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PACIFIC ENTERPRISES INC

Form 10-Q

April 29, 2004

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

☒ Quarterly report pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934

March 31, 2004

For the quarterly period ended.....

Or

☐ Transition report pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number	Name of Registrant, State of Incorporation, Address and Telephone Number	IRS Employer Identification Number
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1-40	Pacific Enterprises (A California Corporation) 101 Ash Street San Diego, California 92101 (619) 696-2020	94-0743670
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1-1402	Southern California Gas Company (A California Corporation) 555 West Fifth Street Los Angeles, California 90013 (213) 244-1200	95-1240705
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No Change

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

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

Yes...X... No.....

Indicate by check mark whether the registrant is an accelerated filer  
(as defined in Rule 12b-2 of the Exchange Act).

Yes...X... No.....

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

Common Stock outstanding:

Pacific Enterprises                      Wholly owned by Sempra Energy

Southern California Gas Company      Wholly owned by Pacific Enterprises

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## INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

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

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

## PART I FINANCIAL INFORMATION ITEM 1. FINANCIAL STATEMENTS.

### PACIFIC ENTERPRISES AND SUBSIDIARIES STATEMENTS OF CONSOLIDATED INCOME (Dollars in millions)

	Quarters ended March 31,	
	2004	2003
Operating revenues	\$ 1,148	\$ 1,008
Operating expenses		
Cost of natural gas	721	600
Other operating expenses	210	197
Depreciation	74	69
Income taxes	44	45

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Franchise fees and other taxes	33	29
	-----	-----
Total operating expenses	1,082	940
	-----	-----
Operating income	66	68
	-----	-----
Other income and (deductions)		
Interest income	8	2
Regulatory interest - net	(3)	--
Allowance for equity funds used during construction	1	2
Income taxes on non-operating income	--	(1)
Other - net	(1)	3
	-----	-----
Total	5	6
	-----	-----
Interest charges		
Long-term debt	9	12
Other	3	5
Allowance for borrowed funds used during construction	--	(1)
	-----	-----
Total	12	16
	-----	-----
Net income	59	58
Preferred dividend requirements	1	1
	-----	-----
Earnings applicable to common shares	\$ 58	\$ 57
	=====	=====

See notes to Consolidated Financial Statements.

## PACIFIC ENTERPRISES AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (Dollars in millions)

	March 31, 2004	December 31, 2003
	-----	-----
ASSETS		
Utility plant - at original cost	\$ 7,063	\$ 7,008
Accumulated depreciation	(2,784)	(2,739)
	-----	-----
Utility plant - net	4,279	4,269
	-----	-----
Current assets:		
Cash and cash equivalents	44	32
Accounts receivable - trade	422	509
Accounts receivable - other	14	36
Interest receivable	31	30
Due from affiliates	248	76
Income taxes receivable	82	103
Regulatory assets arising from fixed-price contracts and other derivatives	90	85
Other regulatory assets	16	8
Inventories	19	74
Other	9	12

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Total current assets	975	965
Other assets:		
Due from affiliates	455	356
Regulatory assets arising from fixed-price contracts and other derivatives	122	148
Sundry	142	150
Total other assets	719	654
Total assets	\$ 5,973	\$ 5,888

See notes to Consolidated Financial Statements.

## PACIFIC ENTERPRISES AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (Dollars in millions)

	March 31, 2004	December 31, 2003
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Common stock (600 million shares authorized; 84 million shares outstanding)	\$ 1,367	\$ 1,367
Retained earnings	311	253
Accumulated other comprehensive income (loss)	(3)	(3)
Total common equity	1,675	1,617
Preferred stock	80	80
Total shareholders' equity	1,755	1,697
Long-term debt	769	762
Total capitalization	2,524	2,459
Current liabilities:		
Accounts payable - trade	195	227
Accounts payable - other	42	44
Due to affiliates	110	121
Interest payable	23	18
Deferred income taxes	35	24
Regulatory balancing accounts - net	194	86
Fixed-price contracts and other derivatives	92	86
Current portion of long-term debt	--	175
Customer deposits	58	43
Other	401	262
Total current liabilities	1,150	1,086
Deferred credits and other liabilities:		
Customer advances for construction	41	40
Postretirement benefits other than pensions	62	72

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Deferred income taxes	166	154
Deferred investment tax credits	43	44
Regulatory liabilities arising from cost of removal obligations	1,411	1,392
Other regulatory liabilities	108	108
Fixed-price contracts and other derivatives	122	148
Preferred stock of subsidiary	20	20
Deferred credits and other	326	365
	-----	-----
Total deferred credits and other liabilities	2,299	2,343
	-----	-----
Contingencies and commitments (Note 5)		
Total liabilities and shareholders' equity	\$ 5,973	\$ 5,888
	=====	=====

See notes to Consolidated Financial Statements.

## PACIFIC ENTERPRISES AND SUBSIDIARIES CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS (Dollars in millions)

	Quarters ended March 31,	
	2004	2003
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 59	\$ 58
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	74	69
Deferred income taxes and investment tax credits	24	(7)
Net changes in other working capital components	415	323
Changes in other liabilities	(39)	(2)
	-----	-----
Net cash provided by operating activities	533	441
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(62)	(58)
Loans to/from affiliates - net	(283)	(195)
	-----	-----
Net cash used in investing activities	(345)	(253)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Preferred dividends paid	(1)	(1)
Payments on long-term debt	(175)	(70)
	-----	-----
Net cash used in financing activities	(176)	(71)
	-----	-----
Increase in cash and cash equivalents	12	117
Cash and cash equivalents, January 1	32	22
	-----	-----
Cash and cash equivalents, March 31	\$ 44	\$ 139
	=====	=====

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## SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Interest payments, net of amounts capitalized	\$ 5	\$ 5
	=====	=====
Income tax refunds, net of payments	\$ --	\$ 34
	=====	=====

See notes to Consolidated Financial Statements.

## SOUTHERN CALIFORNIA GAS COMPANY AND SUBSIDIARIES STATEMENTS OF CONSOLIDATED INCOME (Dollars in millions)

	Quarters ended March 31,	
	2004	2003
	-----	-----
Operating revenues	\$ 1,148	\$ 1,008
	-----	-----
Operating expenses		
Cost of natural gas	721	600
Other operating expenses	209	195
Depreciation	74	69
Income taxes	43	45
Franchise fees and other taxes	33	29
	-----	-----
Total operating expenses	1,080	938
	-----	-----
Operating income	68	70
	-----	-----
Other income and (deductions)		
Interest income	1	1
Regulatory interest - net	(3)	--
Allowance for equity funds used during construction	1	2
Income taxes on non-operating income	--	(1)
Other - net	(1)	(1)
	-----	-----
Total	(2)	1
	-----	-----
Interest charges		
Long-term debt	9	12
Other	1	2
Allowance for borrowed funds used during construction	--	(1)
	-----	-----
Total	10	13
	-----	-----
Net income/earnings applicable to common shares	\$ 56	\$ 58
	=====	=====

See notes to Consolidated Financial Statements.

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## SOUTHERN CALIFORNIA GAS COMPANY AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (Dollars in millions)

	March 31, 2004	December 31, 2003
ASSETS		
Utility plant - at original cost	\$ 7,063	\$ 7,008
Accumulated depreciation	(2,784)	(2,739)
Utility plant - net	4,279	4,269
Current assets:		
Cash and cash equivalents	44	32
Accounts receivable - trade	422	509
Accounts receivable - other	11	35
Interest receivable	31	30
Due from affiliates	261	22
Income taxes receivable	37	57
Regulatory assets arising from fixed-priced contracts and other derivatives	90	85
Other regulatory assets	16	8
Inventories	19	74
Other	7	9
Total current assets	938	861
Other assets:		
Regulatory assets arising from fixed-priced contracts and other derivatives	122	148
Sundry	119	127
Total other assets	241	275
Total assets	\$ 5,458	\$ 5,405

See notes to Consolidated Financial Statements.

## SOUTHERN CALIFORNIA GAS COMPANY AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (Dollars in millions)

	March 31, 2004	December 31, 2003
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Common stock (100 million shares authorized;		

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91 million shares outstanding)	\$ 866	\$ 866
Retained earnings	498	491
Accumulated other comprehensive income (loss)	(3)	(3)
	-----	-----
Total common equity	1,361	1,354
Preferred stock	22	22
	-----	-----
Total shareholders' equity	1,383	1,376
Long-term debt	769	762
	-----	-----
Total capitalization	2,152	2,138
	-----	-----
Current liabilities:		
Accounts payable - trade	195	227
Accounts payable - other	42	44
Due to affiliates	45	55
Interest payable	23	18
Deferred income taxes	27	15
Regulatory balancing accounts - net	194	86
Fixed-price contracts and other derivatives	92	86
Current portion of long-term debt	--	175
Customer deposits	58	43
Other	399	262
	-----	-----
Total current liabilities	1,075	1,011
	-----	-----
Deferred credits and other liabilities:		
Customer advances for construction	41	40
Postretirement benefits other than pensions	62	--
Deferred income taxes	181	168
Deferred investment tax credits	43	44
Regulatory liabilities arising from cost of removal obligations	1,411	1,392
Other regulatory liabilities	108	180
Fixed-price contracts and other derivatives	122	148
Deferred credits and other	263	284
	-----	-----
Total deferred credits and other liabilities	2,231	2,256
	-----	-----
Contingencies and commitments (Note 5)		
Total liabilities and shareholders' equity	\$ 5,458	\$ 5,405
	=====	=====

See notes to Consolidated Financial Statements.

SOUTHERN CALIFORNIA GAS COMPANY AND SUBSIDIARIES  
CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS  
(Dollars in millions)

Quarters ended	
March 31,	
2004	2003
-----	-----



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### CASH FLOWS FROM OPERATING ACTIVITIES

Net income	\$ 56	\$ 58
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	74	69
Deferred income taxes and investment tax credits	24	(6)
Net changes in other working capital components	415	324
Changes in other liabilities	(19)	(1)
	-----	-----
Net cash provided by operating activities	550	444
	-----	-----

### CASH FLOWS FROM INVESTING ACTIVITIES

Capital expenditures	(62)	(58)
Loan to/from affiliate - net	(251)	(199)
	-----	-----
Net cash used in investing activities	(313)	(257)
	-----	-----

### CASH FLOWS FROM FINANCING ACTIVITIES

Dividends paid	(50)	--
Payments on long-term debt	(175)	(70)
	-----	-----
Net cash used in financing activities	(225)	(70)
	-----	-----

Increase in cash and cash equivalents	12	117
Cash and cash equivalents, January 1	32	22
	-----	-----
Cash and cash equivalents, March 31	\$ 44	\$ 139
	=====	=====

### SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Interest payments, net of amounts capitalized	\$ 4	\$ 4
	=====	=====
Income tax refunds, net of payments	\$ --	\$ 34
	=====	=====

See notes to Consolidated Financial Statements.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 1. GENERAL

This Quarterly Report on Form 10-Q is that of Pacific Enterprises (PE) and of Southern California Gas Company (SoCalGas) (collectively referred to as the company or the companies). PE's common stock is wholly owned by Sempra Energy, a California-based Fortune 500 holding company, and PE owns all of the common stock of SoCalGas. The financial statements herein are, in one case, the Consolidated Financial Statements of PE and its subsidiary SoCalGas, and, in the second case, the Consolidated Financial Statements of SoCalGas and its subsidiaries, which comprise less than one percent of SoCalGas' consolidated financial position and results of operations.

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

The accompanying Consolidated Financial Statements have been prepared in accordance with the interim-period-reporting requirements of Form

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10-Q. Results of operations for interim periods are not necessarily indicative of results for the entire year. In the opinion of management, the accompanying statements reflect all adjustments necessary for a fair presentation. These adjustments are only of a normal recurring nature.

Certain December 31, 2003 income tax liabilities have been reclassified from Deferred Income Taxes to current Income Taxes Payable and to Deferred Credits and Other Liabilities to conform to the current presentation of these items.

Information in this Quarterly Report is unaudited and should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2003 (Annual Report).

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

For the quarters ended March 31, 2004 and 2003, comprehensive income was equal to earnings applicable to common shares.

SoCalGas accounts for the economic effects of regulation on utility operations in accordance with Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation."

### NOTE 2. NEW ACCOUNTING STANDARDS

**Stock-Based Compensation:** On March 31, 2004, the Financial Accounting Standards Board (FASB) issued a proposed Exposure Draft to amend SFAS 123, "Accounting for Stock-Based Compensation" and SFAS 95, "Statement of Cash Flows" which provide the current guidance on accounting for stock options and related items. It proposes that the new rules would be effective for 2005. The proposed statement would eliminate the choice of accounting for share-based compensation transactions using Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and instead generally would require that such transactions be accounted for using a fair-value-based method. The Draft would prohibit retroactive application and require that expense be recognized only for those options that actually vest.

**SFAS 132 (revised 2003), "Employers Disclosures about Pensions and Other Postretirement Benefits":** This statement revises employers' disclosures about pension plans and other postretirement benefit plans. It requires disclosures beyond those in the original SFAS 132 about the assets, obligations, cash flows and net periodic benefit cost of defined benefit pension plans and other defined postretirement plans. In addition, the revised statement requires interim-period disclosures regarding the amount of net periodic benefit cost recognized and the total amount of the employers' contributions paid and expected to be paid during the current fiscal year. It does not change the measurement or recognition of those plans.

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

	Pension Benefits	Other Postretirement Benefits
	-----	-----

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(Dollars in millions)	2004	2003	2004	2003
Service cost	\$ 8	\$ 8	\$ 5	\$ 4
Interest cost	23	22	12	11
Expected return on assets	(24)	(27)	(8)	(8)
Amortization of:				
Transition obligation	--	--	2	2
Prior service cost	1	2	--	--
Actuarial loss	1	--	3	1
Regulatory adjustment	(8)	(5)	(2)	1
Total net periodic benefit cost	\$ 1	\$ --	\$ 12	\$ 11

Note 5 of the notes to Consolidated Financial Statements in the Annual Report discusses the company's expected contribution to its pension plan and other postretirement benefit plans in 2004. For the quarter ended March 31, 2004, \$12 million of contributions have been made to its other postretirement benefit plans. There was no contribution made to its pension plan for the quarter ended March 31, 2004.

SFAS 143, "Accounting for Asset Retirement Obligations": SFAS 143 requires entities to record the fair value of liabilities for legal obligations related to asset retirements in the period in which they are incurred. It also requires the reclassification of estimated removal costs, which have historically been recorded in accumulated depreciation, to a regulatory liability. At March 31, 2004 and December 31, 2003, the estimated removal costs recorded as a regulatory liability were \$1.4 billion at both dates.

The change in the asset retirement obligations for the quarter ended March 31, 2004 is as follows (dollars in millions):

Balance as of January 1, 2004	\$ 11
Accretion expense	--
	-----
Balance as of March 31, 2004	\$ 11*
	=====

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

SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities": Effective July 1, 2003, SFAS 149 amended and clarified accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS 133. Under SFAS 149 natural gas forward contracts that are subject to unplanned netting generally do not qualify for the normal purchases and normal sales exception. ("Netting" refers to contract settlement by paying or receiving the monetary difference between the contract price and the market price at the date on which physical delivery would have occurred.) Implementation of SFAS 149 did not have a material impact on reported net income. Additional information on derivative instruments is provided in Note 3.

Emerging Issues Task Force (EITF) 03-11, "Reporting Realized Gains and Losses on Derivative Instruments that are Subject to FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities and Not 'Held for Trading Purposes' as Defined in EITF Issue No. 02-3, Issues Involved in Accounting for Derivative Contracts Held for Trading

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Purposes and Contracts Involved in Energy Trading and Risk Management Activities": During 2003, the EITF reached a consensus that determining whether realized gains and losses on physically settled derivative contracts not held for trading purposes should be reported in the income statement on a gross or net basis is a matter of judgment that depends on the relevant facts and circumstances. Adoption of EITF 03-11 in 2003 did not have and is not expected to have a significant impact on the company's financial statements.

FASB Staff Position (FSP) 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003": Issued January 12, 2004, FSP 106-1 permits a sponsor of a postretirement health care plan that provides a prescription drug benefit to make a one-time election to defer accounting for the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act). The company has elected to defer the effects of the Act as provided by FSP 106-1 until authoritative guidance on the accounting for the federal subsidy is issued. Any measure of the accumulated postretirement benefit obligation or net periodic postretirement benefit cost in the financial statements or the accompanying notes does not reflect the impact of the Act on the plans. At this time, specific authoritative guidance on the accounting for the federal subsidy provided by the Act is pending and that guidance could require the company to change previously reported information.

### NOTE 3. FINANCIAL INSTRUMENTS

As described in Note 7 of the notes to Consolidated Financial Statements in the Annual Report, the company follows the guidance of SFAS 133 as amended by SFAS 138 and 149 (collectively SFAS 133) to account for its derivative instruments and hedging activities. Derivative instruments and related hedges are recognized as either assets or liabilities on the balance sheet, measured at fair value.

SFAS 133 provides for hedge accounting treatment when certain criteria are met. For derivative instruments designated as fair value hedges, the gain or loss is recognized in earnings in the period of change together with the offsetting gain or loss on the hedged item attributable to the risk being hedged. For derivative instruments designated as cash flow hedges, the effective portion of the derivative gain or loss is included in other comprehensive income, but not reflected in the Statements of Consolidated Income until the corresponding hedged transaction is settled. The ineffective portion is reported in earnings immediately.

The company utilizes natural gas derivatives to manage commodity price risk associated with servicing its load requirements. These contracts allow the company to predict with greater certainty the effective prices to be received by the company and the prices to be charged to its customers. The company also periodically enters into interest-rate swap agreements to moderate exposure to interest-rate changes and to lower the overall cost of borrowing. The use of derivative financial instruments is subject to certain limitations imposed by company policy and regulatory requirements. The company classifies its forward contracts as follows:

Contracts that meet the definition of normal purchase and sales generally are long-term contracts that are settled by physical delivery and, therefore, are eligible for the normal purchases and sales

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exception of SFAS 133. The contracts are accounted for under accrual accounting and recorded in Revenues or Cost of Natural Gas on the Statements of Consolidated Income when physical delivery occurs. Due to the adoption of SFAS 149, the company has determined that its natural gas contracts entered into after June 30, 2003 generally do not qualify for the normal purchases and sales exception. However, the effect of this is minimal.

### Fixed-priced Contracts and Other Derivatives

Fixed-priced Contracts and Other Derivatives on the Consolidated Balance Sheets primarily reflect SoCalGas' unrealized gains and losses related to long-term delivery contracts for natural gas transportation. SoCalGas has established offsetting regulatory assets and liabilities to the extent that these gains and losses are recoverable through future rates. If gains and losses are not recoverable or payable through future rates, the company applies hedge accounting if certain criteria are met. When a contract no longer meets the requirements of SFAS 133, the unrealized gains and losses and the related regulatory asset or liability will be amortized over the remaining contract life.

The changes in Fixed-price Contracts and Other Derivatives on the Consolidated Balance Sheets for the quarter ended March 31, 2004 were primarily due to physical deliveries under long-term natural gas transportation contracts.

The transactions associated with fixed-price contracts and other derivatives had no material impact to the Statements of Consolidated Income for the quarters ended March 31, 2004 and 2003.

### NOTE 4. REGULATORY MATTERS

#### NATURAL GAS INDUSTRY RESTRUCTURING

As discussed in the Annual Report, in December 2001 the CPUC issued a decision related to natural gas industry restructuring (GIR), with implementation anticipated during 2002. On April 1, 2004, after many delays and changes, the CPUC issued a decision that adopts tariffs to implement the 2001 decision. However, by that same decision, the CPUC stayed implementation of the GIR tariffs until it issues a decision in Phase I of the Natural Gas Market Order Instituting Ratemaking (OIR) (see below). At that time, the CPUC will reconcile the GIR market structure with whatever structure results from the Phase I decision of the Gas Market OIR. The stayed decision, if implemented, would unbundle the costs of SoCalGas' backbone transmission system from rates and result in revising noncore balancing account treatment to exclude the balancing of SoCalGas' backbone transmission costs and place SoCalGas at risk for throughput. The decision would create firm tradable rights for the transmission system. Other noncore costs/revenues would continue to be fully balanced until the decision in the next Biennial Cost Allocation Proceeding (BCAP) (see below).

#### NATURAL GAS MARKET OIR

The Natural Gas Market OIR was approved on January 22, 2004, and will be addressed in two concurrent phases. The schedule calls for a Phase I decision by summer 2004 and a Phase II decision by the end of 2004. Further discussion of Phase I and Phase II is included in the Annual Report. The focus of the Gas OIR is 2006 to 2016. Since GIR (see above) would end in August 2006 and there is overlap between GIR and the Gas OIR issues, a number of parties (including SoCalGas) advised the CPUC not to implement GIR.

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The California Utilities have made comprehensive filings in the Gas OIR outlining a proposed market structure that will help create access to new natural gas supply sources (such as LNG) for California. In the Phase I filing, SoCalGas and SDG&E proposed a framework to provide firm tradable access rights for intrastate natural gas transportation; provide SoCalGas with continued balancing account protection for intrastate transmission and distribution revenues, thereby eliminating throughput risk; and integrate the transmission systems of SoCalGas and SDG&E so as to have common rates and rules. The California Utilities have proposed that the investments necessary to access new sources of supply be included in rate base. The estimated costs of these system enhancements to access as much as 2 billion cubic feet per day of new supplies are \$200 million.

In addition, the California Utilities have filed a recommended methodology and framework to be used by the CPUC for granting pre-approval of new interstate transportation agreements. They expect to receive a CPUC decision approving a methodology during the third quarter of 2004.

### COST OF SERVICE FILINGS

In 2002, the California Utilities filed Cost Of Service applications with the CPUC, seeking rate increases reflecting forecasts of 2004 capital and operating costs, as further discussed in the Annual Report. SoCalGas is requesting revenue increases of \$45 million. On December 19, 2003, settlements were filed with the CPUC for SoCalGas that, if approved, would resolve most of the cost of service issues. A CPUC decision is likely in the second quarter of 2004. The SoCalGas settlement would reduce rate revenues by \$33 million from 2003 rate revenues. A CPUC order has provided that the new rates will be retroactive to January 1, 2004. Beginning in the first quarter of 2004, SoCalGas is recognizing revenues consistent with the proposed settlements.

SoCalGas has also filed for continuation through 2004 of existing performance-based regulation (PBR) mechanisms for service quality and safety that would otherwise expire at the end of 2003. In January 2004, the CPUC issued a decision that extended 2003 service and safety targets through 2004, but deferred action on applying any rewards or penalties for performance relative to these targets to a decision to be issued later in 2004 in a second phase of these applications. On April 2, 2004, the CPUC's Office of Ratepayers Advocates (ORA) filed its report recommending that a Consumer Price Index with no productivity factor or customer growth factor be used to change the California Utilities' base margin, as opposed to the proposed Margin per Customer proposal of the California Utilities, and that the pending decision be in effect for five years. The ORA also proposed the possibility of performance penalties, without the possibility of performance awards. Hearings are scheduled for June 2004 with a final decision expected by November 2004.

### PERFORMANCE-BASED REGULATION

To promote efficient operations and improved productivity and to move away from reasonableness reviews and disallowances, the CPUC adopted PBR for SoCalGas effective in 1997. As further described in the Annual Report, under PBR, regulators require future income potential to be tied to achieving or exceeding specific performance and productivity goals, rather than relying solely on expanding utility plant to increase earnings. PBR, demand-side management (DSM) and Gas Cost

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Incentive Mechanism (GCIM) rewards are not included in the company's earnings before CPUC approval is received.

The only incentive reward approved during the first quarter of 2004 was \$6.3 million related to SoCalGas' Year 9 GCIM, which was approved on February 26, 2004. This reward is subject to refund based on the outcome of the Border Price Investigation described below. The cumulative amount of rewards so subject is \$54.5 million at March 31, 2004. At March 31, 2004, the only performance incentives pending CPUC approval and, therefore, not included in the company's earnings were \$9.8 million of DSM/Energy Efficiency rewards and \$0.5 million of 2003 safety awards.

### COST OF CAPITAL

Effective January 1, 2003, SoCalGas' authorized rate of return on common equity (ROE) is 10.82 percent and its return on ratebase is 8.68 percent. As discussed in the Annual Report, these rates will continue to be effective until market interest-rate changes are large enough to trigger an automatic adjustment or until the CPUC orders a periodic review. The automatic adjustment occurs when the 12-month trailing average of 30-year Treasury bond rates and the Global Insight forecast of the 30-year Treasury bond rate 12 months ahead vary by greater than 150 basis points from the benchmark, which is currently 5.38 percent. The 12-month trailing average was 4.93 percent at March 31, 2004. It would have to exceed 6.88 percent or fall below 3.88 percent for an automatic adjustment to occur.

### BIENNIAL COST ALLOCATION PROCEEDING

The BCAP determines the allocation of authorized costs between customer classes for natural gas transportation service provided by the company and adjusts rates to reflect variances in customer demand as compared to the forecasts previously used in establishing transportation rates. SoCalGas filed with the CPUC its 2005 BCAP application in September 2003, requesting updated transportation rates effective January 1, 2005. In November 2003, an Assigned Commissioner Ruling delayed the BCAP applications until a decision is issued in the GIR implementation proceeding. As a result of the April 1, 2004 decision on GIR implementation as described in "Natural Gas Industry Restructuring," the ALJ in the 2005 BCAP issued a ruling suspending the BCAP schedule pending CPUC dismissal of the applications. It is not known at this time when the California Utilities would be required to file new BCAP applications. As a result of the deferrals and the forecasted significant decline in noncore gas throughput on SoCalGas' system, in December 2002 the CPUC issued a decision approving 100 percent balancing account protection for SoCalGas' risk on local transmission and distribution revenues from January 1, 2003 until the CPUC issues its next BCAP decision. SoCalGas is seeking to continue this balancing account protection in the Gas OIR proceeding.

### BORDER PRICE INVESTIGATION

In November 2002, the CPUC instituted an investigation into the Southern California natural gas market and the price of natural gas delivered to the California-Arizona border between March 2000 and May 2001. If the investigation determines that the conduct of any party to the investigation, including the California Utilities, contributed to the natural gas price spikes, the CPUC may modify the party's natural gas procurement incentive mechanism, reduce the amount of any shareholder award for the period involved, and/or order the party to issue a refund to ratepayers. Hearings are scheduled to begin on June

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14, 2004. At a later date, the CPUC will hold a second round of hearings to consider whether Sempra Energy or any of its non-utility subsidiaries contributed to the price spikes. Decisions are expected by late 2004. The company believes that the CPUC will find that the California Utilities acted in the best interests of its core customers and that none of the Sempra Energy companies was responsible for the price spikes. The ORA recently filed testimony supporting the GCIM and the actions of SoCalGas during this period.

### CPUC INVESTIGATION OF COMPLIANCE WITH AFFILIATE RULES

In February 2003, the CPUC opened an investigation of the business activities of SDG&E, SoCalGas and Sempra Energy to determine if they have complied with statutes and CPUC decisions in the management, oversight and operations of their companies. In September 2003, the CPUC suspended the procedural schedule until it completes an independent audit to evaluate energy-related holding company systems and affiliate activities undertaken by Sempra Energy within the service territories of SDG&E and SoCalGas. The audit, covering years 1997 through 2003, is expected to be completed by March 2005. The scope of the audit will be broader than the annual affiliate audit. In accordance with existing CPUC requirements, the California Utilities' transactions with other Sempra Energy affiliates have been audited by an independent auditing firm each year, with results reported to the CPUC, and there have been no material adverse findings in those audits.

### CPUC INVESTIGATION OF ENERGY-UTILITY HOLDING COMPANIES

The CPUC has initiated an investigation into the relationship between California's investor-owned utilities (IOUs) and their parent holding companies. The CPUC broadly determined that it would require the holding company to provide cash to a utility subsidiary to cover its operating expenses and working capital to the extent they are not adequately funded through retail rates. This would be in addition to the requirement of holding companies to cover their utility subsidiaries' capital requirements, as the IOUs previously acknowledged in connection with the holding companies' formations. In January 2002 the CPUC ruled on jurisdictional issues, deciding that the CPUC had jurisdiction to create the holding company system and, therefore, retains jurisdiction to enforce conditions to which the holding companies had agreed. The company's request for rehearing on the issues was denied by the CPUC and the company subsequently filed appeals in the California Court of Appeal. Oral argument was held on March 5, 2004 before the First District Court of Appeal and a written opinion from the Court is expected by June 2004.

### NOTE 5. CONTINGENCIES

#### LITIGATION

Except for the matters referred to below, neither the company nor its subsidiaries are party to, nor is their property the subject of, any material pending legal proceedings other than routine litigation incidental to their businesses. Management believes that none of these matters will have further material adverse effect on the company's financial condition or results of operations.

#### Antitrust Litigation

Class-action and individual lawsuits filed in 2000 and currently



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consolidated in San Diego Superior Court seek damages, alleging that Sempra Energy, SoCalGas and SDG&E, along with El Paso Energy Corp. (El Paso) and several of its affiliates, unlawfully sought to control natural gas and electricity markets. In March 2003, plaintiffs in these cases and the applicable El Paso entities (whose cases involved additional issues not applicable to Sempra Energy, SoCalGas or SDG&E) announced that they had reached a \$1.5 billion settlement, of which \$125 million is allocated to customers of the California Utilities. The Court approved that settlement in December 2003. The proceeding against Sempra Energy and the California Utilities has not been settled, is currently in discovery and continues to be litigated.

**Natural Gas Cases:** Similar lawsuits have been filed by the Attorneys General of Arizona and Nevada, alleging that El Paso and certain Sempra Energy subsidiaries unlawfully sought to control the natural gas market in their respective states. In October 2003, the Nevada state court denied defendants' motion to dismiss the complaint. On April 12, 2004, the Sempra Energy defendants filed a motion for reconsideration. In April 2003, Sierra Pacific Resources and its utility subsidiary Nevada Power filed a lawsuit in U.S. District Court in Las Vegas against major natural gas suppliers, including Sempra Energy, the California Utilities and other Sempra Energy subsidiaries, seeking damages resulting from an alleged conspiracy to drive up or control natural gas prices, eliminate competition and increase market volatility, breach of contract and wire fraud. On January 27, 2004, the U.S. District Court dismissed the Sierra Pacific Resources case against all of the defendants, determining that this is a matter for the FERC. Plaintiffs have asked the court to reconsider its decision.

### Price Reporting Practices

In the fourth quarter of 2002, Sempra Energy and SoCalGas were named as defendants in a lawsuit filed in Los Angeles Superior Court against various trade publications and other energy companies alleging that energy prices were unlawfully manipulated by defendants' reporting artificially inflated natural gas prices to trade publications. On July 8, 2003, the Superior Court granted the defendants' demurrer on the grounds that the claims contained in the complaint were subject to the Filed Rate Doctrine and were preempted by the Federal Power Act. Plaintiffs filed an amended complaint, and in September 2003 defendants filed a demurrer to the amended complaint, which was granted in part. In December 2003, the plaintiffs dismissed both Sempra Energy and SoCalGas from the lawsuit.

## ITEM 2.

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

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

### RESULTS OF OPERATIONS

Natural gas revenues increased to \$1.1 billion in 2004 from \$1 billion in 2003, and the cost of natural gas distributed increased to \$721 million in 2004 from \$600 million in 2003. These changes were primarily attributable to natural gas cost increases, which are passed on to customers, and increased volumes.

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Under the current regulatory framework, the cost of natural gas purchased for customers and the variations in that cost are passed through to the customers on a substantially concurrent basis. However, SoCalGas' Gas Cost Incentive Mechanism (GCIM) allows SoCalGas to share in the savings or costs from buying natural gas for customers below or above monthly benchmarks. The mechanism permits full recovery of all costs within a tolerance band above the benchmark price and refunds all savings within a tolerance band below the benchmark price. The costs or savings outside the tolerance band are shared between customers and shareholders.

The table below summarizes natural gas volumes and revenues by customer class for the quarters ended March 31, 2004 and 2003.

### Gas Sales, Transportation and Exchange

(Volumes in billion cubic feet, dollars in millions)

	Gas Sales		Transportation & Exchange		Total	
	Volumes	Revenue	Volumes	Revenue	Volumes	Revenue
<hr/>						
2004:						
Residential	90	\$ 851	1	\$ 2	91	\$ 853
Commercial and industrial	32	249	68	39	100	288
Electric generation plants	--	--	29	8	29	8
Wholesale	--	--	44	8	44	8
	<hr/>					
	122	\$ 1,100	142	\$ 57	264	1,157
Balancing accounts and other						(9)
	<hr/>					
Total						\$ 1,148
<hr/>						
2003:						
Residential	76	\$ 679	1	\$ 2	77	\$ 681
Commercial and industrial	33	227	69	38	102	265
Electric generation plants	--	--	39	11	39	11
Wholesale	--	--	37	6	37	6
	<hr/>					
	109	\$ 906	146	\$ 57	255	963
Balancing accounts and other						45
	<hr/>					
Total						\$ 1,008
<hr/>						

Net income for SoCalGas decreased to \$56 million in 2004 from \$58 million in 2003, as higher 2004 revenues were offset by increased operating costs.

### CAPITAL RESOURCES AND LIQUIDITY

SoCalGas' operations are the major source of liquidity. In addition, working capital requirements can be met through the issuance of short-term and long-term debt. Cash requirements primarily consist of capital expenditures for utility plant.

At March 31, 2004, the company had \$44 million in cash and \$675 million

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in available unused, committed lines of credit (of which PE had \$375 million for the sole purpose of providing loans to Sempra Energy Global Enterprises, another subsidiary of Sempra Energy, and SoCalGas had \$300 million).

Management believes that cash flows from operations and debt issuances will be adequate to finance capital expenditure requirements and other commitments. Management continues to regularly monitor SoCalGas' ability to finance the needs of its operating, financing and investing activities in a manner consistent with its intention to maintain strong, investment-quality credit ratings.

### CASH FLOWS FROM OPERATING ACTIVITIES

Net cash provided by PE's operating activities totaled \$533 million and \$441 million for the quarters ended March 31, 2004 and 2003, respectively. Net cash provided by SoCalGas' operating activities totaled \$550 million and \$444 million for the quarters ended March 31, 2004 and 2003, respectively. The increases were primarily attributable to 2004's increase in overcollected regulatory balancing accounts and lower accounts receivable, partially offset by income tax refunds in 2003.

For the quarter ended March 31, 2004, the company made no pension plan contributions for the 2004 plan year.

### CASH FLOWS FROM INVESTING ACTIVITIES

Net cash used in PE's investing activities totaled \$345 million and \$253 million for the quarters ended March 31, 2004 and 2003, respectively. Net cash used in SoCalGas' investing activities totaled \$313 million and \$257 million for the quarters ended March 31, 2004 and 2003, respectively. The change was primarily due to increased advances from SoCalGas to Sempra Energy in 2004.

Significant capital expenditures in 2004 are expected to be for improvements to the distribution and transmission systems. These expenditures are expected to be financed by cash flows from operations and security issuances.

In connection with the importation of additional sources of natural gas into Southern California, for which the California Utilities have made filings with the CPUC, the California Utilities could incur capital expenditures estimated at \$200 million in order to connect with new delivery locations. The expenditures would be included in utility rate bases.

### CASH FLOWS FROM FINANCING ACTIVITIES

Net cash used in PE's financing activities totaled \$176 million and \$71 million for the quarters ended March 31, 2004 and 2003, respectively. Net cash used in SoCalGas' financing activities totaled \$225 million and \$70 million for the quarters ended March 31, 2004 and 2003, respectively. The changes in PE's and SoCalGas' cash flows were attributable to SoCalGas' redemption of \$175 million of 6.875% first mortgage bonds in January 2004 compared to repayment of \$70 million of medium-term notes in January 2003. Further, SoCalGas paid \$50 million in dividends to PE in 2004.

### FACTORS INFLUENCING FUTURE PERFORMANCE

Performance of the companies will depend primarily on the ratemaking

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and regulatory process, electric and natural gas industry restructuring, and the changing energy marketplace. These matters, including the pending cost of service filings and the CPUC's investigation of compliance with affiliate rules are discussed in the Annual Report and in Note 4 of the notes to Consolidated Financial Statements herein.

### CRITICAL ACCOUNTING POLICIES AND KEY NON-CASH PERFORMANCE INDICATORS

There have been no significant changes to the accounting policies viewed by management as critical or key non-cash performance indicators for the company's subsidiaries, as set forth in the Annual Report.

### NEW ACCOUNTING STANDARDS

Relevant pronouncements that have recently become effective and have had a significant effect on the company are Statement of Financial Accounting Standards Number (SFAS) 143 and 149 as discussed in Note 2 of the notes to Consolidated Financial Statements. Pronouncements that have or are likely to have a material effect on future earnings are described below.

SFAS 143, "Accounting for Asset Retirement Obligations": SFAS 143 requires entities to record the fair value of liabilities for legal obligations related to asset retirements in the period in which they are incurred. It also requires the company to reclassify amounts recovered in rates for future removal costs not covered by a legal obligation from accumulated depreciation to a regulatory liability. Further discussion is provided in Note 2 of the notes to Consolidated Financial Statements.

SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities": SFAS 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS 133. Under SFAS 149 natural gas forward contracts that are subject to unplanned netting do not qualify for the normal purchases and normal sales exception. The company has determined that all natural gas contracts are subject to unplanned netting and as such, these contracts will be marked to market. Implementation of SFAS 149 on July 1, 2003 did not have a material impact on reported net income.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

As of March 31, 2004, the total Value at Risk of SoCalGas' positions was not material.

### ITEM 4. CONTROLS AND PROCEDURES

The companies have designed and maintain disclosure controls and procedures to ensure that information required to be disclosed in the companies' reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and is accumulated and communicated to the companies' management, including their Chief Executive Officers and Chief Financial Officers, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating these controls and procedures, management recognizes that any system of controls and

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procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired objectives and necessarily applies judgment in evaluating the cost-benefit relationship of other possible controls and procedures.

Under the supervision and with the participation of management, including the Chief Executive Officers and the Chief Financial Officers, the companies as of March 31, 2004 have evaluated the effectiveness of the design and operation of the companies' disclosure controls and procedures. Based on that evaluation, the companies' Chief Executive Officers and Chief Financial Officers have concluded that the controls and procedures are effective.

There have been no significant changes in the companies' internal controls over financial reporting or in other factors that could significantly affect the internal controls subsequent to the date the companies completed their evaluations.

### ITEM 5. OTHER INFORMATION

Effective May 1, 2004, Debra L. Reed, President of SoCalGas and SDG&E, also will become their Chief Operating Officer. Simultaneously, Steven D. Davis, who remains Senior Vice President, External Relations, will succeed her as Chief Financial Officer.

## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

Except as described in Notes 4 and 5 of the notes to Consolidated Financial Statements, neither the companies nor their subsidiaries are party to, nor is their property the subject of, any material pending legal proceedings other than routine litigation incidental to their businesses.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

#### (a) Exhibits

Exhibit 12 -- Computation of ratios

12.1 Computation of Ratio of Earnings to Fixed Charges of PE.

12.2 Computation of Ratio of Earnings to Fixed Charges of SoCalGas.

Exhibit 31 -- Section 302 Certifications

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

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

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

31.4 Statement of SoCalGas' Chief 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

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

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

32.3 Statement of SoCalGas' Chief Executive Officer pursuant to 18 U.S.C. Sec. 1350.

32.4 Statement of SoCalGas' Chief Financial Officer pursuant to 18 U.S.C. Sec. 1350.

### (b) Reports on Form 8-K

The following report on Form 8-K was filed after December 31, 2003:

Current Report on Form 8-K filed February 24, 2004, filing as an exhibit Semptra Energy's press release of February 24, 2004, giving the financial results for the quarter ended December 31, 2003.

Current Report on Form 8-K filed April 29, 2004, filing as an exhibit Semptra Energy's press release of April 29, 2004, giving the financial results for the quarter ended March 31, 2004.

### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrants have duly caused this report to be signed on their behalf by the undersigned thereunto duly authorized.

PACIFIC ENTERPRISES

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(Registrant)

Date: April 29, 2004

By: /s/ F. H. Ault

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F. H. Ault  
Sr. Vice President and Controller

SOUTHERN CALIFORNIA GAS COMPANY

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(Registrant)

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By: /s/ D.L. Reed

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D.L. Reed  
President and  
Chief Financial Officer