

Edgar Filing: PACIFIC ENTERPRISES INC - Form 10-Q

PACIFIC ENTERPRISES INC

Form 10-Q

November 04, 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

September 30, 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
1-40	Pacific Enterprises (A California Corporation) 101 Ash Street San Diego, California 92101 (619) 696-2020	94-0743670
1-1402	Southern California Gas Company (A California Corporation) 555 West Fifth Street Los Angeles, California 90013 (213) 244-1200	95-1240705

No Change

-----  
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..... No..X....

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 and other regulatory bodies in the United States; capital market conditions, inflation rates, interest rates and exchange rates; energy and trading markets, including the timing and extent of changes in commodity prices; the availability of natural gas; weather conditions and conservation efforts; war and terrorist attacks; business, regulatory, environmental and legal decisions and requirements; 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.

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## PART I. FINANCIAL INFORMATION

### ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

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

	Three months ended September 30,	
	2004	2003
Operating revenues	\$ 826	\$ 794
Operating expenses		
Cost of natural gas	391	333
Other operating expenses	223	270
Depreciation	75	73

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Income taxes	49	39
Franchise fees and other taxes	23	23
	-----	-----
Total operating expenses	761	738
	-----	-----
Operating income	65	56
	-----	-----
Other income and (deductions)		
Interest income	3	1
Regulatory interest - net	(1)	2
Allowance for equity funds used during construction	1	4
Income taxes on non-operating income	(4)	(2)
Gain on sale of assets	15	--
Other - net	--	(1)
	-----	-----
Total	14	4
	-----	-----
Interest charges		
Long-term debt	9	9
Other	3	--
Allowance for borrowed funds used during construction	--	(1)
	-----	-----
Total	12	8
	-----	-----
Net income	67	52
Preferred dividend requirements	1	1
	-----	-----
Earnings applicable to common shares	\$ 66	\$ 51
	=====	=====

See notes to Consolidated Financial Statements.

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

	Nine months ended September 30,	
	2004	2003
	-----	-----
Operating revenues	\$ 2,821	\$ 2,622
	-----	-----
Operating expenses		
Cost of natural gas	1,537	1,354
Other operating expenses	663	690
Depreciation	225	214
Income taxes	130	111
Franchise fees and other taxes	80	77
	-----	-----
Total operating expenses	2,635	2,446
	-----	-----
Operating income	186	176
	-----	-----

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Other income and (deductions)		
Interest income	13	6
Regulatory interest - net	(3)	1
Allowance for equity funds used during construction	4	8
Income taxes on non-operating income	(4)	(4)
Preferred dividends of subsidiaries	(1)	(1)
Gain on sale of assets	15	--
Other - net	--	(3)
	-----	-----
Total	24	7
	-----	-----
Interest charges		
Long-term debt	26	31
Other	10	9
Allowance for borrowed funds used during construction	(1)	(3)
	-----	-----
Total	35	37
	-----	-----
Net income	175	146
Preferred dividend requirements	3	3
	-----	-----
Earnings applicable to common shares	\$ 172	\$ 143
	=====	=====

See notes to Consolidated Financial Statements.

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

	September 30, 2004	December 31, 2003
	-----	-----
ASSETS		
Utility plant - at original cost	\$ 7,205	\$ 7,008
Accumulated depreciation	(2,866)	(2,739)
	-----	-----
Utility plant - net	4,339	4,269
	-----	-----
Current assets:		
Cash and cash equivalents	26	32
Accounts receivable - trade	265	509
Accounts receivable - other	18	36
Interest receivable	31	30
Due from affiliates	3	76
Income taxes receivable	1	72
Regulatory assets arising from fixed-price contracts and other derivatives	99	85
Other regulatory assets	32	8
Inventories	129	74
Other	22	12
	-----	-----
Total current assets	626	934
	-----	-----
Other assets:		

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Due from affiliates	396	356
Regulatory assets arising from fixed-price contracts and other derivatives	70	148
Sundry	115	150
	-----	-----
Total other assets	581	654
	-----	-----
Total assets	\$ 5,546	\$ 5,857
	=====	=====

See notes to Consolidated Financial Statements.

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

	September 30, 2004	December 31, 2003
	-----	-----
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Common stock (600 million shares authorized; 84 million shares outstanding)	\$ 1,367	\$ 1,367
Retained earnings	275	253
Accumulated other comprehensive income (loss)	(3)	(3)
	-----	-----
Total common equity	1,639	1,617
Preferred stock	80	80
	-----	-----
Total shareholders' equity	1,719	1,697
Long-term debt	765	762
	-----	-----
Total capitalization	2,484	2,459
	-----	-----
Current liabilities:		
Accounts payable - trade	195	227
Accounts payable - other	70	44
Due to affiliates	98	121
Interest payable	25	18
Deferred income taxes	21	24
Regulatory balancing accounts - net	2	86
Fixed-price contracts and other derivatives	100	86
Customer deposits	46	43
Current portion of long-term debt	--	175
Other	245	262
	-----	-----
Total current liabilities	802	1,086
	-----	-----
Deferred credits and other liabilities:		
Customer advances for construction	43	40
Postretirement benefits other than pensions	58	72
Deferred income taxes	155	121
Deferred investment tax credits	42	44
Regulatory liabilities arising from cost of removal obligations	1,448	1,392

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Other regulatory liabilities	112	109
Fixed-price contracts and other derivatives	70	148
Preferred stock of subsidiary	20	20
Deferred credits and other	312	366
	-----	-----
Total deferred credits and other liabilities	2,260	2,312
	-----	-----
Contingencies and commitments (Note 5)		
Total liabilities and shareholders' equity	\$ 5,546	\$ 5,857
	=====	=====

See notes to Consolidated Financial Statements.

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

	Nine months ended September 30,	
	2004	2003
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 175	\$ 146
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	225	214
Deferred income taxes and investment tax credits	28	(39)
Gain on sale of assets	(15)	--
Net changes in other working capital components	177	83
Changes in other assets	5	6
Changes in other liabilities	(32)	13
	-----	-----
Net cash provided by operating activities	563	423
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(234)	(217)
Affiliate loans	(14)	296
Proceeds from sale of assets	7	--
	-----	-----
Net cash provided by (used in) investing activities	(241)	79
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Common dividends paid	(150)	(250)
Preferred dividends paid	(3)	(3)
Payments on long-term debt	(175)	(295)
Increase in short-term debt	--	40
	-----	-----
Net cash used in financing activities	(328)	(508)
	-----	-----
Decrease in cash and cash equivalents	(6)	(6)
Cash and cash equivalents, January 1	32	22
	-----	-----
Cash and cash equivalents, September 30	\$ 26	\$ 16
	=====	=====

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## SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Interest payments, net of amounts capitalized	\$ 24	\$ 32
	=====	=====
Income tax payments, net of refunds	\$ 33	\$ 44
	=====	=====

## SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES

Assets contributed by Sempra Energy	\$ --	\$ 48
Liabilities assumed	--	(17)
	-----	-----
Net assets contributed by Sempra Energy	\$ --	\$ 31
	=====	=====

See notes to Consolidated Financial Statements.

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

	Three months ended September 30,	
	2004	2003
	-----	-----
Operating revenues	\$ 826	\$ 794
	-----	-----
Operating expenses		
Cost of natural gas	391	333
Other operating expenses	222	268
Depreciation	75	73
Income taxes	48	39
Franchise fees and other taxes	23	23
	-----	-----
Total operating expenses	759	736
	-----	-----
Operating income	67	58
	-----	-----
Other income and (deductions)		
Interest income	1	1
Regulatory interest - net	(1)	2
Allowance for equity funds used during construction	1	4
Income taxes on non-operating income	(4)	(2)
Gain on sale of assets	15	--
Other - net	(1)	(1)
	-----	-----
Total	11	4
	-----	-----
Interest charges		
Long-term debt	9	9
Other	1	1
Allowance for borrowed funds used during construction	--	(1)
	-----	-----
Total	10	9

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Earnings applicable to common shares	----- \$ 68 =====	----- \$ 53 =====
See notes to Consolidated Financial Statements.		

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

	Nine months ended September 30,	
	----- 2004 -----	----- 2003 -----
Operating revenues	\$ 2,821	\$ 2,622
Operating expenses		
Cost of natural gas	1,537	1,354
Other operating expenses	660	689
Depreciation	225	214
Income taxes	129	112
Franchise fees and other taxes	80	77
Total operating expenses	----- 2,631 -----	----- 2,446 -----
Operating income	----- 190 -----	----- 176 -----
Other income and (deductions)		
Interest income	3	3
Regulatory interest - net	(3)	1
Allowance for equity funds used during construction	4	8
Income taxes on non-operating income	(4)	(4)
Gain on sale of assets	15	--
Other - net	(1)	(2)
Total	----- 14 -----	----- 6 -----
Interest charges		
Long-term debt	26	31
Other	4	5
Allowance for borrowed funds used during construction	(1)	(3)
Total	----- 29 -----	----- 33 -----
Net income	175	149
Preferred dividend requirements	1	1
Earnings applicable to common shares	----- \$ 174 =====	----- \$ 148 =====
See notes to Consolidated Financial Statements.		

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

	September 30, 2004	December 31, 2003
	-----	-----
ASSETS		
Utility plant - at original cost	\$ 7,205	\$ 7,008
Accumulated depreciation	(2,866)	(2,739)
	-----	-----
Utility plant - net	4,339	4,269
	-----	-----
Current assets:		
Cash and cash equivalents	26	32
Accounts receivable - trade	265	509
Accounts receivable - other	15	35
Interest receivable	31	30
Due from affiliates	--	22
Income taxes receivable	--	25
Regulatory assets arising from fixed-price contracts and other derivatives	99	85
Other regulatory assets	32	8
Inventories	129	74
Other	18	9
	-----	-----
Total current assets	615	829
	-----	-----
Other assets:		
Regulatory assets arising from fixed-price contracts and other derivatives	70	148
Sundry	96	127
	-----	-----
Total other assets	166	275
	-----	-----
Total assets	\$ 5,120	\$ 5,373
	=====	=====

See notes to Consolidated Financial Statements.

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

	September 30, 2004	December 31, 2003
	-----	-----
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Common stock (100 million shares authorized; 91 million shares outstanding)	\$ 866	\$ 866
Retained earnings	515	491

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Accumulated other comprehensive income (loss)	(3)	(3)
	-----	-----
Total common equity	1,378	1,354
Preferred stock	22	22
	-----	-----
Total shareholders' equity	1,400	1,376
Long-term debt	765	762
	-----	-----
Total capitalization	2,165	2,138
	-----	-----
Current liabilities:		
Accounts payable - trade	195	227
Accounts payable - other	70	44
Due to affiliates	28	55
Interest payable	25	18
Income taxes payable	47	--
Deferred income taxes	12	15
Regulatory balancing accounts - net	2	86
Fixed-price contracts and other derivatives	100	86
Customer deposits	46	43
Current portion of long-term debt	--	175
Other	243	262
	-----	-----
Total current liabilities	768	1,011
	-----	-----
Deferred credits and other liabilities:		
Customer advances for construction	43	40
Postretirement benefits other than pensions	58	--
Deferred income taxes	162	136
Deferred investment tax credits	42	44
Regulatory liabilities arising from cost of removal obligations	1,448	1,392
Other regulatory liabilities	112	181
Fixed-price contracts and other derivatives	70	148
Deferred credits and other	252	283
	-----	-----
Total deferred credits and other liabilities	2,187	2,224
	-----	-----
Contingencies and commitments (Note 5)		
Total liabilities and shareholders' equity	\$ 5,120	\$ 5,373
	=====	=====

See notes to Consolidated Financial Statements.

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

Nine months ended September 30,	
-----	-----
2004	2003
-----	-----

## CASH FLOWS FROM OPERATING ACTIVITIES

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Net income	\$ 175	\$ 149
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	225	214
Deferred income taxes and investment tax credits	27	(41)
Gain on sale of assets	(15)	--
Net changes in other working capital components	120	92
Changes in other assets	--	(1)
Changes in other liabilities	(11)	18
	-----	-----
Net cash provided by operating activities	521	431
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(234)	(217)
Affiliate loan	26	86
Proceeds from sale of assets	7	--
	-----	-----
Net cash used in investing activities	(201)	(131)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Common dividends paid	(150)	(50)
Preferred dividends paid	(1)	(1)
Payments on long-term debt	(175)	(295)
Increase in short-term debt	--	40
	-----	-----
Net cash used in financing activities	(326)	(306)
	-----	-----
Decrease in cash and cash equivalents	(6)	(6)
Cash and cash equivalents, January 1	32	22
	-----	-----
Cash and cash equivalents, September 30	\$ 26	\$ 16
	=====	=====
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest payments, net of amounts capitalized	\$ 19	\$ 28
	=====	=====
Income tax payments, net of refunds	\$ 33	\$ 44
	=====	=====
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES		
Assets contributed by Sempra Energy	\$ --	\$ 48
Liabilities assumed	--	(18)
	-----	-----
Net assets contributed by Sempra Energy	\$ --	\$ 30
	=====	=====

See notes to Consolidated Financial Statements.

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## 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

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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 other, 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 10-Q. Results of operations for interim periods are not necessarily indicative of results for the entire year. In the opinion of management, the accompanying statements reflect all adjustments necessary for a fair presentation. These adjustments are only of a normal recurring nature. Certain changes in classification have been made to prior presentations to conform to the current financial statement presentation. Specifically, 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) and the Quarterly Reports on Form 10-Q for the first and second quarters of 2004.

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 and nine months ended September 30, 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. The proposed statement would eliminate the choice of accounting for share-based compensation transactions using Accounting Principles Board (APB) Opinion No. 25,

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Accounting for Stock Issued to Employees, whereby no expense is recorded for most stock options, and instead would require that such transactions be accounted for using a fair-value-based method, whereby expense is recorded for stock options. It would also prohibit application by restating prior periods and would require that expense ultimately be recognized only for those options that actually vest. A final statement is expected to be issued in the fourth quarter of 2004 and be effective July 1, 2005.

SFAS 132 (revised 2003), "Employers' Disclosures about Pensions and

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Other Postretirement Benefits": This statement revises required disclosures about employers' pension plans and other postretirement benefit plans, effective in 2004. It requires disclosures beyond those in the original SFAS 132 related to the assets, obligations, cash flows and net periodic benefit cost of defined benefit pension plans and other defined postretirement benefit plans. In addition, it 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 three and nine months ended September 30:

	Pension Benefits		Other Postretirement Benefits	
	Three months ended September 30,		Three months ended September 30,	
(Dollars in millions)	2004	2003	2004	2003
Service cost	\$ 7	\$ 5	\$ 3	\$ 4
Interest cost	24	22	7	12
Expected return on assets	(24)	(27)	(9)	(8)
Amortization of:				
Transition obligation	--	--	2	2
Prior service cost	2	2	--	--
Actuarial loss	1	--	1	4
Regulatory adjustment	(9)	(1)	7	(3)
Total net periodic benefit cost	\$ 1	\$ 1	\$ 11	\$ 11

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	Pension Benefits		Other Postretirement Benefits	
	Nine months ended September 30,		Nine months ended September 30,	
(Dollars in millions)	2004	2003	2004	2003
Service cost	\$ 22	\$ 21	\$ 12	\$ 12
Interest cost	70	67	32	35
Expected return on assets	(73)	(80)	(25)	(24)
Amortization of:				
Transition obligation	--	--	6	6
Prior service cost	5	5	--	--
Actuarial loss	3	--	6	7
Regulatory adjustment	(25)	(11)	7	(3)
Total net periodic benefit cost	\$ 2	\$ 2	\$ 38	\$ 33

Note 5 of the notes to Consolidated Financial Statements in the Annual

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Report discusses the company's expected contribution to its pension plan and other postretirement benefit plans in 2004. For the nine months ended September 30, 2004, \$3 million and \$38 million of contributions have been made to its pension plan and other postretirement benefit plans, respectively. \$11 million of contributions have been made to its other postretirement benefit plans but no contribution was made to its pension plan for the quarter ended September 30, 2004.

FASB Staff Position (FSP) 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003": In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") was enacted. The Act establishes a prescription drug benefit under Medicare, known as "Medicare Part D," and a tax-exempt federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that actuarially is at least equivalent to Medicare Part D.

In May 2004, the FASB issued FSP 106-2 which requires that the effects of the federal subsidy be considered an actuarial gain and be recognized in the same manner as other actuarial gains and losses. In addition, FSP 106-2 requires certain disclosures for employers that sponsor postretirement health care plans that provide prescription drug benefits. During the third quarter of 2004, the company adopted FSP 106-2 retroactive to the beginning of the year. The company and its actuarial advisors determined that benefits provided to certain participants will actuarially be at least equivalent to Medicare Part D, and, accordingly, the company will be entitled to an expected tax-exempt subsidy that reduces the company's accumulated postretirement benefit obligation under the plan at January 1, 2004 by \$94 million and net periodic benefit cost for 2004 by \$12 million.

The net periodic postretirement benefit costs for the three and nine months ended September 30, 2004 were reduced by \$9 million, before regulatory adjustments, to reflect the expected subsidy as a result of the Act.

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The following tables provide the impact of the Act on components of net periodic postretirement benefit costs. The three-month period includes the entire nine-month subsidy since none of the subsidy was recorded until the third quarter.

(Dollars in millions)	Three months ended September 30, 2004		
	Before Federal Subsidy	Effect of Subsidy	After Federal Subsidy
Service cost	\$ 4	\$ (1)	\$ 3
Interest cost	11	(4)	7
Expected return on assets	(9)	--	(9)
Amortization of:			
Transition obligation	2	--	2
Prior service cost	--	--	--
Actuarial (gain) loss	5	(4)	1

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Regulatory adjustment	(2)	9	7
<hr/>			
Total net periodic benefit cost	\$ 11	\$ --	\$ 11
<hr/>			

Nine months ended  
September 30, 2004

(Dollars in millions)	Before Federal Subsidy	Effect of Subsidy	After Federal Subsidy
<hr/>			
Service cost	\$ 13	\$ (1)	\$ 12
Interest cost	36	(4)	32
Expected return on assets	(25)	--	(25)
Amortization of:			
Transition obligation	6	--	6
Prior service cost	--	--	--
Actuarial (gain) loss	10	(4)	6
Regulatory adjustment	(2)	9	7
<hr/>			
Total net periodic benefit cost	\$ 38	\$ --	\$ 38
<hr/>			

SFAS 143, "Accounting for Asset Retirement Obligations": Beginning in 2003, SFAS 143 requires entities to record liabilities for future costs expected to be incurred when assets are retired from service, if the retirement process is legally required. It also requires the reclassification of estimated removal costs, which have historically been recorded in accumulated depreciation, to a regulatory liability. At both September 30, 2004 and December 31, 2003, the estimated removal costs recorded as a regulatory liability were \$1.4 billion.

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The change in the asset retirement obligations for the nine months ended September 30, 2004 is as follows (dollars in millions):

Balance as of January 1, 2004	\$ 11
Accretion expense (interest)	--
	<hr/>
Balance as of September 30, 2004	\$ 11*
	<hr/>

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

In June 2004, the FASB issued a proposed interpretation, Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143. The interpretation would clarify that a legal obligation to perform an asset retirement activity that is conditional on a future event is within the scope of SFAS 143. Accordingly, the interpretation would require an entity to recognize a liability for a conditional asset retirement obligation if the liability's fair value can be reasonably estimated. The proposed interpretation would be effective for the company on December 31, 2005.

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 and for hedging activities under SFAS 133. Under SFAS 149, natural gas forward

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contracts that are subject to unplanned netting generally do not qualify for the normal purchases and normal sales exception, whereby derivatives are not required to be marked to market when the contract is usually settled by the physical delivery of natural gas. ("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.) The company has determined that all natural gas contracts are subject to unplanned netting and as such, these contracts are marked to market. Implementation of SFAS 149 did not have a material impact on reported net income. Additional information on derivative instruments is provided in Note 3.

FASB Interpretation No. (FIN) 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees": The company has a residual value guarantee under a fleet lease arrangement. As of September 30, 2004, the company had no liabilities recorded for the fleet lease guarantee due to the immaterial amount of the estimated fair value of such guarantee.

### 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 hedged items 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,

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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. Any 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 or paid 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.

Contracts that meet the definition of normal purchases and sales generally are long-term contracts that are settled by physical delivery and, therefore, are eligible for the normal purchases and sales 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 September 30, 2003 generally do not



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qualify for the normal purchases and sales exception and, accordingly, are marked to market. However, the effect of this is minimal.

### Fixed-price Contracts and Other Derivatives

Fixed-price Contracts and Other Derivatives on the Consolidated Balance Sheets primarily reflect the company's unrealized gains and losses related to long-term delivery contracts for natural gas transportation. The company has established offsetting regulatory assets and liabilities to the extent that these gains and losses are included in the calculation of future rates. If gains and losses are not recoverable or payable through future rates, the company applies hedge accounting if certain criteria are met. If 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 nine months ended September 30, 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 nine months ended September 30, 2004 and 2003.

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### NOTE 4. REGULATORY MATTERS

#### NATURAL GAS MARKET OIR

The CPUC's Natural Gas Market Order Instituting Rulemaking (OIR) was instituted on January 22, 2004, and will be addressed in two phases. A decision on Phase I was issued on September 2, 2004 and the schedule for Phase II calls for a 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 the period from 2006 to 2016. Since Natural Gas Industry Restructuring (GIR), as discussed in the Annual Report, would end in August 2006 and there is overlap between GIR and the OIR issues, a number of parties (including SoCalGas) have requested the CPUC not to implement GIR.

The California Utilities have made comprehensive filings in the OIR outlining a proposed market structure that is intended to create access to new natural gas supply sources (such as liquefied natural gas (LNG)) for California. In their Phase I and Phase II filings, 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 also proposed that the capital expenditures necessary to access new sources of supply be included in ratebase and that the total amount of the expenditures would be \$200 million to \$300 million.

The California Utilities also proposed a methodology and framework to be used by the CPUC for granting pre-approval of new interstate transportation agreements. The Phase I decision approves the California Utilities' transportation capacity pre-approval procedures with some modifications. SoCalGas' existing pipeline capacity contract with Transwestern Pipeline Company expires in November 2005 and its primary

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contracts with El Paso Natural Gas Company expire in August 2006. Discussions are underway pursuant to the framework approved by the CPUC to acquire replacement capacity. The Phase I decision also directs the California Utilities to file, by December 2, 2004, an application to implement proposals for transmission system integration, firm access rights, and off-system delivery services. The CPUC has determined that project developers, not the utilities, will be presumed to pay for the costs for access-related infrastructure, subject to future applications to be filed when more is known about the particular projects. Phase II of the Gas Market OIR will review the CPUC's ratemaking policies on throughput risk to better align these with its objectives of promoting energy conservation and adequate infrastructure. Phase II will also investigate the need for emergency natural gas storage reserves and the role of the utility in backstopping the noncore market.

### 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 requested revenue increases of \$37 million. As previously reported, in December 2003 SoCalGas filed with the CPUC a proposed

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settlement of its cost of service proceeding. The settlement, if approved by the CPUC, would reduce the company's annual rate revenues by an aggregate net amount of approximately \$33 million from the rates in effect during 2003. The CPUC's Office of Ratepayer Advocates (ORA) and all other major parties to the cost of service proceedings have recommended that the CPUC approve the settlement.

On September 28, 2004, the CPUC's Administrative Law Judge (ALJ) and the CPUC Commissioner assigned to the cost of service proceedings issued differing proposed decisions for consideration by the CPUC. Both of these proposed decisions recommend that the CPUC reject the proposed settlement. The ALJ's proposed decision would, if adopted by the CPUC, increase annual rate revenues by \$44 million from that contemplated by the settlement but would also adopt a one-way balancing account requiring that any reductions in operating labor costs from those estimated in establishing rates be refunded to customers. CPUC Commissioner Wood's alternate proposed decision, which does not include a one-way labor balancing account, would, if adopted by the CPUC, decrease the annual rate reduction by \$8 million from that contemplated by the proposed settlement.

If various minor factual errors are corrected, they would increase the annual rate revenues that would be provided by the ALJ's proposed decision to \$46 million above that contemplated by the settlement and would increase the annual rate revenues that would be provided by Commissioner Wood's alternative proposed decision to \$10 million above that contemplated by the settlement. Both proposed decisions would approve balancing accounts for pension costs similar to those contemplated by the settlement and various other cost balancing accounts not contemplated by the settlement. All the proposals contemplate that the rates resulting from the cost of service proceedings would remain effective through 2007 subject to annual attrition adjustments.

The company previously reported that it expects that another CPUC commissioner will issue an additional proposed decision that, if adopted by the CPUC, would essentially approve the proposed

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settlements. Subsequently, on October 28, 2004, the CPUC at its regularly scheduled meeting deferred acting on the cost of service proceedings at the request of Commissioner Brown, who stated that he would issue an additional proposed decision.

The CPUC may adopt any one of the proposed decisions or reject all of them and adopt a different outcome. The company expects that a CPUC decision will be issued by year end.

The CPUC previously ordered that any changes in rates resulting from the cost of service proceedings would be effective retroactively to January 1, 2004. Consequently, during 2004 the company has, in general, recorded revenue and resulting net income in a manner consistent with the reduced rates contemplated by the proposed settlement, except for the favorable effect of the recovery of pension costs contemplated by the proposed settlement and provided by the proposed decisions. To the extent that the revenues provided by the CPUC's decision in the cost of service proceedings differ from those previously recorded, a reconciling adjustment to revenues and resulting net income would be

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recorded in the latest quarter for which financial statements had not been published.

Other ratemaking issues are included in Phase II of the cost of service proceeding. In addition to recommending changes in the performance-based regulation (PBR) formulas, the ORA also proposed the possibility of performance penalties for service quality, safety and electric service reliability, without the possibility of performance awards. Hearings took place in June 2004. On July 21, 2004, all of the active parties in Phase II who dealt with post test year ratemaking and performance incentives filed for adoption by the CPUC of an all-party settlement agreement for most of the Phase II issues, including annual inflation adjustments and revenue sharing. The agreement does not cover performance incentives. For the interim years of 2005-2007, the Consumer Price Index would be used to adjust the escalatable authorized base rate revenues within identified floors and ceilings. It is not likely that the CPUC will address this matter in its decision related to Phase II of this proceeding before year-end 2004. Consequently, to ensure that the results of Phase II would be applicable for a full year in 2005, SoCalGas and SDG&E filed with the CPUC on September 29, 2004, a petition to modify a prior decision that provided for the differences between 2004's rates and the amounts determined in the cost of service decision to be collected or refunded in future rates, to also apply to similar differences occurring in 2005 prior to implementation of the cost of service decision.

SoCalGas had filed for continuation of existing 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 did not determine the applicability of rewards or penalties. As part of the proposed Phase II Settlement Agreement, Revenue Sharing, under which IOUs return to customers a percentage of earnings above specified levels, would be suspended for 2004 and resume for 2005 through 2007. The proposed revenue sharing mechanism also provides the utility the option to file for suspension of the earnings sharing mechanism if earnings for two consecutive years fall 175 basis points or more below its authorized rate of return; however, if earnings are 300 or more basis points above the utility's authorized rate of return, the revenue sharing mechanism would be automatically suspended and trigger a formal regulatory review

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by the CPUC to determine whether modification of the ratemaking mechanism is required.

### PERFORMANCE-BASED REGULATION

As further described in the Annual Report, under PBR, the CPUC requires 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 Incentive Mechanism (GCIM) rewards are not included in the company's earnings before CPUC approval is received.

The only incentive reward approved during the nine months ended September 30, 2004 consisted of \$6.3 million related to SoCalGas' Year 9 GCIM, which was approved on February 26, 2004. This reward was awarded by the CPUC subject to refund based on the outcome of the

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Border Price Investigation, as discussed below. The cumulative amount of rewards subject to refund based on the outcome of the Border Price Investigation is \$56.9 million, substantially all of which has been included in net income.

At September 30, 2004, the following performance incentives were pending CPUC approval and, therefore, were not included in the company's earnings (dollars in millions):

Program	
-----	
DSM/Energy Efficiency*	\$ 10.9
GCIM Year 10	2.4
2003 safety	.5
-----	
Total	\$ 13.8
-----	

\* Dollar amounts shown do not include interest, franchise fees or uncollectible amounts.

### COST OF CAPITAL

Effective January 1, 2003, SoCalGas' authorized rate of return on equity (ROE) is 10.82 percent and its return on ratebase (ROR) is 8.68 percent. These rates are subject to automatic adjustment if 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 a benchmark, which is currently 5.38 percent. The 12-month trailing average was 5.10 percent and the Global Insight forecast was 5.84 percent at September 30, 2004.

### BIENNIAL COST ALLOCATION PROCEEDING (BCAP)

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 sales volumes 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 application until a decision is issued in the GIR implementation proceeding. As a result of the April 1, 2004 decision on GIR

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implementation as described in Natural Gas Industry Restructuring in the Annual Report, on May 27, 2004 the ALJ in the 2005 BCAP issued a decision dismissing the BCAP application. The company is required to file a new BCAP application after the stay of the GIR implementation decision is lifted. As a result of the deferrals and the significant decline forecasted 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 Natural Gas OIR proceeding.

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### 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. The California Utilities are the parties to the first phase of the investigation. If the investigation were to determine that the conduct of either of the California Utilities contributed to the natural gas price spikes that occurred during the investigation period, 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. At September 30, 2004, the cumulative amount of shareholder awards, substantially all of which has been included in net income, was \$56.9 million. The ORA has filed testimony supporting the GCIM and the actions of SoCalGas during this period. The first phase of this investigation was reopened for one day on October 25, 2004, for additional testimony and supplemental opening and reply briefs. While the ALJ stated that a proposed decision is not imminent, the company expects that a proposed decision will be issued before year end for consideration by the CPUC. Although the proposed decision may be adverse to it, the company believes it is unlikely that the full CPUC would adopt any such adverse decision and would instead conclude that the California Utilities were not responsible for any natural gas price spikes. A final CPUC decision in the first phase of the investigation is not expected until 2005.

### CPUC INVESTIGATION OF ENERGY-UTILITY HOLDING COMPANIES

The CPUC has initiated an investigation into the relationship between California's IOUs and their parent holding companies. The CPUC broadly determined that it could, in appropriate circumstances, 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 provide for their utility subsidiaries' capital requirements, as the IOUs previously acknowledged in connection with the holding companies' formations. In January 2002, the CPUC ruled that it had jurisdiction to create the holding company system and, therefore, retains jurisdiction to enforce conditions to which the holding companies had agreed.

In an opinion issued May 21, 2004, the California Court of Appeal upheld the CPUC's assertion of limited enforcement jurisdiction, but concluded that the CPUC's interpretation of the "first priority" condition (that the holding companies could be required to infuse cash into the utilities as necessary to meet the utilities' obligation to serve) was not ripe for review. In September 2004, the California

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Supreme Court declined to review the California Court of Appeal's decision.

### NOTE 5. 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

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matters will have further material adverse effect on the company's financial condition or results of operations.

#### Energy Crisis Litigation

In 2000 and 2001, California experienced a severe energy crisis characterized by dramatic increases in the prices of natural gas. Many, often duplicative, lawsuits have been filed against numerous energy companies seeking overlapping damages aggregating in the tens of billions of dollars for allegedly unlawful activities asserted to have caused or contributed to the energy crisis. In addition, the energy crisis has generated numerous governmental investigations and regulatory proceedings. The company is cooperating in various investigations, including an investigation being conducted by the California Attorney General into possible anti-competitive behavior. The material regulatory proceedings arising out of the energy crisis that involve the company are briefly summarized, along with other proceedings, in Note 4 and this Note 5. The lawsuits arising out of the energy crisis to which the company is a defendant are briefly summarized below.

Class-action and individual antitrust and unfair competition lawsuits filed in 2000 and thereafter, and currently consolidated in San Diego Superior Court seek damages, alleging that Sempra Energy, SoCalGas and SDG&E, along with El Paso Natural Gas Company (El Paso) and several of its affiliates, unlawfully sought to control natural gas and electricity markets. In December 2003, the Court approved a settlement whereby the applicable El Paso entities (including cases involving unrelated claims not applicable to Sempra Energy, SoCalGas or SDG&E) will pay approximately \$1.7 billion to resolve these claims. The proceeding against Sempra Energy and the California Utilities has not been settled and continues to be litigated. During the third quarter of 2004, the court denied motions by Sempra Energy and the California Utilities for summary judgment in their favor. Sempra Energy and the California Utilities have requested the Court of Appeal to review these denials; however, such an interim review pending a final decision on the merits of the case is entirely at the discretion of the appellate court. In October 2004, certain of the plaintiffs issued a news release asserting that they could recover as much as \$24 billion from Sempra Energy and the California Utilities if their allegations were upheld at trial. The trial of the case was previously set for September 2004 but has been postponed and the newly assigned judge has yet to schedule a new trial date. (The original judge is retiring at year end.)

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. The claims against the Sempra Energy defendants in the Arizona lawsuit were settled in September 2004 for \$150,000 and have been dismissed with prejudice.

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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 Semptra Energy, the California Utilities and other company subsidiaries, seeking recovery of damages alleged to aggregate in excess of \$150 million (before trebling) from an alleged conspiracy to drive up or control natural gas

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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 to resolve. However, the court granted plaintiffs' request to amend their complaint, which they have done and Semptra Energy has filed another motion to dismiss, which is scheduled to be heard on November 29, 2004.

In July 2004, the City and County of San Francisco, the County of Santa Clara and the County of San Diego brought actions, alleging that energy prices were unlawfully manipulated by defendants' reporting artificially inflated natural gas prices to trade publications and by entering into wash trades and by engaging in "churning" transactions with Reliant Energy, in San Diego Superior Court against various entities, including Semptra Energy, SET, SoCalGas and SDG&E.

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" and "Risk Factors" contained in the Annual Report.

#### RESULTS OF OPERATIONS

##### Revenues and Cost of Sales

Natural gas revenues increased to \$2.8 billion for the nine months ended September 30, 2004 from \$2.6 billion for the corresponding period in 2003, and the cost of natural gas increased to \$1.5 billion in 2004 from \$1.4 billion in 2003. Additionally, natural gas revenues were \$826 million for the quarter ended September 30, 2004 compared to \$794 million for the corresponding period in 2003, and the cost of natural gas was \$391 million in 2004 compared to \$333 million in 2003. These increases were primarily attributable to natural gas cost increases, which are passed on to customers, offset by \$48 million of GCIM awards recognized during the third quarter of 2003. Performance awards are discussed in Note 4 of the notes to Consolidated Financial Statements.

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 and in Note 4 of the notes to Consolidated Financial Statements. In accordance with generally accepted accounting principles, SoCalGas is generally recognizing 2004 revenue in a manner consistent with the reduced rates contemplated by the proposed settlements, except for the favorable effect of the recovery of pension costs contemplated by the proposed settlements and provided by both proposed decisions. To the

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extent that the revenues provided by the CPUC's decision in the cost of service proceedings differ from those previously recorded, a reconciling adjustment to revenues and resulting net income would be recorded in the latest quarter for which financial statements had not

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been published. To date, the impacts of accounting consistent with the settlement have not had a material effect on the financial statements.

The table below summarizes natural gas volumes and revenues by customer class for the nine months ended September 30, 2004 and 2003.

Natural 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	172	\$ 1,705	1	\$ 5	173	\$ 1,710
Commercial and industrial	78	614	204	139	282	753
Electric generation plants	--	--	137	41	137	41
Wholesale	--	--	112	32	112	32
	<hr/>					
	250	\$ 2,319	454	\$ 217	704	2,536
Balancing accounts and other						285
	<hr/>					
Total						\$ 2,821
<hr/>						
2003:						
Residential	165	\$ 1,547	1	\$ 5	166	\$ 1,552
Commercial and industrial	79	559	206	134	285	693
Electric generation plants	--	--	141	39	141	39
Wholesale	--	--	100	23	100	23
	<hr/>					
	244	\$ 2,106	448	\$ 201	692	2,307
Balancing accounts and other						315
	<hr/>					
Total						\$ 2,622
<hr/>						

### Other Operating Expenses

Other operating expenses at SoCalGas decreased to \$660 million for the nine-month period ended September 30, 2004 from \$689 million for the same period in 2003 and decreased to \$222 million for the quarter ended September 30, 2004 from \$268 million for the same period in 2003 primarily as a result of a \$55 million before-tax charge in the third quarter of 2003 for litigation and for losses associated with a sublease of portions of the SoCalGas headquarters building, offset by an increase in refundable costs.

### Net Income

SoCalGas recorded net income of \$175 million and \$149 million for the nine-month periods ended September 30, 2004 and 2003, respectively, and net income of \$68 million and \$53 million for the quarters ended



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September 30, 2004 and 2003, respectively. The increases were primarily due to the \$32 million after-tax charge for litigation and for losses associated with a long-term sublease of portions of its headquarters building in 2003, higher margins in 2004 and the gain on the sale of partnership property, partially offset by higher GCIM awards in 2003 and higher depreciation expense in 2004.

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### CAPITAL RESOURCES AND LIQUIDITY

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

At September 30, 2004, the company had \$26 million in cash and \$800 million in available unused, committed lines of credit (of which PE had \$500 million for the sole purpose of providing loans to Sempra Energy Global Enterprises, another subsidiary of Sempra Energy, and SoCalGas had \$300 million). See "Cash Flows from Financing Activities" for discussion on changes in PE's credit facility in 2004.

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. Rating agencies and others that evaluate a company's liquidity generally consider a company's capital expenditures and working capital requirements in comparison to cash from operations, available credit lines and other sources available to meet liquidity requirements.

### CASH FLOWS FROM OPERATING ACTIVITIES

Net cash provided by PE's operating activities totaled \$563 million and \$423 million for the nine months ended September 30, 2004 and 2003, respectively. PE's operating activities included \$521 million and \$431 million, respectively, from SoCalGas. The increases were primarily attributable to a lower decrease in overcollected regulatory balancing accounts and higher decrease in accounts receivable in 2004 and 2003 refunds of customer deposits.

For the nine months ended September 30, 2004, the company made pension plan and other postretirement benefit plan contributions of \$3 million and \$38 million, respectively.

### CASH FLOWS FROM INVESTING ACTIVITIES

Net cash provided by (used in) PE's investing activities totaled \$(241) million and \$79 million for the nine months ended September 30, 2004 and 2003, respectively. Net cash used in SoCalGas' investing activities totaled \$201 million and \$131 million for the nine months ended September 30, 2004 and 2003, respectively. The changes were primarily due to increased advances to and lower repayments by Sempra Energy in 2004 for PE and SoCalGas, respectively.

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 debt issuances.

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In September 2004, the CPUC approved a proposed framework for the contracting of interstate pipeline capacity for core customers. Discussions are underway for the California Utilities to acquire

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pipeline capacity to replace capacity contracts expiring over the next two years. The CPUC also approved requests to establish receipt points to accept new supplies, including imported LNG, to the California Utilities' service area. Approval for a point of receipt to import natural gas from Mexico to Southern California via pipelines at Otay Mesa was also obtained. As a result, the California Utilities expect to install capital facilities starting in 2005, in order to receive natural gas supplies from new delivery locations. The CPUC has determined that project developers, not the utilities, will be presumed to pay for the costs for access-related infrastructure, subject to future applications to be filed when more is known about the particular projects. Note 4 of the notes to Consolidated Financial Statements herein provides further details.

### CASH FLOWS FROM FINANCING ACTIVITIES

Net cash used in PE's financing activities totaled \$328 million and \$508 million for the nine months ended September 30, 2004 and 2003, respectively. Net cash used in SoCalGas' financing activities totaled \$326 million and \$306 million for the nine months ended September 30, 2004 and 2003, respectively. The changes were attributable to lower debt and dividend payments by PE and lower debt payments partially offset by higher dividend payments by SoCalGas in 2004.

In September 2004, PE extended the termination date of its revolving credit agreement to September 30, 2005, and increased the revolving credit commitment from \$250 million to \$500 million. Borrowings under the credit agreement, none of which are outstanding, are available to provide loans to Global and would bear interest at rates varying with market rates, PE's credit ratings and amounts borrowed. They would be guaranteed by Semptra Energy and would be subject to mandatory repayment if Semptra Energy's or SoCalGas' ratio of debt to total capitalization (as defined in the agreement) were to exceed 65%, or if there were to be a change in law materially and adversely affecting SoCalGas' ability to pay dividends or make other distributions to PE.

### FACTORS INFLUENCING FUTURE PERFORMANCE

Performance of the companies will depend primarily on the ratemaking and regulatory process, electric and natural gas industry restructuring, and the changing energy marketplace. These factors are discussed in the Annual Report and in Note 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, 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 SFAS Nos. 132 (revised 2003), 143 and 149, FASB Staff Position 106-2, and FIN 45, as discussed

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in Note 2 of the notes to Consolidated Financial Statements.

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Pronouncements that have or are likely to have a material effect on future earnings are described below.

SFAS 143, "Accounting for Asset Retirement Obligations": Beginning in 2003, SFAS 143 requires entities to record liabilities for future costs expected to be incurred when assets are retired from service, if the retirement process is legally required. 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.

In June 2004, the FASB issued a proposed interpretation of SFAS 143, Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143. The interpretation would clarify that a legal obligation to perform an asset retirement activity that is conditional on a future event is within the scope of SFAS 143. Accordingly, the interpretation would require an entity to recognize a liability for a conditional asset retirement obligation if the liability's fair value can be reasonably estimated. The proposed interpretation would be effective for the company on December 31, 2005.

SFAS 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities": SFAS 149 amends and clarifies accounting for derivative instruments 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, whereby derivatives are not required to be marked to market when the contract is usually settled by the physical delivery of natural gas. The company has determined that all natural gas contracts are subject to unplanned netting and as such, these contracts are 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 September 30, 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 procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired objectives and

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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 evaluated the effectiveness of the design and operation of the companies' disclosure controls and procedures as of September 30, 2004, the end of the period covered by this report. Based on that evaluation, the companies' Chief Executive Officers and Chief Financial Officers concluded that the companies' disclosure controls and procedures were effective at the reasonable assurance level.

There has been no change in the companies' internal controls over financial reporting during the companies' most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the companies' internal controls over financial reporting.

### PART II - OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

Except as described in Notes 4 and 5 of the notes to Consolidated Financial Statements herein, 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 10 - Material Contracts

Compensation

- 10.1 Sempra Energy Employee Stock Incentive Plan  
(September 30, 2004 Sempra Energy Form 10-Q  
Exhibit 10.1).
- 10.2 Sempra Energy Amended and Restated Executive Life  
Insurance Plan (September 30, 2004 Sempra Energy  
Form 10-Q Exhibit 10.2).
- 10.3 Sempra Energy Excess Cash Balance Plan  
(September 30, 2004 Sempra Energy Form 10-Q  
Exhibit 10.3).
- 10.4 Form of Sempra Energy 1998 Long Term Incentive Plan  
Performance-Based Restricted Stock Award  
(September 30, 2004 Sempra Energy Form 10-Q  
Exhibit 10.4).
- 10.5 Form of Sempra Energy 1998 Long Term Incentive Plan  
Nonqualified Stock Option Agreement  
(September 30, 2004 Sempra Energy Form 10-Q  
Exhibit 10.5).

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- 10.6 Form of Sempra Energy 1998 Non-Employee Directors' Stock

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Plan Nonqualified Stock Option Agreement  
(September 30, 2004 Sempra Energy Form 10-Q  
Exhibit 10.6).

- 10.7 Sempra Energy Supplemental Executive Retirement Plan  
(September 30, 2004 Sempra Energy Form 10-Q  
Exhibit 10.7).
- 10.8 Neal Schmale Restricted Stock Award Agreement  
(September 30, 2004 Sempra Energy Form 10-Q  
Exhibit 10.8).
- 10.9 Severance Pay Agreement between Sempra Energy and  
Donald E. Felsing (September 30, 2004 Sempra Energy  
Form 10-Q Exhibit 10.9).
- 10.10 Severance Pay Agreement between Sempra Energy and  
Neal Schmale (September 30, 2004 Sempra Energy  
Form 10-Q Exhibit 10.10).
- 10.11 Sempra Energy Executive Personal Financial Planning Program  
Policy Document (September 30, 2004 Sempra Energy  
Form 10-Q Exhibit 10.11).

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.

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.

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

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(b) Reports on Form 8-K

The following reports on Form 8-K were filed after June 30, 2004:

Current Report on Form 8-K filed August 5, 2004, filing as an exhibit Semptra Energy's press release of August 5, 2004, giving the financial results for the quarter ended June 30, 2004.

Current Report on Form 8-K filed September 30, 2004, announcing proposed decisions issued by the CPUC's Administrative Law Judge and the Assigned CPUC Commissioner on September 28, 2004, in the California Utilities' Cost of Service Proceedings.

Current Report on Form 8-K filed October 27, 2004, discussing the current status of the California Utilities' Cost of Service Proceedings and the Border Price Investigation.

Current Report on Form 8-K filed November 4, 2004, filing as an exhibit Semptra Energy's press release of November 4, 2004, giving the financial results for the quarter ended September 30, 2004.

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### 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: November 4, 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)

Date: November 4, 2004

By: /s/ S. D. Davis

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S. D. Davis

Sr. Vice President-External Relations  
and Chief Financial Officer

