



# Edgar Filing: PACIFIC ENTERPRISES INC - Form 10-Q

## 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," "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, national and international 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.

### ITEM 1. FINANCIAL STATEMENTS.

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

	Three months ended June 30,	
	2003	2002
OPERATING REVENUES	\$ 820	\$ 670
OPERATING EXPENSES		
Cost of natural gas	421	269
Other operating expenses	223	210
Depreciation	72	68
Income taxes	27	42
Franchise fees and other taxes	25	23
Total operating expenses	768	612

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Operating income	52	58
Other income and (deductions)		
Interest income	3	4
Regulatory interest - net	(1)	--
Allowance for equity funds used during construction	2	2
Income taxes on non-operating income	(1)	--
Preferred dividends of subsidiaries	(1)	(1)
Other - net	(5)	2
Total	(3)	7
Interest charges		
Long-term debt	10	10
Other	4	5
Allowance for borrowed funds used during construction	(1)	--
Total	13	15
Net income	36	50
Preferred dividend requirements	1	1
Earnings applicable to common shares	\$ 35	\$ 49

See notes to Consolidated Financial Statements.

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

	Six months ended June 30,	
	2003	2002
OPERATING REVENUES	\$ 1,828	\$ 1,402
OPERATING EXPENSES		
Cost of natural gas	1,021	616
Other operating expenses	420	391
Depreciation	141	136
Income taxes	72	89
Franchise fees and other taxes	54	47
Total operating expenses	1,708	1,279
Operating income	120	123
Other income and (deductions)		
Interest income	5	6
Regulatory interest - net	(1)	(4)
Allowance for equity funds used		

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during construction	4	4
Income taxes on non-operating income	(2)	3
Preferred dividends of subsidiaries	(1)	(1)
Other - net	(2)	5
	-----	-----
Total	3	13
	-----	-----
Interest charges		
Long-term debt	22	19
Other	9	9
Allowance for borrowed funds used during construction	(2)	(1)
	-----	-----
Total	29	27
	-----	-----
Net income	94	109
Preferred dividend requirements	2	2
	-----	-----
Earnings applicable to common shares	\$ 92	\$ 107
	=====	=====

See notes to Consolidated Financial Statements.

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

	June 30, 2003	December 31, 2002
	-----	-----
ASSETS		
Utility plant - at original cost	\$6,860	\$6,701
Accumulated depreciation	(4,027)	(3,914)
	-----	-----
Utility plant - net	2,833	2,787
	-----	-----
Current assets:		
Cash and cash equivalents	12	22
Accounts receivable - trade	319	458
Accounts receivable - other	19	44
Due from unconsolidated affiliates	172	83
Income taxes receivable	55	97
Deferred income taxes	79	55
Regulatory assets arising from fixed-price contracts and other derivatives	88	92
Other regulatory assets	14	--
Inventories	57	76
Other	18	20
	-----	-----
Total current assets	833	947
	-----	-----
Other assets:		
Due from unconsolidated affiliates	213	419
Regulatory assets arising from fixed-price contracts and other derivatives	191	233
Sundry	162	173
	-----	-----

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Total other assets	566	825
	-----	-----
Total assets	\$4,232	\$4,559
	=====	=====

See notes to Consolidated Financial Statements.

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

	June 30, 2003	December 31, 2002
	-----	-----
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Common Stock (600,000,000 shares authorized; 83,917,664 shares outstanding)	\$1,349	\$1,318
Retained earnings	128	286
	-----	-----
Total common equity	1,477	1,604
Preferred stock	80	80
	-----	-----
Total shareholders' equity	1,557	1,684
Long-term debt	562	657
	-----	-----
Total capitalization	2,119	2,341
	-----	-----
Current liabilities:		
Accounts payable - trade	227	200
Accounts payable - other	30	36
Due to unconsolidated affiliates	87	96
Regulatory balancing accounts - net	200	184
Interest payable	26	25
Regulatory liabilities	--	16
Fixed-price contracts and other derivatives	93	96
Current portion of long-term debt	100	175
Customer deposits	124	108
Other	235	265
	-----	-----
Total current liabilities	1,122	1,201
	-----	-----
Deferred credits and other liabilities:		
Customer advances for construction	39	37
Post-retirement benefits other than pensions	76	77
Deferred income taxes	205	176
Deferred investment tax credits	46	47
Regulatory liabilities	117	121
Fixed-price contracts and other derivatives	191	233
Deferred credits and other liabilities	297	306
Preferred stock of subsidiary	20	20
	-----	-----
Total deferred credits and other liabilities	991	1,017
	-----	-----
Contingencies and commitments (Note 3)		

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Total liabilities and shareholders' equity	\$4,232	\$4,559
	=====	=====

See notes to Consolidated Financial Statements.

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

	Six months ended June 30,	
	2003	2002
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 94	\$ 109
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	141	136
Deferred income taxes and investment tax credits	(12)	(8)
Net changes in other working capital components	223	399
Changes in other assets	(2)	(1)
Changes in other liabilities	(4)	(14)
	-----	-----
Net cash provided by operating activities	440	621
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(135)	(143)
Loan to/from affiliate - net	107	(298)
	-----	-----
Net cash used in investing activities	(28)	(441)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Common dividends paid	(250)	(100)
Preferred dividends paid	(2)	(2)
Payment of long-term debt	(170)	--
Decrease in short-term debt	--	(50)
	-----	-----
Net cash used in financing activities	(422)	(152)
	-----	-----
Increase (decrease) in cash and cash equivalents	(10)	28
Cash and cash equivalents, January 1	22	13
	-----	-----
Cash and cash equivalents, June 30	\$ 12	\$ 41
	=====	=====
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest payments, net of amounts capitalized	\$ 26	\$ 24
	=====	=====
Income tax payments, net of refunds	\$ 44	\$ 74
	=====	=====
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES		
Assets contributed by Sempra Energy	\$ 48	\$ --
Liabilities assumed	(18)	--
	-----	-----

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Net assets contributed by Sempra Energy	\$ 30	\$ --
	=====	=====

See notes to Consolidated Financial Statements.

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

	Three months ended June 30,	
	2003	2002
	-----	-----
OPERATING REVENUES	\$ 820	\$ 670
	-----	-----
OPERATING EXPENSES		
Cost of natural gas	421	269
Other operating expenses	226	208
Depreciation	72	68
Income taxes	28	44
Franchise fees and other taxes	25	23
	-----	-----
Total operating expenses	772	612
	-----	-----
Operating income	48	58
	-----	-----
Other income and (deductions)		
Interest income	1	1
Regulatory interest - net	(1)	--
Allowance for equity funds used during construction	2	2
Income taxes on non-operating income	(1)	1
	-----	-----
Total	1	4
	-----	-----
Interest charges		
Long-term debt	10	10
Other	2	--
Allowance for borrowed funds used during construction	(1)	--
	-----	-----
Total	11	10
	-----	-----
Net income	38	52
Preferred dividend requirements	1	1
	-----	-----
Earnings applicable to common shares	\$ 37	\$ 51
	=====	=====

See notes to Consolidated Financial Statements.

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

	Six months ended June 30,	
	2003	2002
OPERATING REVENUES	\$ 1,828	\$ 1,402
OPERATING EXPENSES		
Cost of natural gas	1,021	616
Other operating expenses	421	386
Depreciation	141	136
Income taxes	73	92
Franchise fees and other taxes	54	47
Total operating expenses	1,710	1,277
Operating income	118	125
Other income and (deductions)		
Interest income	2	2
Regulatory interest - net	(1)	(4)
Allowance for equity funds used during construction	4	4
Income taxes on non-operating income	(2)	5
Other - net	(1)	--
Total	2	7
Interest charges		
Long-term debt	22	19
Other	4	2
Allowance for borrowed funds used during construction	(2)	(1)
Total	24	20
Net income	96	112
Preferred dividend requirements	1	1
Earnings applicable to common shares	\$ 95	\$ 111

See notes to Consolidated Financial Statements.

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

June 30, 2003	December 31, 2002
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ASSETS		
Utility plant - at original cost	\$6,860	\$6,701
Accumulated depreciation	(4,027)	(3,914)
	-----	-----
Utility plant - net	2,833	2,787
	-----	-----
Current assets:		
Cash and cash equivalents	12	22
Accounts receivable - trade	319	458
Accounts receivable - other	19	44
Due from unconsolidated affiliates	171	81
Income taxes receivable	--	28
Deferred income taxes	109	87
Regulatory assets arising from fixed-priced contracts and other derivatives	88	92
Other regulatory assets	14	--
Inventories	57	76
Other	17	20
	-----	-----
Total current assets	806	908
	-----	-----
Other assets:		
Regulatory assets arising from fixed-priced contracts and other derivatives	191	233
Sundry	137	151
	-----	-----
Total other assets	328	384
	-----	-----
Total assets	\$3,967	\$4,079
	=====	=====

See notes to Consolidated Financial Statements.

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

	----- June 30, 2003 -----	December 31, 2002 -----
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Common stock (100,000,000 shares authorized; 91,300,000 shares outstanding)	\$ 866	\$ 836
Retained earnings	527	482
	-----	-----
Total common equity	1,393	1,318
Preferred stock	22	22
	-----	-----
Total shareholders' equity	1,415	1,340
Long-term debt	562	657
	-----	-----
Total capitalization	1,977	1,997

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Current liabilities:		
Accounts payable - trade	227	199
Accounts payable - other	30	36
Due to unconsolidated affiliates	22	31
Regulatory balancing accounts - net	200	184
Income taxes payable	15	--
Interest payable	21	24
Regulatory liabilities	--	16
Fixed-price contracts and other derivatives	93	96
Current portion of long-term debt	100	175
Customer deposits	124	108
Other	233	264
	-----	-----
Total current liabilities	1,065	1,133
	-----	-----
Deferred credits and other liabilities:		
Customer advances for construction	39	37
Deferred income taxes	266	237
Deferred investment tax credits	46	47
Regulatory liabilities arising from deferred taxes	165	164
Other regulatory liabilities	28	37
Fixed-price contracts and other derivatives	191	233
Deferred credits and other liabilities	190	194
	-----	-----
Total deferred credits and other liabilities	925	949
	-----	-----
Contingencies and commitments (Note 3)		
Total liabilities and shareholders' equity	\$3,967	\$4,079
	=====	=====

See notes to Consolidated Financial Statements.

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

	Six months ended June 30,	
	2003	2002
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 96	\$ 112
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	141	136
Deferred income taxes and investment tax credits	(12)	(12)
Net changes in other working capital components	224	396
Changes in other assets	(1)	--
Changes in other liabilities	--	(12)
	-----	-----
Net cash provided by operating activities	448	620
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		

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Capital expenditures	(135)	(143)
Loan to/from affiliate - net	(102)	(298)
	-----	-----
Net cash used in investing activities	(237)	(441)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends paid	(51)	(101)
Payments of long-term debt	(170)	--
Decrease in short-term debt	--	(50)
	-----	-----
Net cash used in financing activities	(221)	(151)
	-----	-----
Increase (decrease) in cash and cash equivalents	(10)	28
Cash and cash equivalents, January 1	22	13
	-----	-----
Cash and cash equivalents, June 30	\$ 12	\$ 41
	=====	=====
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest payments, net of amounts capitalized	\$ 24	\$ 22
	=====	=====
Income tax payments, net of refunds	\$ 44	\$ 74
	=====	=====
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.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 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 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

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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.

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, 2002 (Annual Report) and the Quarterly Report on Form 10-Q for the three months ended March 31, 2003.

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.

As described in the notes to Consolidated Financial Statements in the Annual Report, 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".

### COMPREHENSIVE INCOME

The following is a reconciliation of net income to comprehensive income.

	Pacific Enterprises				SoCalGas			
	Three months ended June 30,		Six months ended June 30,		Three months ended June 30,		Six months ended June 30,	
	2003	2002	2003	2002	2003	2002	2003	2002
(Dollars in millions)								
Net income	\$ 36	\$ 50	\$ 94	\$ 109	\$ 38	\$ 52	\$ 96	\$ 112
Financial instruments	--	--	--	(1)*	--	--	--	(1)*
Comprehensive income	\$ 36	\$ 50	\$ 94	\$ 108	\$ 38	\$ 52	\$ 96	\$ 111

\* This did not affect the reported balance of accumulated other comprehensive income related to this topic (\$0 at the beginning and end of the period) due to rounding.

### 2. NEW ACCOUNTING STANDARDS

SFAS 143, "Accounting for Asset Retirement Obligations": On January 1, 2003, the company recorded asset retirement obligations of \$10 million associated with the future retirement of three storage facilities.

The change in the asset retirement obligations for the six months ended June 30, 2003 is as follows (dollars in millions):

Balance as of January 1, 2003	\$ --
Adoption of SFAS 143	10
Accretion expense	1
	-----



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period. On August 1, 2003, the Administrative Law Judge (ALJ) issued a revised schedule with hearings scheduled to begin in March 2004 and with a Commission decision by late 2004.

### CPUC INVESTIGATION OF COMPLIANCE WITH AFFILIATE RULES

On February 27, 2003, the CPUC opened an investigation of the business activities of SDG&E, SoCalGas and Sempra Energy to ensure that they have complied with relevant statutes and CPUC decisions in the management, oversight and operations of their companies. The Assigned Commissioner and ALJ issued a ruling which suspends the procedural schedule until the CPUC completes an independent audit to evaluate energy-related business activities undertaken by Sempra Energy within the service territories of SDG&E and SoCalGas, relative to holding company systems and affiliate activities. The audit is to consider whether these activities pose any problems for ratepayers and whether they are consistent with the CPUC's decision, rules or orders and/or affiliate statutes. The objective of the audit is to analyze the adequacy of the Affiliate Rules. 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.

### COST OF SERVICE FILING

On May 22, 2003, the assigned CPUC Commissioner modified his previously adopted procedural schedule on the California Utilities' Cost of Service applications to expedite a decision by approximately one month, permitting a decision by as early as March 2004. The assigned Commissioner also provided for additional comments to be filed on the California Utilities' request for interim relief for the period from January 1, 2004 to the date of the Cost of Service decision and stated that a decision on the request would be prepared for consideration of the full Commission. On June 3, 2003, various parties filed reply comments supporting or opposing the motion for January 1, 2004 interim relief. The CPUC's Office of Ratepayer Advocates' (ORA) report on the California Utilities' filing is due on August 8, 2003.

An October 10, 2001 decision denied the California Utilities' request to continue equal sharing between ratepayers and shareholders of the estimated savings for the 1998 Enova-PE business combination that created Sempra Energy and, instead, ordered that all of the estimated 2003 merger savings go to ratepayers. This decision will adversely affect 2003 net income by \$24 million.

### GAS COST INCENTIVE MECHANISM (GCIM)

SoCalGas' GCIM allows SoCalGas to receive a share of the savings it achieves by buying natural gas for customers below monthly benchmarks. The mechanism permits full recovery of all costs within a tolerance band above the benchmark price and refunds savings within a tolerance band below the benchmark price. The costs outside the tolerance band are shared between customers and shareholders.

On June 25, 2003, the assigned CPUC commissioner issued two separate, but essentially identical, Draft Decisions in SoCalGas' GCIM Year 7 and Year 8 proceedings. A final CPUC decision is expected during the third quarter of 2003. If the final decision agrees with the assigned commissioner's Draft Decisions approving the shareholder rewards of \$30.8 million for Year 7 and \$17.4 million for Year 8 (subject to refund or adjustment as determined by the Commission in the Border

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Price Investigation described above), the rewards would be included in income in the third quarter of 2003.

On June 16, 2003, SoCalGas filed an application with the CPUC requesting a \$6.3 million shareholder reward for GCIM Year 9 (April 1, 2002 through March 31, 2003). The company's natural gas purchasing activities resulted in a net savings of \$33 million to ratepayers during Year 9, which led to the requested shareholder reward.

Performance incentives rewards are not included in the company's earnings until CPUC approval is received.

### LITIGATION

Lawsuits filed in 2000 and currently consolidated in San Diego Superior Court seek class-action certification and 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 announced that they had reached a settlement in principle of the class actions, certain of the individual actions, claims asserted by the California Attorney General and by other western states, and certain complaint proceedings filed with FERC by the CPUC and the California Energy Oversight Board. On June 26, 2003, the settlement was filed for approval with the relevant state courts and the FERC. The settlement provides more than \$1.5 billion in consideration to be received by customers, with no effect on the income of the utilities processing the refunds. Of these funds, the settlement provides the following allocation for each SDG&E and SoCalGas customer group: SDG&E Electric Customers -- \$60 million, SDG&E Core Gas -- \$29 million and SoCalGas Core Gas -- \$36 million. Non-core natural gas customers will go through a claims process in the courts, by which they can establish their harm and receive a fair share of the consideration.

A similar lawsuit has been filed by the Attorney General of Arizona alleging that El Paso and certain Sempra Energy subsidiaries unlawfully sought to control the natural gas market in Arizona. In April 2003, Sierra Pacific and its utility subsidiary Nevada Power jointly filed a lawsuit in U.S. District Court in Las Vegas against major natural gas suppliers, including Sempra Energy, the California Utilities and other company subsidiaries, seeking damages resulting from an alleged conspiracy to drive up or control natural gas prices, eliminate competition and increase market volatility, and breach of contract and wire fraud.

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. However, the Court has provided plaintiffs with an opportunity to amend their claims.

Except for the matters referred to above, 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 a material

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adverse effect on the company's financial condition or results of operations.

### PENDING INTERNAL REVENUE SERVICE MATTERS

The company is in discussions with the Internal Revenue Service (IRS) to resolve issues related to various prior years' returns. A recently issued Revenue Ruling dealing with utility balancing accounts, and recent discussions with the IRS concerning this Ruling lead the company to believe it will be entitled to reverse recorded interest associated with the reporting of these items in prior periods. The company expects that these matters will be favorably resolved before year end and estimates that the resolution will increase reported 2003 earnings in excess of \$10 million.

### QUASI-REORGANIZATION

In 1993, PE divested its merchandising operations and most of its oil and natural gas exploration and production business. In connection with the divestitures, PE effected a quasi-reorganization for financial reporting purposes effective December 31, 1992. Management believes the remaining balances of the liabilities established in connection with the quasi-reorganization are adequate.

### 4. FINANCIAL INSTRUMENTS

Note 7 of the notes to Consolidated Financial Statements in the Annual Report discusses the companies' financial instruments, including the adoption of SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities." The effect is to recognize all derivatives as assets or liabilities on the balance sheet, measure those instruments at fair value, and recognize any changes in fair value in earnings for the period that the change occurs unless the derivative qualifies as an effective hedge that offsets other exposures.

The company utilizes derivative financial instruments to manage its exposure to unfavorable changes in commodity prices, which are subject to significant and often volatile fluctuations. Derivative financial instruments include futures, forwards, swaps, options and long-term delivery contracts. These contracts allow the company to predict with greater certainty the effective prices to be received by the company and their customers. In accordance with SFAS 133, the company has elected to account for contracts that are settled by physical delivery at historical cost, with gains and losses reflected in the income statement at the contract settlement date.

Fixed-price contracts and other derivatives on the Consolidated Balance Sheets primarily reflect the company's derivative gains and losses related to long-term delivery contracts for natural gas transportation. The company has established regulatory assets and liabilities to the extent that these gains and losses are recoverable or payable through future rates. The changes in fixed-price contracts and other derivatives on the Consolidated Balance Sheets for the six months ended June 30, 2003 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 six months ended June 30, 2003 or 2002.

ITEM 2.



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## 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 \$1.8 billion for the six months ended June 30, 2003 from \$1.4 billion for the corresponding period in 2002, and the cost of natural gas increased to \$1 billion in 2003 from \$616 million in 2002. Additionally, natural gas revenues increased to \$820 million for the three months ended June 30, 2003 from \$670 million for the corresponding period in 2002, and the cost of natural gas increased to \$421 million in 2003 from \$269 million in 2002. These changes were primarily attributable to natural gas price increases, which are passed on to customers, partially offset by reduced volumes.

Under the current regulatory framework, changes in core-market natural gas prices for core customers (primarily residential and small commercial and industrial customers) do not affect net income, since core-customer rates generally recover the actual cost of natural gas on a substantially concurrent basis and are fully balanced. However, SoCalGas' 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 six months ended June 30, 2003 and 2002.

Gas Sales, Transportation and Exchange  
(Volumes in billion cubic feet, dollars in millions)

	Gas Sales		Transportation & Exchange		Total	
	Volumes	Revenue	Volumes	Revenue	Volumes	Revenue
2003:						
Residential	129	\$ 1,188	1	\$ 4	130	\$ 1,192
Commercial and industrial	58	411	138	86	196	497
Electric generation plants	--	--	67	18	67	18
Wholesale	--	--	68	13	68	13
	187	\$ 1,599	274	\$ 121	461	1,720
Balancing accounts and other						108
<b>Total</b>						<b>\$ 1,828</b>
2002:						
Residential	144	\$ 968	1	\$ 4	145	\$ 972

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Commercial and industrial	53	271	142	76	195	347
Electric generation plants	--	--	85	15	85	15
Wholesale	--	--	83	10	83	10
	197	\$ 1,239	311	\$ 105	508	1,344
Balancing accounts and other						58
Total						\$ 1,402

SoCalGas recorded net income of \$96 million and \$112 million for the six-month periods ended June 30, 2003 and 2002, respectively, and net income of \$38 million and \$52 million for the three-month periods ended June 30, 2003 and 2002, respectively. The change was primarily due to the end of sharing of the merger savings (discussed in the Annual Report) and increased operating expenses associated with legal costs principally related to antitrust litigation, partially offset by increased margins and other factors.

### 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 June 30, 2003, the company had \$12 million in cash and \$800 million (of which PE had \$500 million for the sole purpose of providing loans to Sempra Energy Global Enterprises (Global) and SoCalGas had \$300 million) in unused, committed lines of credit available. On July 10, 2003, the CPUC issued a decision authorizing SoCalGas to issue up to \$715 million of long-term debt, of which not less than \$500 million will be used for the retirement of currently outstanding debt or preferred stock. The decision also grants SoCalGas an exemption from the Competitive Bidding Rule and permits the company to enter into interest-rate swaps, caps, collars and currency-exchange contracts.

Management believes these amounts, cash flows from operations and new debt issuances will be adequate to finance capital expenditure requirements and other commitments. Management continues to regularly monitor the company's ability to adequately meet the needs of its operating, financing and investing activities.

### CASH FLOWS FROM OPERATING ACTIVITIES

Net cash provided by operating activities totaled \$440 million and \$621 million for the six months ended June 30, 2003 and 2002, respectively. The decrease in cash flows from operations was primarily attributable to an increase in overcollected regulatory balancing accounts in 2002 resulting from higher natural gas usage in 2002 and lower deposits from customers in 2003.

### CASH FLOWS FROM INVESTING ACTIVITIES

Net cash used in investing activities totaled \$28 million and \$441 million for the six months ended June 30, 2003 and 2002, respectively. The change in cash flows from investing activities was primarily due to the repayments by Sempra Energy in 2003 of advances made to it in 2002.

Capital expenditures for property, plant and equipment are estimated to be \$350 million for the full year 2003 and are being financed primarily

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by internally generated funds and security issuances. Construction, investment and financing programs are continuously reviewed and revised in response to changes in competition, customer growth, inflation, customer rates, the cost of capital, and environmental and regulatory requirements.

### CASH FLOWS FROM FINANCING ACTIVITIES

Net cash used in financing activities totaled \$422 million and \$152 million for the six months ended June 30, 2003 and 2002, respectively. The change in cash flows from financing activities was attributable to the repayment of \$70 million of medium-term notes in January 2003 and \$100 million of 7.375% first-mortgage bonds in April 2003. Dividends paid to Sempra Energy were \$250 million (including \$50 million dividended to PE by SoCalGas) and \$100 million (all dividended to PE by SoCalGas) for the first six months of 2003 and 2002, respectively. In addition, repayments of short-term debt amounted to \$50 million for the first six months of 2002.

In April 2003, PE amended its revolving line of credit and extended the expiration date by an additional two years. The revolving credit commitment, initially \$500 million, declines semi-annually by \$125 million until expiration on April 5, 2005 and is for the purpose of funding loans by PE to Global. Borrowings under the agreement would bear interest at rates varying with market rates, PE's credit ratings and the amount of the borrowings outstanding. They would be guaranteed by Sempra Energy and would be subject to mandatory repayment if SoCalGas' unsecured long-term credit ratings were to cease to be at least BBB by S&P and Baa2 by Moody's, if Sempra Energy's or SoCalGas' debt to total capitalization ratio (as defined in the agreement) were to exceed 65 percent, or if there were to be a change in law materially and adversely affecting the ability of SoCalGas to pay dividends or make distributions to PE. No borrowings have been made under this agreement.

In May 2003, SoCalGas and SDG&E replaced their expiring \$500 million, 364-day credit agreement with a substantially identical agreement expiring on May 14, 2004. Under the agreement, each utility may individually borrow up to \$300 million, subject to a combined borrowing limit for both utilities of \$500 million. At the maturity date, each utility may convert its then outstanding borrowings to a one-year term loan, subject to having obtained any requisite regulatory approvals. Borrowings under the agreement would be available for general corporate purposes including back-up support for commercial paper and variable-rate long-term debt, and would bear interest at rates varying with market rates and the borrowing utility's credit rating. The agreement requires each utility to maintain a debt-to-total capitalization ratio (as defined in the agreement) of not to exceed 60 percent. The rights, obligations and covenants of each utility under the agreement are individual rather than joint with those of the other utility, and a default by one utility would not constitute default by the other.

### 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 3 of the notes to Consolidated Financial Statements herein.

Income-Tax Issues

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Resolution of the income-tax issues described in Note 3 of the notes to Consolidated Financial Statements herein could have a material impact on results of operations for 2003, or one or more future periods.

### Natural Gas Restructuring and Rates

As discussed in the Annual Report, in December 2001 the CPUC issued a decision related to natural gas industry restructuring, with implementation anticipated during 2002. During 2002 the California Utilities filed a proposed implementation schedule and revised tariffs and rules required for implementation. However, on February 27, 2003, the CPUC issued a resolution rejecting without prejudice those proposed tariffs and rules. The resolution ordered SoCalGas to file a new application, which would address detailed proposals for implementation of the December 2001 decision, but also would allow reconsideration of the December 2001 decision. SoCalGas filed such an application on June 30, 2003, and proposed some modifications to the provisions of the December 2001 decision to respond to concerns that it could lead to higher natural gas costs for consumers. Modifications proposed by SoCalGas would also remove SoCalGas' exposure to risk or reward for the sale of receipt-point capacity. The filing proposes implementation of these provisions on April 1, 2004 and continuing through August 31, 2006. If the December 2001 decision is implemented, it is not expected to affect adversely the California Utilities' results of operations, cash flows or financial position. A CPUC decision is expected during 2004.

### CPUC Investigation of Compliance with Affiliate Rules

On February 27, 2003, the CPUC opened an investigation of the business activities of SDG&E, SoCalGas and Sempra Energy to ensure that they have complied with relevant statutes and CPUC decisions in the management, oversight and operations of their companies. The Assigned Commissioner and ALJ issued a ruling which suspends the procedural schedule until the CPUC completes an independent audit to evaluate energy-related business activities undertaken by Sempra Energy within the service territories of SDG&E and SoCalGas, relative to holding company systems and affiliate activities. The audit is to consider whether these activities pose any problems for ratepayers and whether they are consistent with the CPUC's decision, rules or orders and/or affiliate statutes. The objective of the audit is to analyze the adequacy of the Affiliate Rules. 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.

### Cost of Service Filing

On May 22, 2003, the assigned CPUC Commissioner modified his previously adopted procedural schedule on the California Utilities' Cost of Service applications to expedite a decision by approximately one month, permitting a decision by as early as March 2004. The assigned Commissioner also provided for additional comments to be filed on the California Utilities' request for interim relief for the period from January 1, 2004 to the date of the Cost of Service decision and stated that a decision on the request would be prepared for consideration of the full Commission. On June 3, 2003, various parties filed reply comments supporting or opposing the motion for January 1, 2004 interim relief. The CPUC's Office of Ratepayer Advocates' (ORA) report on the

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California Utilities' filing is due on August 8, 2003.

An October 10, 2001 decision denied the California Utilities' request to continue equal sharing between ratepayers and shareholders of the estimated savings for the 1998 Enova-PE business combination that created Sempra Energy and, instead, ordered that all of the estimated 2003 merger savings go to ratepayers. This decision will adversely affect 2003 net income by \$24 million.

### NEW ACCOUNTING STANDARDS

New pronouncements that have recently become effective or that are yet to be effective are SFAS 143, 148, 149 and 150, Interpretations 45 and 46, EITF 02-3, and the rescission of EITF 98-10. See discussion in Note 2 of the notes to Consolidated Financial Statements.

### ITEM 3. MARKET RISK

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

As of June 30, 2003, the total Value at Risk of SoCalGas' natural gas 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 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 within 90 days prior to the date of this report 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 or in other factors that could significantly affect the internal controls subsequent to the date the companies completed their evaluations.

## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

Except as described in Note 3 of the notes to Consolidated Financial Statements, neither the companies nor their subsidiaries are party to,

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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

10.1 2003 Executive Incentive Plan (June 30, 2003 Sempra Energy 10-Q Exhibit 10.1)

10.2 Amended 1998 Long-Term Incentive Plan (June 30, 2003 Sempra Energy 10-Q Exhibit 10.2)

##### 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.

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 March 31, 2003:

Current Report on Form 8-K filed May 1, 2003, filing as an exhibit Sempra Energy's press release of May 1, 2003, giving the financial results for the three months ended March 31, 2003.

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Current Report on Form 8-K filed August 7, 2003, filing as an exhibit Semptra Energy's press release of August 7, 2003, giving the financial results for the three months ended June 30, 2003.

SIGNATURE

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: August 7, 2003

By: /s/ F. H. Ault

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F. H. Ault  
Sr. Vice President and Controller

SOUTHERN CALIFORNIA GAS COMPANY

-----  
(Registrant)

By: /s/ D.L. Reed

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D.L. Reed  
President and  
Chief Financial Officer