

APPENDIX H
SDG&E SETTLEMENT AGREEMENT

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Gas Company for Authority to Update its Gas Revenue Requirement and Base Rates. (U 904 G)	Application 02-12-027 (Filed December 20, 2002)
Application of San Diego Gas & Electric Company for Authority to Update Its Gas and Electric Revenue Requirement and Base Rates. (U 902 M)	Application 02-12-028 (Filed December 20, 2002)
Investigation on the Commission's Own Motion Into the Rates, Operations, Practices, Service and Facilities of Southern California Gas Company and San Diego Gas & Electric Company.	Investigation 03-03-016 (Filed March 13, 2003)

**SETTLEMENT AGREEMENT
REGARDING SAN DIEGO GAS & ELECTRIC COMPANY**

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**SETTLEMENT AGREEMENT
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Pursuant to the California Public Utilities Commission (“Commission”) Rules of Practice and Procedure, Section 51.3 (“Rule 51.3”), the Commission’s Office of Ratepayer Advocates (“ORA”), San Diego Gas & Electric Company (“SDG&E”), the Coalition of California Utility Employees (“CCUE”), Coral Energy Resources, L.P., and the Greenlining Institute (“Greenlining”) [collectively referred to hereafter as “Joint Parties”] respectfully submit to the Commission this Settlement Agreement. In this Settlement Agreement, the Joint Parties provide to the Commission a recommended resolution of the vast majority of the issues applicable to SDG&E that have been designated for consideration in Phase 1 of this proceeding, including the revenue requirement for SDG&E for Test Year 2004. Greenlining is joining in the Settlement Agreement only as to issues raised in Greenlining's testimony (see Attachment C to this Settlement Agreement) and takes no position on the remaining issues.

Certain topics designated for Phase I of this proceeding are not resolved by this Settlement Agreement and will be litigated unless resolved by subsequent agreement. These unresolved matters include the method of recovery of fumigation-related costs, and SDG&E’s gas resource plan (except as specifically provided below with respect to receipt of gas at Otay

Mesa). In addition, issues designated for consideration in Phase II of this proceeding pertaining to performance based ratemaking are not addressed in this Settlement Agreement.

Accompanying this Settlement Agreement is the Motion of the Joint Parties requesting that the Commission adopt the terms of this Settlement Agreement in its decision on Application No. 02-12-028.

Attached to this Settlement and incorporated as integral parts of the Settlement are the following attachments:

Attachment A: Pension Balancing Account – SDG&E

Attachment B: Summary of Earnings Table (reflecting Settlement results)

Attachment C: Settlement Agreement between the Greenlining Institute and SoCalGas and SDG&E

Attachment D: Joint Comparison Exhibit, Results of Operations; Settlement Agreement for SDG&E

I.

INTRODUCTION AND BACKGROUND

SDG&E filed A.02-12-028 on December 20, 2002, which requested an increase in its authorized base rate revenues for electric service of \$59 million in 2004 over the 2002 authorized level and for gas service of \$22 million in 2004 over the 2002 authorized level. Also, on December 20, 2002, Southern California Gas Company (“SoCalGas”) filed A.02-12-027, requesting an increase in its authorized base rate revenues for gas service. The assigned ALJ consolidated the applications in light of the similarities of the filings, including many of the same witnesses, use of the same ratemaking calculations or “models,” and the fact that the two companies are operated in large part by the same management. On March 13, 2003 the Commission issued a companion order instituting investigation (I) 03-03-016, stating that the proceeding will “determine whether the companies are properly organized, managed and controlled so as to provide safe, reliable and cost effective gas and/or gas and electric retail service to their customers.” (I.03-03-016, mimeo, pg. 3.) On April 2, 2003 Assigned Commissioner Wood issued a Ruling Establishing Scope, Schedule and Procedures For

Proceeding (Scoping Memo). On May 22, 2003, the Assigned Commissioner and ALJ issued a further ruling, modifying the procedural schedule and deferring to a second phase of the proceedings issues related to performance-based ratemaking.

ORA's examination of an appropriate revenue level for SDG&E's 2004 Test Year began only days after the SDG&E filing. ORA issued to the Applicants data requests consisting of over 250 questions and requests for information. Over the next ten months, ORA continued its in-depth discovery, propounding over 1,000 questions and requests for information. These requests probed virtually every element of SDG&E's prepared testimony addressing Phase 1 issues. ORA also assigned financial examiners who reviewed the financial, accounting and operating records of SDG&E. Other interested parties also engaged in substantial discovery of SDG&E.

On August 8, 2003, ORA served its testimony on the parties to this proceeding, including detailed reports on SDG&E gas results of operations, and other reports. On September 5 or September 12 other interested parties served their prepared testimonies. Twenty days of hearings were held between October 7 and November 14, 2003. Following a fully litigated proceeding, and based upon the positions expressed in SDG&E's direct and rebuttal testimony, ORA's reports and the prepared testimony of other parties, the Joint Parties perceived a potential to reach compromises on various issues. Accordingly, the parties began intensive discussions of potential settlement positions. On November 10, 2003, SDG&E, SoCalGas, and ORA sent to all parties a Notice of Settlement Conference, which was held on November 17, 2003 at the Commission's offices in San Francisco, California. Numerous subsequent meetings of parties were held, resulting in the instant Settlement Agreement.

Compared to SDG&E's final, close-of-hearings position requesting a 2004 revenue requirement of \$1,065,547,000 (\$841,785,000 for electricity and \$223,761,000 for gas), this Settlement Agreement provides for a 2004 revenue requirement in the amount of \$1,002,263,000 (\$788,258,000 for electricity and \$214,005,000 for gas), or over \$63 million less than proposed by SDG&E for electricity and gas combined. Furthermore, the settlement 2004 revenue requirement represents a decrease of approximately \$20 million from the Commission-authorized electric revenue requirement in 2003 for the same costs, and a very modest increase of approximately \$1.8 million from the Commission-authorized gas revenue requirement in 2003.

II. REASONABLENESS OF THE SETTLEMENT

The Joint Parties believe this Settlement Agreement complies with the Commission's requirements that settlements be reasonable, consistent with law, and clearly in the public interest. The Joint Parties have recognized that there is risk involved in litigation, and that no party was likely to be 100% successful in supporting its filed case. The Joint Parties have vigorously argued their positions in this matter, and have reached compromise positions that they believe are appropriate in light of the litigation risks. Furthermore, the Joint Parties have specifically considered the potential litigated outcome of issues raised by parties other than SDG&E and ORA. In the process of reaching these compromises, the Joint Parties in certain instances have considered some smaller issues in the aggregate rather than item by item. The Joint Parties believe that this approach was used appropriately given the multiplicity of issues addressed. The level of revenues agreed to in this Settlement Agreement reflects the Joint Parties' best judgments as to the totality of all parties' positions and risks, and their agreement herein is explicitly based on the bottom line result achieved.

Forecast Methodology

Both SDG&E and ORA based their respective test year expense forecasts largely on analyses of historical data. In many instances the differences in their forecasts are the result of employing different forecast methodologies, such as: 1) trends, 2) averages, 3) zero-based estimating, 4) adjustments to recorded expenses, and 5) varying historical time periods. The Joint Parties agree that the proper application of forecast methodologies requires the use of judgment and that, as in any forecasting exercise; there is a range of reasonable outcomes. The Joint Parties also agree that different methodologies can produce results within this range and that no single methodology will produce the sole reasonable result in every instance.

The level of test year expenses recommended by the Joint Parties is based upon their individual judgments regarding the strengths and weaknesses of competing forecasting methodologies, including those proposed by parties other than SDG&E and ORA, and the resulting compromises each party felt were reasonable. Except as specifically identified in this Settlement Agreement, the substantial differences among the Joint Parties' initial positions in each major expense area were resolved through such judgments and compromises.

III. SETTLEMENT AND STIPULATIONS

Appendix B to this Settlement Agreement contains a Summary of Earnings table. This table sets forth the positions expressed in SDG&E's application and testimony, as revised during the proceeding, and in ORA's reports, by FERC functional account area.¹ The final column on each table, labeled "Settlement", presents the levels of expense (by functional area), revenue and rate base agreed upon by the Joint Parties, subject to adjustments described in this Settlement Agreement.

In addition to the agreements expressed in the "Settlement" column on the Summary of Earnings table, the Joint Parties agree as follows:

A. BASE MARGIN

The Joint Parties agree on a 2004 SDG&E base margin of \$760,107,000 for electricity and \$205,032,000 for gas, for a total of \$965,139,000.

B. MISCELLANEOUS REVENUES

The Joint Parties agree to miscellaneous revenues of \$28,150,000 for electricity and \$8,972,000 for gas for the 2004 Test Year, a total of \$37,122,000. SDG&E in its testimony forecast miscellaneous electric revenues of \$26,731,000, whereas ORA forecast miscellaneous electric revenues of \$29,386,000. This difference is in large part attributable to the different treatment of the gain on sale associated with the sale of the former Sundesert nuclear plant site near Blythe. ORA proposed an allocation of the gain on sale of this property that allocated more of the gain to ratepayers (Ex. 301 at pp. 2-2ff). The miscellaneous revenue forecast adopted in the settlement reflects a compromise of the litigation positions of SDG&E and ORA of the Blythe gain on sale issue based on each party's perception of the litigation risk associated with their position. The settlement does not adopt either party's position of allocating gain on sale of this property.

¹ All operations and maintenance expenses set forth in this Settlement Agreement are expressed in 2001 dollars unless otherwise specified. Capital related costs reflect SDG&E's currently authorized rate of return.

C. REVENUE REQUIREMENT

The Joint Parties agree to a TY 2004 Revenue Requirement for SDG&E of \$1,002,261,000 (\$788,257,000 for electricity and \$214,004,000 for gas).

D. OPERATIONS AND MAINTENANCE (“O&M”) EXPENSE

Authorized O&M Expense. The Joint Parties agree that the amount of O&M expenses that SDG&E should be allowed to recover in rates in the 2004 Test Year is \$431,278,000 (\$336,029,000 for electricity and \$95,250,000 for gas), before escalation to 2004 dollars, and \$453,312,000 after escalation to 2004 dollars (\$351,710,000 for electricity and \$101,601,000 for gas). Details are set forth below regarding Clearing Accounts, Nuclear Generation, Procurement, Gas Transmission, Distribution, Uncollectibles, Customer Services, Administrative & General, and Franchise Fees.

E. CLEARING ACCOUNTS

The Joint Parties agree to a total for clearing accounts of \$12,731,000 (\$8,795,000 for electric and \$3,936,000 for gas).

F. NUCLEAR GENERATION – SONGS

Most of SDG&E’s 2004 revenue requirement with respect to its 20% ownership in the San Onofre Nuclear Generating Station (“SONGS”) is being litigated in Phase 1 of Southern California Edison Company’s (“SCE”) General Rate Case (“GRC”) (A.02-05-004), which still is pending. The Joint Parties agree that SDG&E’s level of electric production expense adopted in the final revenue requirement in this proceeding should reflect SDG&E’s share of the actual SONGS costs the Commission authorizes in its decision in Phase 1 of the SCE GRC. For purposes of this settlement agreement, the Joint Parties have used ORA’s proposed level of nuclear expenses, but agree upon issuance of a final decision in Phase 1 of the SCE GRC to serve a late-filed exhibit showing SDG&E’s share of the SONGS costs the Commission authorizes in A.02-05-004. With respect to the SONGS costs that SDG&E presented in this

proceeding that SCE does not directly bill to SDG&E or that were not addressed in SCE's GRC showing, the Joint Parties have agreed to use SDG&E's forecast of these costs, which total \$8 million. These costs include U.S. Department of Energy uranium enrichment plant decontamination and decommissioning fees attributable to SONGS 1, 2 and 3, Spent Fuel Storage costs attributable to SONGS 1, SONGS site easement fees paid to the U.S. Department of the Navy and other SONGS-related costs for depreciation expenses (including AFUDC), taxes and franchise fees, nuclear insurance, uncollectibles and return on rate base. These costs also include the SONGS costs SDG&E identified in Exhibit 96 to comply with new security orders the Nuclear Regulatory Commission ("NRC") issued on April 29, 2003, although nothing in this agreement is intended to preclude parties from proposing adjustments to these NRC security costs in SCE's next GRC proceeding.

The SONGS revenue requirement will be recovered in SDG&E's electric energy commodity rate and will be subject to balancing account treatment in a proposed new regulatory account, the Non-Fuel Generation Balancing Account ("NGBA"). SDG&E has sought authorization to establish the NGBA in A.03-06-002.²

G. PROCUREMENT

SDG&E requested \$5,544,000 for labor and non-labor expenses related to purchasing and scheduling gas and electricity for bundled customers. ORA recommended downward adjustments totaling \$476,000 based on lower staffing in this area, and \$494,000 related to consulting expenses. UCAN also recommended a reduction, on the grounds that demands on this group would be lower after SDG&E's recent RFP and consultant costs would decline because consultants' models had already been developed and would need only to be maintained in 2004. In this Settlement, the Joint Parties accept ORA's proposed reductions, resulting in a total funding level of \$4,574,000. SDG&E pledges to expend whatever is required to effectively procure gas and electricity for its customers, regardless of the particular amount that is authorized by the Commission for this function.

² A decision approving this application was issued by the Commission on December 18, 2003. The decision number was not available as of the time this Settlement was prepared.

H. GAS TRANSMISSION

The Joint Parties agree to SDG&E's estimated test year costs of \$5,216,000.

I. ELECTRIC DISTRIBUTION

The Joint Parties agree to Electric Distribution expense of \$79,319,000. Reductions have been made for several items, including: growth-related reduction to tree-trimming expense (\$500,000); elimination of SDG&E's requested funding for New Business Construction Managers (\$174,000); and a reduction of \$901,000 in O&M expense for SDG&E's Sustainable Communities project.

J. GAS DISTRIBUTION

The Joint Parties agree to Gas Distribution expense of \$14,116,000. The Joint Parties agree to reductions from the amount originally requested by SDG&E in the areas of maturing work force (\$75,000) and in funding sought to comply with stricter permitting and work rules (\$19,000).

K. UNCOLLECTIBLES

The uncollectibles portion of O&M expense has been calculated using a rate of 0.266%, the rate proposed by ORA. This rate is acceptable to the Joint Parties. It should be noted that, because franchise fees and uncollectibles are calculated based on total revenues, they are stated in 2004 dollars throughout the Settlement Agreement.

L. CUSTOMER SERVICES

The Joint Parties agree to customer service expenses of \$92,401,000 (\$62,331,000 for electricity and \$30,070,000 for gas). This compares to SDG&E's final litigation position of \$100,822,000 and ORA's final litigation position of \$90,433,000.

The Settlement revenue requirement for Customer Services was arrived at by accepting essentially all ORA recommendations in the area, except for retaining SDG&E's proposed revenue requirement for Electric Meter Testing training and approximately \$1 million of SDG&E's request for approximately \$4 million for incremental customer outreach programs. Furthermore, the Settlement's Customer Service revenue requirement also reflects adoption of approximately \$2 million in further reductions by accepting in whole 17 issues and in part one issue UCAN raised regarding Customer Service. Thus, this Settlement reflects a reasonable assessment of litigation risk with respect to issues raised by all parties, not just ORA.

Fumigation: The Settlement reflects the expense level recommended by SDG&E in its final position, but leaves for the Commission to determine in a decision in Phase 1 of this proceeding whether this cost should be recovered through base rates or through a separate fee that would be charged per fumigation to fumigators or SDG&E customers of record at locations being fumigated.

M. ADMINISTRATIVE & GENERAL (A&G)

The Joint Parties agree to A&G expenses of \$122,307,000 (\$86,387,000 for electricity and \$35,920,000 for gas). In response to SDG&E's request in A.02-12-027, interested parties sought large A&G reductions, and the Settlement reflects \$37 million less than SDG&E's final litigation position. The Settlement therefore reflects the litigation risks but also protects against some of SDG&E's major concerns, such as pension contribution requirements and medical cost increases:

Incentive Compensation: Only 50% of SDG&E's forecast for costs associated with the incentive compensation plan, the long-term incentive plan and spot cash awards is included in the Settlement. This represents a reduction of \$18,086,000 from SDG&E's proposal.

D&O Liability Insurance: The Joint Parties agree to an amount in D&O liability insurance funding \$1,055,000 less than requested by SDG&E. This amount reflects a compromise among the parties on both the reasonable cost of future D&O liability insurance as well as the

appropriate sharing of this expense between shareholders and ratepayers. The Settlement does not adopt any specific policy on whether these costs should be shared between shareholders and ratepayers.

Pension Expense: The Joint Parties recognize that Internal Revenue Service (“IRS”) Code Section 412 as amended by the Employee Retirement Income Security Act of 1974 (“ERISA”) obligates SDG&E to make minimum contributions to its pension trust and that the amount of the required minimum contribution can fluctuate over time based on factors not subject to management control such as market return on invested assets, interest rates and federal legislative changes. To protect both ratepayers and shareholders, the Joint Parties therefore support adoption of a two-way balancing account to address the difference between forecasted and actual minimum contributions. The two-way balancing account allows SDG&E to recover required pension contributions, subject to one exception: if the minimum required contribution in any year exceeds the estimate for that year that SDG&E provided in its testimony, shareholders will have to pay 20% of the excess. The test year authorized pension expense for SDG&E will be \$17 million, \$8.1 million below SDG&E’s forecasted amount. Attachment A provides the details on how the balancing account will operate. The wording of Attachment A is controlling on this issue.

Supplemental Pensions: In Account 926, the Joint Parties agree to funding for supplemental pensions of \$277,000. This represents 50% of the amount requested by SDG&E.

Post-Retirement Benefits Other Than Pensions (“PBOPS”): The Joint Parties agree to SDG&E’s PBOPs forecast of \$7.1 million, subject to a two-way balancing account (consistent with the approach the Commission employs for all California utilities).

Medical, Dental and Vision: The Joint Parties agree to SDG&E’s updated cost estimates for medical, dental and vision benefits (set forth in Exhibit 102), subject to the generic adjustment identified below for reduced workforce projections.

Benefits Adjustment – FTE Projections: The Joint Parties agree to a \$2.2 million downward adjustment in benefits costs. This is attributed to reduced workforce (281 fewer incremental full-time equivalents or FTEs) compared to SDG&E’s original request and is intended to resolve concerns raised by ORA and other interested parties about workforce levels, vacancy rates and synchronizing benefits costs to payroll.

Other Benefits Adjustment: The Joint Parties agree to a \$1.174 million downward adjustment in benefits costs to reflect concerns raised by ORA and other interested parties regarding the appropriateness of including in rates certain benefits such as executive life insurance, employee recognition, etc.

Regional Public Affairs: The Joint Parties agree to a \$396,000 adjustment to RPA funding. This adjustment consists of a decrease in Account 920 of \$276,000 (from SDG&E’s request) and a decrease in Account 921 of \$120,000 (from SDG&E’s request).

N. CORPORATE AND SHARED SERVICES

Corporate Center charges: In Corporate Center charges, the Joint Parties agree to a \$7.475 million reduction to the SDG&E’s forecast; which addresses both the settlement’s inclusion of only 50% of costs associated with the incentive compensation plans and supplemental pensions, and significant reductions of the costs requested to provide other benefits. It also reflects compromise regarding disputed positions at the Corporate Center and certain expense allocations from the Corporate Center, without adopting any specific positions on those disputed issues individually.

Utility Shared Services: In Utility Shared Services the Joint Parties agree to a \$1.2 million reduction from the SDG&E forecast. This resolves concerns about the ability of ORA and other interested parties to reconcile some of these costs, and also to account for reductions in these charges that would occur due to other reductions in the Settlement Agreement.

The Joint Parties agree that an adjustment shall be made in the shared services billings area of \$1,196,000 at SDG&E (\$620,000 in Account 920 and \$576,000 in Account 921). This

adjustment to the shared services forecast is a compromise based on two factors: 1) reduced FTEs and 2) impacts on other shared services due to other portions of this Settlement Agreement. The Joint Parties agree that the utilities shared services presentation was difficult to follow, but when provided with all necessary information the parties were able to confirm that the shared service credits and debits ultimately reconciled. The ORA recommendation for shared services revenues being subject to refund is no longer necessary and herein eliminated. Applicants shall work with ORA and any other interested parties who chose to participate to develop a reasonable and more easily understood shared services presentation for the next base rate proceeding for SDG&E and SoCalGas.

O. FRANCHISE FEES

Franchise Fees: Consistent with the Joint Recommendation of SDG&E and ORA (Exhibit 145), the franchise fees portion of O&M expense has been calculated using a franchise fee rate of Electric: 3.67%; Gas: 2.13% (the franchise fee factor used to calculate customer bills will differ depending on whether the customer is inside or outside the City of San Diego; these figures represent the system average). Because franchise fees are calculated based on total revenues, they are stated in 2004 dollars throughout the Settlement Agreement.

P. COST ESCALATION

Cost Escalation. The Joint Parties agree to use an escalation rate of 1.106 for escalating labor expenses from 2001 dollars to 2004 dollars. For escalating non-labor O&M expenses, the Joint Parties mutually agree to use 1.076. The labor, non-labor and other expense allocations for purposes of escalating from 2001 dollars to 2004 dollars are set forth in Appendix C hereto.

Q. DEPRECIATION.

The Joint Parties agree upon the method for calculating depreciation and that depreciation and amortization expense shall be \$214,776,000 (\$166,680,000 for electric and \$48,096,000 for gas). The Joint Parties agree with SDG&E's proposed change in service lives used to calculate depreciation, which was not contested, and the amount of depreciation expense provided for in this Settlement is consistent with that change. The amount of depreciation expenses allowed in

this Settlement is lower than what SDG&E had requested. The lower amount is due to two factors. First, the Joint Parties have agreed to a lower amount of capital additions than SDG&E had requested. Second, the Settlement reflects a compromise between SDG&E's and ORA's positions on net salvage rates. ORA had argued to leave unchanged the net salvage rates the Commission adopted in SDG&E's 1999 Cost of Service Case; in contrast, SDG&E submitted testimony updating its net salvage rates. The Settlement reflects a net salvage expense that is in the mid-range between what SDG&E had requested and ORA had proposed, and reflects parties' perceptions of litigation risk on this issue. Finally, the Settlement reflects SDG&E's position with respect to the amortization of land rights.

R. TAXES ON INCOME

The Joint Parties agree to an income tax expense of \$103,956,000 (\$84,296,000 for electricity and \$19,660,000 for gas). This amount is consistent with the method for computing taxes on income and the weighted average deferred tax amounts to be deducted from rate base for test year 2004 that SDG&E, ORA, and UCAN agreed to in their Joint Recommendation on taxes (Exhibit 145).

S. TAXES OTHER THAN ON INCOME

The Joint Parties agree to a tax expense, for taxes other than on income, of \$39,154,000 (\$30,670,000 for electricity and \$8,484,000 for gas). This amount is consistent with the methods for computing payroll taxes and ad valorem taxes that SDG&E, ORA and UCAN agreed to in their Joint Recommendation on taxes (Exhibit 145).

T. TOTAL OPERATING EXPENSES

The Joint Parties agree to Total Operating Expenses of \$811,198,000 (\$633,357,000 for electricity and \$177,841,000 for gas).

U. RETURN

The Joint Parties agree to Return of \$191,063,000 (\$154,900,000 for electric and \$36,163,000 for gas), assuming the currently-authorized rate of return on rate base of 8.77%.

V. RATE BASE

Rate Base: The Joint Parties agree to rate base for SDG&E of \$2,178,593,000 (\$1,766,246,000 for electricity and \$412,347,000 for gas). This is a reduction of approximately \$31,809,000 from SDG&E's request. This Settlement explicitly includes the Otay Mesa pressure betterment project within capital additions authorized in rate base, within the above total rate base amount.

Working Capital: ORA recommended reductions of approximately \$3,216,000 from SDG&E's proposed level of working capital. UCAN also recommended reduction by approximately \$47 million of SDG&E's proposed working capital (and, therefore, rate base) on a variety of grounds. Joint Parties have taken into consideration the positions of UCAN as well as of SDG&E and ORA, and a downward adjustment to SDG&E's proposed working cash of \$16.8 million is made by this Settlement.

Capital Additions: The Joint Parties agree to an approximate \$15 million reduction in capital additions compared to SDG&E's position in the proceeding.

W. RATE OF RETURN

The Settlement assumes SDG&E's authorized rate of return on rate base at 8.77%, as last authorized by the Commission. The Settlement does not address when or how the Commission may revise this authorized rate of return.

X. SALES AND CUSTOMER LEVELS

The parties agree that the Commission should adopt the forecasts of number of gas and electric customers (811, 934 and 1,311,434, respectively) and electric sales (19,069 Gwh), set forth in Exhibit No. 50 (Greg Katsapis), which is SDG&E's uncontested testimony on this issue.

Y. MISCELLANEOUS

General Ledger Reconciliation

The Settlement reflects the agreement of ORA and SDG&E during hearings to an adjustment in the amount of \$3.356 million in SDG&E's requested revenue requirement to reflect the results of ORA's review of the reconciliation between SDG&E's general ledger and SDG&E's 2001 base year starting point. No further review of reconciliation is required.

Audit

The Joint Parties agree that no further audits are necessary in this proceeding, and do not support any proposals in this proceeding for further audits.

Term of Rate Case: The term of the rate case cycle starting with Test Year 2004 and ending with SDG&E next cost of service or General Rate Case application shall be no less than 4 years; i.e., the next Test Year shall be no earlier than 2008, provided that the Commission may in a decision in Phase 2 of this proceeding adopt such provisions as it sees fit for the timing of the next rate case not inconsistent with the provisions of this Settlement.

Next GRC: SDG&E agrees to file a notice of intent (NOI) as a part of the processing of its next cost of service or GRC application, in a manner and on a schedule consistent with the provisions of the Rate Case Plan adopted in D.89-01-040, as modified by the Commission.

Personal Computer (PC) Life Cycle:

The Joint Parties agree to use for ratemaking purposes of a life cycle of four years for personal computers, which represents a compromise between SDG&E's position of three years and

UCAN's position of five years. The revenue requirements provided by this Settlement for each account including personal computer expenses reflects a four-year PC life cycle.

Change in Capitalization Policy:

SDG&E proposed the adoption of SOP 98-1, which would result in expensing certain costs that would be capitalized under the current policy, and also proposed a change in its capitalization policy (especially as to the threshold for capitalization of "general equipment" and certain pipeline replacements) as described in Exhibit No.39 (S. Wayland Kan) at pp.4-7. No party in its testimony expressly opposed SDG&E adopting SOP 98-1. No party in its testimony expressly opposed SDG&E's proposal for "harmonizing" capitalization policies. FEA did propose a "phase-in" of the revenue requirement impacts for SDG&E's capitalization policy change. The Joint Parties agree that SDG&E's recommendations on these items are adopted by the settlement within the settled revenue requirement. The Joint Parties agree that no "phase in" is necessary. The Joint Parties agree that adoption of this accounting policy in this Settlement is not precedential.

Long Term Gas Resource Plans and Otay Mesa gas receipt point: Issues concerning long-term gas resource planning are not addressed by this Settlement; provided, however, that SDG&E: (1) commits to placing the Otay Mesa pressure betterment project in service by December 31, 2004, subject only to matters beyond SDG&E's control³; (2) agrees to propose in an appropriate Commission approval process to establish Otay Mesa as a gas receipt point by December 31, 2004; and (3) agrees to put forth its best efforts to file with the Commission the necessary proposal to accomplish this result by January 31, 2004, and in any event no later than February 27, 2004.

³ As noted in the section on Rate Base above, this Settlement explicitly includes the Otay Mesa pressure betterment project within capital additions authorized in rate base.

IV.
ADDITIONAL TERMS AND CONDITIONS

A. PERFORMANCE

The Joint Parties agree to perform diligently, and in good faith, all actions required or implied hereunder, including, but not necessarily limited to, the execution of any a other documents required to effectuate the terms of this Settlement Agreement, and the preparation of exhibits for, and presentation of witnesses at, any required hearings to obtain the approval and adoption of this Settlement Agreement by the Commission. No Settling Party will contest in this proceeding, or in any other forum, or in any manner before this Commission, the recommendations contained in this Settlement Agreement. It is understood by the Joint Parties that time is of the essence in obtaining the Commission's approval of this Settlement Agreement and that all will extend their best efforts to ensure its adoption.

B. THE PUBLIC INTEREST

The Joint Parties agree jointly by executing and submitting this Settlement Agreement that the relief requested herein is just, fair and reasonable, and in the public interest.

C. NON-PRECEDENTIAL EFFECT.

This Settlement Agreement is not intended by the Joint Parties to be binding precedent for any future proceeding. The Joint Parties have assented to the terms of this Settlement Agreement only for the purpose of arriving at the settlement embodied in this Settlement Agreement. Each Settling Party expressly reserves its right to advocate, in current and future proceedings, positions, principles, assumptions, arguments and methodologies which may be different than those under-lying this Settlement Agreement, and the Joint Parties expressly declare that, as provided in Rule 51.8 of the Commission's Rules of Practice and Procedure, this Settlement Agreement should not be considered as a precedent for or against them.

The Settlement explicitly does not establish any precedent on the litigated revenue requirement issues in the case, even though the Settlement adopts revenue requirement

reductions identified with specific FERC accounts and disputed items. For instance, items for which reduced funding have been agreed to, but for which no precedent is established regarding the right to record such costs in utility accounts or to recover such costs in a future case include (but are not limited to) the following: costs associated with the regional public affairs department; costs associated with incentive compensation and other benefits; costs associated with D&O insurance; and whether interest bearing customer deposits should be considered in the calculation of working cash requirements.

D. INDIVISIBILITY.

This Settlement Agreement embodies compromises of the Joint Parties' positions. No individual term of this Settlement Agreement is assented to by any Settling Party, except in consideration of the other Joint Parties' assents to all other terms. Thus, the Settlement Agreement is indivisible and each part is interdependent on each and all other parts. Any party may withdraw from this Settlement Agreement if the Commission modifies, deletes from, or adds to the disposition of the matters stipulated herein. The Joint Parties agree, however, to negotiate in good faith with regard to any Commission-ordered changes in order to restore the balance of benefits and burdens, and to exercise the right to withdraw only if such negotiations are unsuccessful.

The Joint Parties acknowledge that the positions expressed in the Settlement Agreement were reached after consideration of all positions advanced in the prepared testimony of SDG&E, ORA, and the other interested parties, as well as proposals offered during the settlement negotiations. This document sets forth the entire agreement of Joint Parties on all of those issues, except as specifically described within the Settlement Agreement. The terms and conditions of this Settlement Agreement may only be modified in writing subscribed by all Joint Parties.

E. ATTACHMENTS.

Attachments A through D to this Settlement Agreement are part of the agreement of the Joint Parties and are incorporated by reference.

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Dated this 19th day of December, 2003.

OFFICE OF RATEPAYER ADVOCATES

By: _____
Robert Mark Pocta
Program Manager

SAN DIEGO GAS & ELECTRIC COMPANY

By: _____
William L. Reed
Senior Vice President

THE COALITION OF CALIFORNIA UTILITY EMPLOYEES

By: _____
Marc D. Joseph
Attorney

CORAL ENERGY RESOURCES, L.P

By: _____
John W. Leslie
Attorney

THE GREENLINING INSTITUTE

By: _____
Robert L. Gnaizda
General Counsel

**ATTACHMENT A TO SETTLEMENT AGREEMENT FOR
SDG&E IN A.02-12-028**

PENSION BALANCING ACCOUNT – SDG&E

The Joint Parties recognize that Internal Revenue Service (“IRS”) Code Section 412 as amended by the Employee Retirement Income Security Act of 1974 (“ERISA”) obligates SDG&E to make minimum contributions to its pension trust (“ERISA minimum contribution”) and that the amount of the required ERISA minimum contribution can fluctuate over time based on factors not subject to management control such as market return on invested assets, interest rates and federal legislative changes. To protect both ratepayers and shareholders, the Joint Parties therefore support adoption of a two-way balancing account to address the difference between forecasted and actual minimum contributions.

Specifically, this settlement provides a test year authorized expense for SDG&E of \$17 million. The agreed-upon test year authorized expense is somewhat lower than SDG&E had originally requested (\$25.1 million), which reflects slightly improved equity market conditions (which lower the amount of needed contributions), but also the continuation of low interest rates (which increase the amount of needed contributions). The balancing account will operate in accordance with the following provisions:

- Beginning in 2004, and in each subsequent year of the period covered by this agreement,⁴ SDG&E shall record in its pension balancing account the difference between the test year 2004 funding level set forth above (\$17 million) and the customers’ share of the actual contribution made to the pension fund for that year, as described below. The contribution recorded in the account shall not exceed the ERISA minimum contribution for any given year, if any, as set forth in IRS Code Section 412.
- The customers’ share of the pension contribution shall be equal to the ERISA minimum except as follows. If the ERISA minimum contribution in any given year exceeds the amount forecasted in the bottom line of Appendix III of Exhibit 34 (\$25.1 million in 2004, \$28 million in 2005, \$31 million in 2006, \$33 million in 2007 and \$34 million in 2008), SDG&E’s customers will fund the forecasted amount plus 80% of the excess of the actual ERISA minimum above the forecasted amount; SDG&E’s shareholders will

⁴ The period covered by this agreement shall be from the effective date of the decision in this proceeding through the effective date of the decision in SDG&E’s next cost-of-service proceeding.

fund the remaining 20% of the excess amount. For example, if the ERISA minimum contribution for 2005 is \$33 million, instead of the forecasted amount of \$28 million, SDG&E's customers will fund \$32 million (\$28 million plus \$4 million, which represents 80% of the \$5 million difference between the ERISA minimum and the forecasted amount); SDG&E's shareholders will fund the remaining \$1 million (20% of the \$5 million difference between the ERISA minimum and the forecasted contribution).

- SDG&E shall provide to ORA, at or near the time the contribution is paid, an explanation of the amount to be contributed. The material provided to ORA would include all supporting workpapers (e.g., actuarial valuations) for the development of the minimum ERISA payment.
- The account will be maintained on a monthly basis and will be interest-bearing. The pension contribution will be reflected in the month in which such contribution is made to the pension trust fund for that year. The balancing account will accrue interest at the three-month commercial paper rate through the term of this agreement. Any accumulated credit balance shall be returned to ratepayers through a revenue/rate decrease and any accumulated debit balance shall be recovered by SDG&E through a revenue/rate increase. SDG&E may request that any filings and rate changes required by this provision be consolidated with other appropriate filing(s).

**ATTACHMENT B TO SETTLEMENT AGREEMENT FOR
SDG&E IN A.02-12-028**

**SUMMARY OF EARNINGS COMPARISON
Settlement Agreement
(\$000)**

No.	Description	SDG&E End-of-Hearings	ORA End-of-Hearings	Settlement
1	Base Margin	\$ 1,029,746	\$ 934,410	\$ 965,141
2	Miscellaneous Revenues	35,801	38,358	37,122
3	Revenue Requirement	1,065,547	972,768	1,002,263
	Operating and Maintenance Expenses			
4	Clearing Accounts	12,864	12,731	12,731
5	Nuclear Generation (SONGS)	72,974	65,849	65,849
6	Procurement	5,544	4,574	4,574
7	Gas Transmission	5,216	5,216	5,216
8	Distribution	96,744	88,421	93,383
9	Uncollectibles ('04: 0.266%)	2,739	2,411	2,567
10	Customer Services	100,822	90,433	92,401
11	Administrative & General	148,352	117,435	122,307
12	Franchise Fees (Electric: 3.67%; Gas: 2.13%)	34,485	31,215	32,263
13	Subtotal (2001\$)	\$ 479,742	\$ 418,286	\$ 431,292
14	Labor Escalation Amount	18,343	12,284	16,274
15	Non-Labor Escalation Amount	6,108	4,936	5,753
16	Subtotal (2004\$)	\$ 504,192	\$ 435,506	\$ 453,319
17	Depreciation	219,342	206,836	214,776
18	Taxes on Income	108,042	101,549	103,956
19	Taxes Other Than on Income	40,382	38,503	39,149
20	Total Operating Expenses	871,957	782,393	811,200
21	Return	193,589	190,375	191,063
22	Rate Base	2,207,402	2,170,750	2,178,593
23	Rate of Return	8.77%	8.77%	8.77%
24	Derivation of Base Margin			
25	O&M Expenses	504,192	435,506	453,319
26	Depreciation	219,342	206,836	214,776
27	Taxes	148,424	140,051	143,105
28	Return	193,589	190,375	191,063
29	Revenue Requirement	1,065,547	972,768	1,002,263
30	Less: Miscellaneous Revenues	35,801	38,358	37,122
31	Base Margin	\$ 1,029,746	\$ 934,410	\$ 965,141