Elliott and Bluescape to restructure our board of directors, dispose of assets or businesses, make certain investments or expenditures or change certain aspects of our strategy, or similar proposals made by any of our shareholders or pursuant to a proxy contest, the resulting changes in our business, assets, results of operations and financial condition may be material and may have an impact, which may be material, on the market prices of our common stock and our preferred stock, and may also cause substantial volatility in the trading price of those securities.

Certain credit rating agencies may downgrade our credit ratings or place those ratings on negative outlook.

Credit rating agencies routinely evaluate us, and their ratings of our long-term and short-term debt are based on a number of factors, including the perceived supportiveness of the regulatory environment affecting our utility operations, our cash generating capability, level of indebtedness, overall financial strength, the status of certain capital projects, and most recently the indebtedness used to fund the Oncor Merger, as well as factors beyond our control, such as tax reform, the state of the economy and our industry generally.

The credit ratings of Sempra Energy, SDG&E and SoCalGas remained at investment grade levels during the first six months of 2018. Moody’s and S&P have issued public comments and reports regarding the risk of an increase in California wildfires and the current California regulatory environment, which may prohibit California utilities from recovering any uninsured wildfire costs in cases where the doctrine of inverse condemnation is applied to impose strict liability on a utility (meaning that the utility may be found liable without evidence of its negligence) whose equipment is determined to be the cause of a fire. On April 11, 2018, Moody’s changed its rating outlook for SDG&E to negative from stable. Moody’s indicated that SDG&E’s credit profile is weighed down by potential for large contingent exposure created by the application of inverse condemnation and that the increasing inverse condemnation risk exposure has caused Moody’s to reassess its view of the credit supportiveness of the regulatory environment in California. Moody’s also indicated that the negative outlook reflects the adverse impact of the TCJA on SDG&E’s financial performance going forward. The April 11, 2018 Moody’s announcement also indicated that SDG&E’s credit ratings could be downgraded if its ratio of cash flow from operations before changes in working capital to debt falls below 25 percent on a sustained basis or if there is little meaningful progress in addressing inverse condemnation via changes in legislation and/or regulation in California which significantly reduces the exposure of electric utilities operations to strict liability in connection with wildfires.

S&P issued a public comment on June 18, 2018 regarding its view that the recent heightened risks associated with natural disasters, including wildfires, earthquakes and mudslides, combined with California courts’ application of inverse condemnation, significantly increases SDG&E’s, SoCalGas’, Sempra Energy’s and the other California investor-owned utilities’ potential contingent liabilities and reduces their credit quality. S&P further noted that if the key issues related to California’s liability rules and regulations for utilities are not resolved in an expedited manner, S&P may change its assessment of the California regulatory environment and that this could ultimately result in ratings below investment grade for California utilities that are the most affected by wildfires. Further, on July 9, 2018, S&P reaffirmed its credit ratings for Sempra Energy, SDG&E and SoCalGas, but changed its outlook of each such rating to negative from stable. S&P indicated that the negative outlook reflects the possibility that the California legislature may not pass a bill within the current legislative session (ending August 31, 2018) that establishes a transparent standard for California utilities to recover wildfire-related costs and limits the risks borne by California’s electric utilities for natural disasters, including wildfires. If the legislature does not pass such a bill during its current session, S&P indicated that it would likely downgrade Sempra Energy’s and SoCalGas’ credit ratings by one notch and SDG&E’s credit ratings by three notches, which would result in a rating of BBB for Sempra Energy’s senior unsecured debt, A for SoCalGas’ senior secured debt and BBB+ for SDG&E’s senior secured debt. We discuss the 2007 wildfires and wildfire cost recovery further in Note 15 of the Notes to Consolidated Financial Statements in the Annual Report

and in Note 11 of the Notes to Condensed Consolidated Financial Statements herein.

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Prior to completion of the Oncor Merger in March 2018, credit rating agencies issued comments regarding the possible negative impact of, among other things, the financing structure for the Merger on our credit ratings. On January 9, 2018, Moody's indicated that the debt Sempra Energy incurred to fund a portion of the cost of the Oncor Merger was credit negative and that there was uncertainty regarding the impact of the TCJA on our credit metrics, and further indicated the Moody's negative outlook reflected its expectation that our ratio of cash flow from operations before changes in working capital to debt will remain weak and will be more commensurate with the mid-range of the Baa-rating category. Further, on June 25, 2018, Moody's placed Sempra Energy's credit ratings on review for downgrade. Moody's indicated that the review was triggered by, among other things, the increased leverage to fund the Oncor Merger, execution risk associated with any initiatives that we may undertake to improve our credit quality, and uncertainty regarding the timing and extent of potential recovery of Sempra Energy's consolidated financial metrics. On June 29, 2018, Moody's then indicated that the first phase of the capital rotation plan we announced on June 28, 2018 as described above in "MD&A – Factors Influencing Future Performance," if successfully implemented in a timely and efficient manner, has the potential to be credit supportive because, among other things, our planned divestiture of the Assets and the Oncor Merger would reduce our exposure to unregulated and merchant power operations and improve our consolidated risk profile, and that the Oncor Merger provides regulatory diversification to our overall portfolio, reducing our consolidated business risk profile. However, Moody's noted there is high execution risk that our capital rotation plan will not be implemented in a timely or efficient matter, or at all, and that several milestones must occur over the next several years, including the successful completion of the sale of the Assets, while we continue to produce key financial credit metrics that are weak relative to our current credit rating category.

The recent Moody's and S&P actions with respect to Sempra Energy, SDG&E and SoCalGas, any downgrade of the credit ratings of Sempra Energy or any of its subsidiaries by S&P, Fitch Ratings or Moody's, or any additional negative outlook on those credit ratings may adversely affect the market prices of our common stock and our preferred stock, the rates at which borrowings bear interest and the commitment fees on available unused credit, which could make it more costly for us to issue debt securities, to borrow under our credit facilities and to raise certain other types of financing. We provide additional information about our credit ratings at Sempra Energy, SDG&E and SoCalGas in "Item 7. MD&A – Credit Ratings" in the Annual Report.

ITEM 6. EXHIBITS

The following exhibits relate to each registrant as indicated.

EXHIBIT 3 -- BYLAWS AND ARTICLES OF INCORPORATION

Sempra Energy

3.1	Certificate of Determination of the 6.75% Mandatory Convertible Preferred Stock, Series B, of Sempra Energy (including the form of certificate representing the 6.75% Mandatory Convertible Preferred Stock, Series B), filed with the Secretary of State of the State of California and effective July 11, 2018 (Form 8-K filed on July 13, 2018, Exhibit 3.1).

EXHIBIT 4 -- INSTRUMENTS DEFINING THE RIGHTS OF SECURITY HOLDERS, INCLUDING INDENTURES

Sempra Energy agrees to furnish a copy of the following instrument to the Commission upon request:

4.1	Certificate of Determination of the 6.75% Mandatory Convertible Preferred Stock, Series B, of Sempra Energy (including the form of certificate representing the 6.75% Mandatory Convertible Preferred Stock, Series B), filed with the Secretary of State of the State of California and effective July 11, 2018 (Form 8-K filed on July 13, 2018, Exhibit 3.1).

EXHIBIT 10 -- MATERIAL CONTRACTS

Sempra Energy

10.1	Confirmation of Registered Forward Transaction, dated July 10, 2018, by and between Sempra Energy and Citibank, N.A. (Form 8-K filed on July 13, 2018, Exhibit 1.3).

10.2	Confirmation of Registered Forward Transaction, dated July 10, 2018, by and between Sempra Energy and JPMorgan Chase Bank, National Association, London Branch (Form 8-K filed on July 13, 2018, Exhibit 1.4).

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Sempra Energy/San Diego Gas & Electric Company/Southern California Gas Company

Compensation

10.3 Amended and Restated Severance Pay Agreement between Sempra Energy and Jeffrey W. Martin, dated May 1, 2018.

10.4 Amended and Restated Severance Pay Agreement between Sempra Energy and Joseph A. Householder, dated May 1, 2018.

10.5 Amended and Restated Severance Pay Agreement between Sempra Energy and Trevor I. Mihalik, dated May 1, 2018.

10.6 Amended and Restated Severance Pay Agreement between Sempra Energy and Peter R. Wall, dated May 1, 2018.

EXHIBIT 12 -- STATEMENTS RE: COMPUTATION OF RATIOS

Sempra Energy

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

San Diego Gas & Electric Company

12.2 San Diego Gas & Electric Company Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends.

Southern California Gas Company

12.3 Southern California Gas Company Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends.

EXHIBIT 31 -- SECTION 302 CERTIFICATIONS

Sempra Energy

31.1 Certification of Sempra Energy’s Principal Executive Officer pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934.

31.2 Certification of Sempra Energy’s Principal Financial Officer pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934.

San Diego Gas & Electric Company

31.3 Certification of San Diego Gas & Electric Company’s Principal Executive Officer pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934.

31.4 Certification of San Diego Gas & Electric Company’s Principal Financial Officer pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934.

Southern California Gas Company

31.5 Certification of Southern California Gas Company’s Principal Executive Officer pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934.

31.6 Certification of Southern California Gas Company's Principal Financial Officer pursuant to Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934.

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EXHIBIT 32 -- SECTION 906 CERTIFICATIONS

Sempra Energy

32.1	Certification of Sempra Energy's Principal Executive Officer pursuant to 18 U.S.C. Sec. 1350.
32.2	Certification of Sempra Energy's Principal Financial Officer pursuant to 18 U.S.C. Sec. 1350.

San Diego Gas & Electric Company

32.3	Certification of San Diego Gas & Electric Company's Principal Executive Officer pursuant to 18 U.S.C. Sec. 1350.
32.4	Certification of San Diego Gas & Electric Company's Principal Financial Officer pursuant to 18 U.S.C. Sec. 1350.

Southern California Gas Company

32.5	Certification of Southern California Gas Company's Principal Executive Officer pursuant to 18 U.S.C. Sec. 1350.
32.6	Certification of Southern California Gas Company's Principal Financial Officer pursuant to 18 U.S.C. Sec. 1350.

EXHIBIT 101 -- INTERACTIVE DATA FILE

Sempra Energy/San Diego Gas & Electric Company/Southern California Gas Company

101.INS	XBRL Instance Document - the instance document does not appear in the Interactive Data file because its XBRL tags are embedded within the Inline XBRL document.
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

Sempra Energy:

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

SEMPRA ENERGY,
(Registrant)

Date: August 6, 2018 By: /s/ Peter R. Wall
Peter R. Wall
Vice President, Controller and
Chief Accounting Officer

San Diego Gas & Electric Company:

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

SAN DIEGO GAS & ELECTRIC COMPANY,
(Registrant)

Date: August 6, 2018 By: /s/ Bruce A. Folkmann
Bruce A. Folkmann
Vice President, Controller, Chief Financial Officer and Chief Accounting Officer

Southern California Gas Company:

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

SOUTHERN CALIFORNIA GAS COMPANY,
(Registrant)

Date: August 6, 2018 By: /s/ Bruce A. Folkmann
Bruce A. Folkmann
Vice President, Controller, Chief Financial Officer and Chief Accounting Officer