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PACIFIC ENTERPRISES INC
Form 10-Q
November 14, 2001

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

[..X..] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

September 30, 2001

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 _____

Table with 4 columns: Commission File Number, Name of Registrant as specified in its charter, State of Incorporation, and IRS Employer Identification Number. Rows include Pacific Enterprises (California, 94-0743670) and Southern California Gas Company (California, 95-1240705).

555 West Fifth Street, Los Angeles, California 90013
(Address of principal executive offices) (Zip Code)

Registrants' telephone number, including area code (213) 244-1200
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 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

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

PACIFIC ENTERPRISES AND SUBSIDIARIES

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STATEMENTS OF CONSOLIDATED INCOME

Dollars in millions

| | Three Months Ended September 30, | |
|---|-------------------------------------|--------|
| | 2001 | 2000 |
| Operating Revenues | \$ 561 | \$ 722 |
| Operating Expenses | | |
| Cost of natural gas distributed | 163 | 349 |
| Operating and maintenance | 188 | 175 |
| Depreciation and amortization | 68 | 65 |
| Other taxes and franchise payments | 20 | 19 |
| Income taxes | 50 | 44 |
| Total operating expenses | 489 | 652 |
| Operating Income | 72 | 70 |
| Other Income and (Deductions) | | |
| Interest income | 8 | 19 |
| Allowance for equity funds used during construction | 2 | 1 |
| Regulatory interest - net | (2) | (4) |
| Taxes on non-operating income | (1) | (3) |
| Other - net | (1) | (8) |
| Total | 6 | 5 |
| Income Before Interest Charges | 78 | 75 |
| Interest Charges | | |
| Long-term debt | 17 | 17 |
| Other | 5 | 7 |
| Allowance for borrowed funds used during construction | (1) | (1) |
| Total | 21 | 23 |
| Net Income | 57 | 52 |
| Preferred Dividend Requirements | 1 | 1 |
| Earnings Applicable to Common Shares | \$ 56 | \$ 51 |

See notes to Consolidated Financial Statements.

PACIFIC ENTERPRISES AND SUBSIDIARIES

STATEMENTS OF CONSOLIDATED INCOME

Dollars in millions

| | Nine Months Ended September 30, | |
|--------------------|------------------------------------|---------|
| | 2001 | 2000 |
| Operating Revenues | \$3,036 | \$2,050 |
| Operating Expenses | | |

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| | | |
|---|--------|--------|
| Cost of natural gas distributed | 1,847 | 959 |
| Operating and maintenance | 580 | 493 |
| Depreciation and amortization | 200 | 196 |
| Other taxes and franchise payments | 79 | 69 |
| Income taxes | 130 | 132 |
| | ----- | ----- |
| Total operating expenses | 2,836 | 1,849 |
| | ----- | ----- |
| Operating Income | 200 | 201 |
| | ----- | ----- |
| Other Income and (Deductions) | | |
| Interest income | 37 | 47 |
| Allowance for equity funds used during construction | 4 | 2 |
| Regulatory interest - net | (8) | (9) |
| Taxes on non-operating income | (5) | (7) |
| Preferred dividends of subsidiaries | (1) | (1) |
| Other - net | (1) | (6) |
| | ----- | ----- |
| Total | 26 | 26 |
| | ----- | ----- |
| Income Before Interest Charges | 226 | 227 |
| | ----- | ----- |
| Interest Charges | | |
| Long-term debt | 50 | 52 |
| Other | 22 | 24 |
| Allowance for borrowed funds used during construction | (2) | (2) |
| | ----- | ----- |
| Total | 70 | 74 |
| | ----- | ----- |
| Net Income | 156 | 153 |
| Preferred Dividend Requirements | 3 | 3 |
| | ----- | ----- |
| Earnings Applicable to Common Shares | \$ 153 | \$ 150 |
| | ===== | ===== |

See notes to Consolidated Financial Statements.

PACIFIC ENTERPRISES AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
Dollars in millions

| | Balance at | |
|---|-----------------------|----------------------|
| | September 30, 2001 | December 31, 2000 |
| | ----- | ----- |
| ASSETS | | |
| Property, plant and equipment | \$6,511 | \$6,337 |
| Accumulated depreciation | (3,754) | (3,571) |
| | ----- | ----- |
| Property, plant and equipment - net | 2,757 | 2,766 |
| | ----- | ----- |
| Current assets | | |
| Cash and cash equivalents | 164 | 205 |
| Accounts receivable - trade | 190 | 589 |
| Accounts receivable - other | 18 | 83 |
| Due from affiliate | 119 | 214 |
| Income tax receivable | 32 | -- |
| Deferred income taxes | 43 | 43 |
| Fixed price contracts and other derivatives | 72 | -- |

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| | | |
|--|---------|---------|
| Regulatory assets arising from fixed price contracts and other derivatives | 56 | -- |
| Inventories | 109 | 67 |
| Other | 8 | 84 |
| | ----- | ----- |
| Total current assets | 811 | 1,285 |
| | ----- | ----- |
| Other assets | | |
| Regulatory assets | 90 | 108 |
| Regulatory assets arising from fixed price contracts and other derivatives | 138 | -- |
| Due from affiliates | 412 | 617 |
| Other | 90 | 52 |
| | ----- | ----- |
| Total other assets | 730 | 777 |
| | ----- | ----- |
| Total assets | \$4,298 | \$4,828 |
| | ===== | ===== |

See notes to Consolidated Financial Statements.

PACIFIC ENTERPRISES AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
Dollars in millions

| | Balance at | |
|---|-----------------------|----------------------|
| | September 30, 2001 | December 31, 2000 |
| | ----- | ----- |
| CAPITALIZATION AND LIABILITIES | | |
| Capitalization | | |
| Common Stock | \$1,282 | \$1,282 |
| Retained earnings | 127 | 165 |
| Accumulated other comprehensive income (loss) | 1 | (1) |
| | ----- | ----- |
| Total common equity | 1,410 | 1,446 |
| Preferred stock | 80 | 80 |
| Long-term debt | 722 | 821 |
| | ----- | ----- |
| Total capitalization | 2,212 | 2,347 |
| | ----- | ----- |
| Current liabilities | | |
| Current portion of long-term debt | 220 | 120 |
| Accounts payable - trade | 135 | 368 |
| Accounts payable - other | 78 | 43 |
| Regulatory balancing accounts - net | 114 | 463 |
| Income taxes payable | -- | 50 |
| Dividends and interest payable | 32 | 28 |
| Due to affiliates | 146 | 365 |
| Fixed price contracts and other derivatives | 56 | -- |
| Other | 329 | 300 |
| | ----- | ----- |
| Total current liabilities | 1,110 | 1,737 |
| | ----- | ----- |

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| | | |
|--|---------|---------|
| Deferred credits and other liabilities | | |
| Customer advances for construction | 18 | 16 |
| Post-retirement benefits other than pensions | 91 | 97 |
| Deferred income taxes | 244 | 224 |
| Deferred investment tax credits | 51 | 53 |
| Regulatory liabilities | 50 | -- |
| Fixed price contracts and other derivatives | 140 | -- |
| Deferred credits and other liabilities | 362 | 334 |
| Preferred stock of subsidiary | 20 | 20 |
| | ----- | ----- |
| Total deferred credits and other liabilities | 976 | 744 |
| | ----- | ----- |
| Contingencies and commitments (Note 2) | | |
| | | |
| Total liabilities and shareholders' equity | \$4,298 | \$4,828 |
| | ===== | ===== |

See notes to Consolidated Financial Statements.

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

| | Nine Months Ended September 30, | |
|---|------------------------------------|--------|
| | 2001 | 2000 |
| | ----- | ----- |
| Cash Flows from Operating Activities | | |
| Net income | \$ 156 | \$ 153 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 200 | 196 |
| Deferred income taxes and investment tax credits | 18 | 41 |
| Other - net | 62 | 50 |
| Net changes in other working capital components | (179) | 179 |
| | ----- | ----- |
| Net cash provided by operating activities | 257 | 619 |
| | ----- | ----- |
| Cash Flows from Investing Activities | | |
| Capital expenditures | (190) | (130) |
| Loans repaid by (paid to) affiliates | 88 | (387) |
| | ----- | ----- |
| Net cash used in investing activities | (102) | (517) |
| | ----- | ----- |
| Cash Flows from Financing Activities | | |
| Common dividends paid | (190) | -- |
| Preferred dividends paid | (3) | (3) |
| Repayment of long-term debt | -- | (30) |
| Other | (3) | -- |
| | ----- | ----- |
| Net cash used in financing activities | (196) | (33) |
| | ----- | ----- |
| Increase (decrease) in cash and cash equivalents | (41) | 69 |
| Cash and cash equivalents, January 1 | 205 | 11 |
| | ----- | ----- |
| Cash and cash equivalents, September 30 | \$ 164 | \$ 80 |

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| | ===== | ===== |
|--|--------|--------|
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | |
| Cash paid during the year for: | | |
| Income tax payments - net | \$ 192 | \$ 105 |
| | ===== | ===== |
| Interest payments, net of amounts capitalized | \$ 66 | \$ 98 |
| | ===== | ===== |

See notes to Consolidated Financial Statements.

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

| | Three Months Ended September 30, | |
|---|-------------------------------------|--------|
| | 2001 | 2000 |
| | ----- | ----- |
| Operating Revenues | \$ 561 | \$ 722 |
| | ----- | ----- |
| Operating Expenses | | |
| Cost of natural gas distributed | 163 | 349 |
| Operation and maintenance | 188 | 175 |
| Depreciation and amortization | 68 | 65 |
| Other taxes and franchise payments | 20 | 19 |
| Income taxes | 49 | 45 |
| | ----- | ----- |
| Total operating expenses | 488 | 653 |
| | ----- | ----- |
| Operating Income | 73 | 69 |
| | ----- | ----- |
| Other Income and (Deductions) | | |
| Interest income | 4 | 9 |
| Allowance for equity funds used during construction | 2 | 1 |
| Regulatory interest - net | (2) | (4) |
| Taxes on non-operating income | (1) | (2) |
| Other - net | -- | (2) |
| | ----- | ----- |
| Total | 3 | 2 |
| | ----- | ----- |
| Income Before Interest Charges | 76 | 71 |
| | ----- | ----- |
| Interest Charges | | |
| Long-term debt | 17 | 17 |
| Other | 3 | 2 |
| Allowance for borrowed funds used during construction | (1) | (1) |
| | ----- | ----- |
| Total | 19 | 18 |
| | ----- | ----- |
| Net Income | 57 | 53 |
| Preferred Dividend Requirements | -- | -- |
| | ----- | ----- |
| Earnings Applicable to Common Shares | \$ 57 | \$ 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, | |
|---|------------------------------------|---------|
| | 2001 | 2000 |
| Operating Revenues | \$3,036 | \$2,050 |
| Operating Expenses | | |
| Cost of natural gas distributed | 1,847 | 959 |
| Operating and maintenance | 572 | 492 |
| Depreciation and amortization | 200 | 196 |
| Other taxes and franchise payments | 79 | 69 |
| Income taxes | 131 | 132 |
| Total operating expenses | 2,829 | 1,848 |
| Operating Income | 207 | 202 |
| Other Income and (Deductions) | | |
| Interest income | 20 | 20 |
| Allowance for equity funds used during construction | 4 | 2 |
| Regulatory interest - net | (8) | (9) |
| Taxes on non-operating income | (5) | (6) |
| Other - net | (1) | (2) |
| Total | 10 | 5 |
| Income Before Interest Charges | 217 | 207 |
| Interest Charges | | |
| Long-term debt | 50 | 52 |
| Other | 12 | 6 |
| Allowance for borrowed funds used during construction | (2) | (2) |
| Total | 60 | 56 |
| Net Income | 157 | 151 |
| Preferred Dividend Requirements | 1 | 1 |
| Earnings Applicable to Common Shares | \$ 156 | \$ 150 |

See notes to Consolidated Financial Statements.

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

Balance at

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| | September 30, 2001 | December 31, 2000 |
|--|-----------------------|----------------------|
| ASSETS | | |
| Utility plant - at original cost | \$6,399 | \$6,314 |
| Accumulated depreciation | (3,675) | (3,557) |
| Utility plant - net | 2,724 | 2,757 |
| Current assets | | |
| Cash and cash equivalents | 164 | 205 |
| Accounts receivable - trade | 190 | 589 |
| Accounts receivable - other | 18 | 83 |
| Due from affiliates | 119 | 214 |
| Deferred income taxes | 73 | 74 |
| Regulatory assets arising from fixed priced contracts and other derivatives | 56 | -- |
| Fixed price contracts and other derivatives | 72 | -- |
| Inventories | 109 | 67 |
| Other | 6 | 80 |
| Total current assets | 807 | 1,312 |
| Other assets | | |
| Regulatory assets | -- | 12 |
| Regulatory assets arising from fixed priced contracts and other derivatives | 138 | -- |
| Other | 94 | 35 |
| Total other assets | 232 | 47 |
| Total assets | \$3,763 | \$4,116 |

See notes to Consolidated Financial Statements.

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

| | Balance at | |
|---|-----------------------|----------------------|
| | September 30, 2001 | December 31, 2000 |
| CAPITALIZATION AND LIABILITIES | | |
| Capitalization | | |
| Common stock | \$ 835 | \$ 835 |
| Retained earnings | 418 | 453 |
| Accumulated other comprehensive income (loss) | 1 | (1) |
| Total common equity | 1,254 | 1,287 |
| Preferred stock | 22 | 22 |
| Long-term debt | 722 | 821 |

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| | | |
|--|---------|---------|
| Total capitalization | 1,998 | 2,130 |
| Current liabilities | | |
| Current portion of long-term debt | 220 | 120 |
| Accounts payable - trade | 135 | 368 |
| Accounts payable - other | 78 | 44 |
| Regulatory balancing accounts - net | 114 | 463 |
| Income taxes payable | 8 | 90 |
| Interest payable | 31 | 26 |
| Fixed price contracts and other derivatives | 56 | -- |
| Other | 329 | 300 |
| Total current liabilities | 971 | 1,411 |
| Deferred credits and other liabilities | | |
| Customer advances for construction | 18 | 16 |
| Deferred income taxes | 335 | 314 |
| Deferred investment tax credits | 50 | 53 |
| Regulatory liabilities | 51 | -- |
| Fixed price contracts and other derivatives | 140 | -- |
| Deferred credits and other liabilities | 200 | 192 |
| Total deferred credits and other liabilities | 794 | 575 |
| Contingencies and commitments (Note 2) | | |
| Total liabilities and shareholders' equity | \$3,763 | \$4,116 |

See notes to Consolidated Financial Statements.

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

| | Nine Months Ended September 30, | |
|---|------------------------------------|-------|
| | 2001 | 2000 |
| Cash Flows from Operating Activities | | |
| Net income | \$157 | \$151 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 200 | 196 |
| Deferred income taxes and investment tax credits | 18 | 38 |
| Other - net | 40 | 28 |
| Net changes in other working capital components | (179) | 175 |
| Net cash provided by operating activities | 236 | 588 |
| Cash Flows from Investing Activities | | |
| Capital expenditures | (190) | (130) |
| Loan repaid by (paid to) affiliate | 104 | (258) |
| Net cash used in investing activities | (86) | (388) |
| Cash Flows from Financing Activities | | |
| Dividends paid | (191) | (101) |

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| | | |
|---|-------|-------|
| Repayment of long-term debt | -- | (30) |
| | ---- | ---- |
| Net cash used in financing activities | (191) | (131) |
| | ---- | ---- |
| Increase (decrease) in cash and cash equivalents | (41) | 69 |
| Cash and cash equivalents, January 1 | 205 | 11 |
| | ---- | ---- |
| Cash and cash equivalents, September 30 | \$164 | \$ 80 |
| | ===== | ===== |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Cash paid during the year for: | | |
| Income tax payments - net | \$199 | \$107 |
| | ===== | ===== |
| Interest payments, net of amounts capitalized | \$ 55 | \$ 55 |
| | ===== | ===== |

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 or the Company) and of Southern California Gas Company (SoCalGas) (collectively the companies). PE's common stock is wholly owned by Sempra Energy, a California-based Fortune 500 energy services company. SoCalGas' common stock is wholly owned by PE. 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.

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.

The companies' significant accounting policies are described in the notes to Consolidated Financial Statements in the companies' 2000 Annual Reports. The same accounting policies are followed for interim reporting purposes.

Information in this Quarterly Report is unaudited and should be read in conjunction with the companies' 2000 Annual Reports and March 31, 2001 and June 30, 2001 Quarterly Reports on Form 10-Q.

As described in the notes to Consolidated Financial Statements in the companies' 2000 Annual Reports, 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."

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2. MATERIAL CONTINGENCIES

NATURAL GAS INDUSTRY RESTRUCTURING

The companies' 2000 Annual Reports discuss various proposals and actions related to natural gas industry restructuring. As discussed therein, no significant impacts on the companies are expected when the various issues are finalized. Various developments since January 1, 2001 are described herein.

A settlement agreement between SoCalGas and certain parties settling the issue of retroactive refunding of costs in rates of ownership and operation of one of SoCalGas' storage fields was approved by the California Public Utilities Commission (CPUC) in June 2001. The settlement provides for no retroactive refund of the costs in rates of this field.

In October 2001, a CPUC commissioner issued a revised Proposed Decision (PD) which adopts, with some modification, many of the provisions of the settlement proposal that SoCalGas and SDG&E (an affiliated company also owned by Sempra Energy) were parties to (one of several that arose during 1999 and 2000). On the SoCalGas system these provisions include, among other things, the unbundling of intrastate transmission and the implementation of a system of firm, tradable intrastate transmission rights that are viewed to be in the public interest. The revised PD also would increase SoCalGas shareholder risks and rewards for unbundled storage service, while at the same time granting SoCalGas greater flexibility in charges for unbundled storage service. A CPUC decision could be issued at any time, but there is no deadline for CPUC action and the provisions of a final CPUC decision are uncertain.

LITIGATION

Lawsuits filed in 2000 and currently consolidated at the Federal Court in Las Vegas seek class-action certification and allege that Sempra Energy, SoCalGas, SDG&E and El Paso Energy Corp. acted to drive up the price of natural gas for Californians by agreeing to stop a pipeline project that would have brought new and less-expensive natural gas supplies into California. Management believes the allegations are without merit. On October 30, 2001, the Federal Court ruled that the State Court is the appropriate jurisdiction for these lawsuits.

Except for the above, 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.

Management believes that these matters will not have a material adverse effect on the companies' results of operations, financial condition or liquidity.

QUASI-REORGANIZATION

In 1993, PE divested its merchandising operations and most of its oil and 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.

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3. COMPREHENSIVE INCOME

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

| (Dollars in millions) | Pacific Enterprises | | | | SoCalGas | | | |
|---|---|-------|--|-------|---|-------|--|-------|
| | Three-month periods ended September 30, | | Nine-month periods ended September 30, | | Three-month periods ended September 30, | | Nine-month periods ended September 30, | |
| | 2001 | 2000 | 2001 | 2000 | 2001 | 2000 | 2001 | 2000 |
| Net income | \$ 57 | \$ 52 | \$156 | \$153 | \$ 57 | \$ 53 | \$157 | \$151 |
| Change in unrealized gain on marketable securities | -- | (14) | -- | 7 | -- | (14) | -- | 7 |
| Minimum pension liability adjustments | -- | 1 | 1 | 3 | -- | 1 | 1 | 3 |
| Financial instruments (Note 4) | 1 | -- | 1 | -- | 1 | -- | 1 | -- |
| Comprehensive income | \$ 58 | \$ 39 | \$158 | \$163 | \$ 58 | \$ 40 | \$159 | \$161 |

4. FINANCIAL INSTRUMENTS

Adoption of SFAS 133

Effective January 1, 2001, the companies adopted SFAS 133, as amended by SFAS 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities." As amended, SFAS 133 requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position, measure those instruments at fair value and recognize changes in the fair value of derivatives in earnings in the period of change unless the derivative qualifies as an effective hedge that offsets certain exposures.

\$982 million in current assets, \$1.1 billion in noncurrent assets, and \$4 million in current liabilities were recorded as of January 1, 2001, in the Consolidated Balance Sheet as fixed-priced contracts and other derivatives. Due to the regulatory environment in which SoCalGas operates, regulatory assets and liabilities were established to the extent that derivative gains and losses are recoverable or payable through future rates. The effect on earnings was minimal. The ongoing effects will depend on future market conditions and on the companies' hedging activities.

Market Risk

The companies' policy is to use derivative financial instruments to manage exposure to fluctuations in interest rates and energy prices. Transactions involving these financial instruments are with credit-worthy firms and major exchanges. The use of these instruments exposes the companies to market and credit risk which may at times be concentrated with certain counterparties, although counterparty

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nonperformance is not anticipated.

Energy Derivatives

SoCalGas utilizes derivative financial instruments to reduce exposure to unfavorable changes in energy prices which are subject to significant and often volatile fluctuation. Derivative financial instruments are comprised of futures, forwards, swaps, options and long-term delivery contracts. These contracts allow SoCalGas to predict with greater certainty the effective prices to be received and to be charged to its customers.

If gains and losses are not recoverable or payable through future rates, SoCalGas will apply hedge accounting if certain criteria are met.

In instances where hedge accounting is applied to energy derivatives, cash flow hedge accounting is elected and, accordingly, changes in fair values of the derivatives are included in other comprehensive income. The entire balance of \$1 million, currently included in accumulated other comprehensive income, is expected to be reclassified into income within the next 12 months. In instances where energy derivatives do not qualify for hedge accounting, gains and losses are recorded in the Statement of Consolidated Income.

Accounting for Derivative Activities

At September 30, 2001, \$72 million in current assets, \$56 million in current liabilities, \$140 million in noncurrent liabilities and \$1 million in other noncurrent assets were recorded in the Consolidated Balance Sheet as fixed priced contracts and other derivatives. Regulatory assets and liabilities were established to the extent that derivative gains and losses are recoverable or payable through future rates. As such, \$56 million in current regulatory assets, \$138 million in noncurrent regulatory assets, \$62 million in regulatory balancing account liabilities, \$4 million of current regulatory liabilities (included in other current liabilities), \$1 million of noncurrent regulatory liabilities (included in deferred credits and other liabilities) and \$1 million of accumulated other comprehensive income were recorded in the Consolidated Balance Sheet as of September 30, 2001. For the nine-month period ended September 30, 2001, a net \$3 million was recorded in other operating income in the Statement of Consolidated Income.

Fair Value

The fair value of the companies' derivative financial instruments (fixed-price contracts and other derivatives) is not materially different from their carryings amounts. The fair values of fixed-price contracts and other derivatives were estimated based on quoted market prices. Information regarding the fair value of the companies' non-derivative financial instruments is provided in Note 8 of the notes to Consolidated Financial Statements in the 2000 Annual Reports on Form 10-K.

ITEM 2.

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

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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 companies' 2000 Annual Report.

INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q 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 CPUC, the California Legislature, and the FERC; the financial condition of other investor-owned utilities; capital market conditions, inflation rates, interest rates and exchange rates; energy markets, including the timing and extent of changes in commodity prices; weather conditions and conservation efforts; business, regulatory and legal decisions; the pace 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 quarterly report and other reports filed by the companies from time to time with the Securities and Exchange Commission.

See also "Factors Influencing Future Performance" below.

EVENTS OF SEPTEMBER 11, 2001

The terrorist attacks of September 11 have not affected the companies' operations and are not expected to have an effect on the companies' future operations, except to the extent that they significantly affect the general economy, or the business or geographic areas in which the companies operate.

CAPITAL RESOURCES AND LIQUIDITY

Cash and cash equivalents at September 30, 2001 are available for investment in utility plant, the retirement of debt and other corporate purposes. Major changes in cash flows not described elsewhere are described below.

CASH FLOWS FROM OPERATING ACTIVITIES

For the nine-month period ended September 30, 2001, the decrease in cash flows from operations compared to the corresponding period in 2000 was primarily due to the decrease in overcollected regulatory balancing accounts due to a decrease in the spot gas price compared to

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the average cost of gas, the decrease in trade accounts payable due to lower September 2001 gas prices, and lower accrued income taxes in 2001 reflecting tax payments made during the first quarter of 2001 (none were made during the same period in 2000), partially offset by the decrease in SoCalGas' trade accounts receivable due to the lower September 2001 gas prices passed on to its customers.

CASH FLOWS FROM INVESTING ACTIVITIES

Capital expenditures for property, plant and equipment are estimated to be \$300 million for the full year 2001 and are being financed primarily by internally generated funds. 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. For the nine months ended September 30, 2001, the decrease in cash flows used in investing activities compared to the corresponding period in 2000 was primarily due to loans being repaid by Semptra Energy in 2001 versus being made to Semptra Energy in 2000, partially offset by an increase in capital expenditures by SoCalGas.

During the second quarter of 2001, SoCalGas announced plans to add 11 percent more capacity to its transmission system by the end of the year. The expansion will help meet increased demand for natural gas from new and existing electric generation projects in Southern California.

CASH FLOWS FROM FINANCING ACTIVITIES

In September 2001, SoCalGas filed a shelf registration for the public offering of up to an additional \$350 million of debt securities. Any securities under this shelf registration are offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933. At September 30, 2001, no debt securities had been issued under this registration statement.

For the nine-month period ended September 30, 2001, cash flows used in financing activities increased from the corresponding period in 2000 due primarily to an increase in common dividends paid during 2001.

In October 2001, \$120 million of 6.38-percent, SoCalGas medium-term notes matured. On November 7, 2001, SoCalGas called its \$150 million, 8.75-percent, first mortgage bonds at a premium of 3.59 percent.

On February 9, 2001, SoCalGas' \$200 million credit line expired and was replaced on February 27, 2001, with a \$170 million, one-year agreement. This agreement bears interest at various rates based on market rates and SoCalGas' credit rating. On April 18, 2001, PE entered into a \$500 million two-year revolving line of credit which bears interest at various rates based on market rates and PE's credit rating.

RESULTS OF OPERATIONS

The companies' net income increased slightly for the three-month and nine-month periods ended September 30, 2001, compared to the same periods in 2000. The increases were primarily due to the reduction of operating expenses as a percentage of related revenues.

Seasonality

SoCalGas' natural gas sales volumes generally are higher in the winter

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due to heating demands, although that difference is lessening as the use of natural gas to fuel electric generation increases.

The table below summarizes natural gas volumes and revenues by customer class for the nine-month periods ended September 30, 2001 and 2000.

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

| | Gas Sales | | Transportation & Exchange | | Total | |
|------------------------------|-----------|---------|---------------------------|---------|---------|----------------|
| | Volumes | Revenue | Volumes | Revenue | Volumes | Revenue |
| 2001: | | | | | | |
| Residential | 186 | \$1,864 | 2 | \$ 4 | 188 | \$1,868 |
| Commercial and industrial | 68 | 543 | 187 | 125 | 255 | 668 |
| Electric generation plants | -- | -- | 299 | 73 | 299 | 73 |
| Wholesale | -- | -- | 131 | 27 | 131 | 27 |
| | 254 | \$2,407 | 619 | \$229 | 873 | 2,636 |
| Balancing accounts and other | | | | | | 400 |
| Total | | | | | | \$3,036 |
| 2000: | | | | | | |
| Residential | 172 | \$1,373 | 2 | \$ 9 | 174 | \$1,382 |
| Commercial and industrial | 62 | 409 | 241 | 165 | 303 | 574 |
| Utility electric generation | -- | -- | 230 | 82 | 230 | 82 |
| Wholesale | -- | -- | 119 | 39 | 119 | 39 |
| | 234 | \$1,782 | 592 | \$295 | 826 | 2,077 |
| Balancing accounts and other | | | | | | (27) |
| Total | | | | | | \$2,050 |

The increases in natural gas revenues and the cost of natural gas distributed were primarily due to higher natural gas prices. Under the current regulatory framework, the cost of natural gas is passed on to customers without markup and changes in core-market natural gas prices do not affect net income since, as explained more fully in the 2000 Annual Report, current or future core customer rates normally recover the actual cost of natural gas on a substantially concurrent basis.

FACTORS INFLUENCING FUTURE PERFORMANCE

Performance of the companies in the near future 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 this section and in Note 2 of the notes to Consolidated Financial Statements.

Performance-Based Regulation (PBR)

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To promote efficient operations and improved productivity and to move away from reasonableness reviews and disallowances, the CPUC has been directing utilities to use PBR. PBR has replaced the general rate case and certain other regulatory proceedings for the California utilities. Under PBR, regulators require future income potential to be tied to achieving or exceeding specific performance and productivity goals, as well as cost reductions, rather than relying solely on expanding utility plant in a market where a utility already has a highly developed infrastructure.

SoCalGas' PBR mechanism is in effect through December 31, 2002, at which time the mechanisms will be updated. That update is described in the companies' 2000 Annual Reports. The PBR and Cost of Service (COS) cases for SoCalGas and SDG&E were both due to be filed on December 21, 2001. However, both SoCalGas' and SDG&E's PBR/COS cases were delayed by an October 10, 2001 CPUC decision such that the resulting rates would be effective in 2004 instead of 2003. The decision also denies the utilities' request to continue 50/50 allocation between ratepayers and shareholders of estimated savings stemming from the 1998 merger between Pacific Enterprises (parent company of SoCalGas) and Enova Corporation (parent company of SDG&E). Instead, the CPUC ordered that 100 percent of the estimated 2003 merger benefits go to ratepayers.

Gas Cost Incentive Mechanism (GCIM)

This mechanism for evaluating SoCalGas' natural gas purchases substantially replaced the previous process of reasonableness reviews. GCIM compares SoCalGas' cost of natural gas with a benchmark level, which is the average price of 30-day firm spot supplies in the basins in which SoCalGas purchases natural gas. 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 equally between customers and shareholders. The CPUC approved the use of natural gas futures for managing risk associated with the GCIM.

In May 2001 the CPUC approved a \$10 million shareholder award for the year ended March 31, 2000. In June 2001 SoCalGas filed its annual GCIM application with the CPUC, requesting a shareholder award of \$106 million for the year ended March 31, 2001. Notwithstanding this request, SoCalGas stated that it would retroactively reduce the award request to \$31 million if the CPUC approves the settlement agreement entered into in June 2001 between SoCalGas, the CPUC's Office of Ratepayer Advocates and The Utilities Reform Network, a consumer-based intervenor, on modifying the GCIM. A final CPUC decision is expected in the first quarter of 2002.

Biennial Cost Allocation Proceeding (BCAP)

Rates to recover the changes in the cost of natural gas transportation services are determined in the BCAP. The BCAP adjusts rates to reflect variances in customer demand from estimates previously used in establishing customer natural gas transportation rates. The mechanism substantially eliminates the effect on income of variances in market demand and natural gas transportation costs. SoCalGas filed its 2003 BCAP on September 21, 2001.

Cost of Capital

For 2001, SoCalGas is authorized to earn a rate of return on common

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equity (ROE) of 11.6 percent and a 9.49 percent return on rate base (ROR), the same as in 2000 and 1999, unless interest-rate changes are large enough to trigger an automatic adjustment as discussed in the companies' 2000 Annual Reports.

Utility Integration

On September 20, 2001 the CPUC approved Sempra Energy's request to integrate the management teams of SoCalGas and SDG&E. Utility operations/management was not, and is not expected to be, shifted to the parent company. CPUC approval would be required if such a shift were contemplated. The decision retains the separate identities of both utilities and is not a merger. Instead, utility integration is a reorganization that consolidates senior management functions of the two utilities and returns to the utilities a significant portion of shared support services currently provided by Sempra Energy's centralized corporate center. Once implemented, the integration is expected to result in more efficient and effective operations.

CPUC INVESTIGATION OF ENERGY-UTILITY HOLDING COMPANIES

The CPUC has initiated an investigation into the relationship between California's investor-owned utilities and their parent holding companies. Among the matters to be considered in the investigation are utility dividend policies and practices and obligations of the holding companies to provide financial support for utility operations. The investigation is currently on hold while certain jurisdictional issues are being resolved.

NEW ACCOUNTING STANDARDS

Effective January 1, 2001, the companies adopted SFAS 133 "Accounting for Derivative Instruments and Hedging Activities" as amended by SFAS 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities." The adoption of this new standard on January 1, 2001, did not have a material impact on earnings. For further information regarding the implementation of SFAS 133, see Note 4 of the notes to Consolidated Financial Statements.

In July 2001 the Financial Accounting Standards Board (FASB) approved three statements, SFAS 141 "Business Combinations," SFAS 142 "Goodwill and Other Intangible Assets" and SFAS 143 "Accounting for Asset Retirement Obligations."

-- SFAS 141 provides guidance on the accounting for a business combination at the date the combination is completed. It requires the use of the purchase method of accounting for all business combinations initiated after June 30, 2001. The pooling-of-interest method is eliminated.

-- SFAS 142 provides guidance on how to account for goodwill and other intangible assets after the acquisition is complete. Goodwill and certain other intangible assets will no longer be amortized and will be tested in the aggregate for impairment at least annually. Goodwill will not be tested on an acquisition-by-acquisition basis. SFAS 142 applies to existing goodwill and other intangible assets, beginning with fiscal years starting after December 15, 2001.

-- SFAS 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes a cost by increasing the carrying amount of the related

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long-lived asset. Over time, the liability is accreted to its present value, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement.

In August 2001 the FASB approved SFAS 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" that replaces SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS 144 applies to all long-lived assets, including discontinued operations. SFAS 144 requires that those long-lived assets be measured at the lower of carrying amount or fair value less cost to sell. Therefore, discontinued operations will no longer be measured at net realizable value or include amounts for operating losses that have not yet occurred. SFAS 144 also broadens the reporting of discontinued operations to include all components of an entity with operations that can be distinguished from the rest of the entity and that will be eliminated from the ongoing operations of the entity in a disposal transaction. The provisions of SFAS 144 are effective for fiscal years beginning after December 15, 2001.

The companies have not yet determined the effect on its financial statements of SFASs 141-144 or of the various subsequent guidance concerning SFAS 133/138.

ITEM 3. MARKET RISK

There have been no significant changes in the risk issues affecting the companies subsequent to those discussed in the Annual Reports for 2000. As noted in those reports, SoCalGas may, at times, be exposed to limited market risk in its natural gas purchase, sale and storage activities as a result of activities under SoCalGas' Gas Cost Incentive Mechanism. The risk is managed within the parameters of the companies' market-risk management and trading framework. However, to lessen the impact on customers from the unprecedented natural gas price volatility at the California border during the first quarter of 2001, SoCalGas began hedging a larger portion of its customer natural gas requirements than in the past. As of March 31, 2001, the Value at Risk (VaR) of the hedges was \$1.8 million. During the second and third quarters of 2001, the gas hedging activity at SoCalGas was sharply reduced and, as of September 30, 2001, the VaR of the SoCalGas hedges was \$200,000. This represents the 50-percent shareholder portion under the PBR mechanism and excludes the 50-percent portion subject to rate recovery. In addition, certain fixed price contracts that traditionally have not been considered derivatives, but now meet the derivative definition under SFAS 133 (see "New Accounting Standards" above), are excluded from the VaR amounts due to the offsetting regulatory asset or liability.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Except as otherwise described in this report, the companies' 2000 Annual Reports, or their March 31, 2001 or June 30, 2001 Quarterly Reports on Form 10-Q, 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.

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ITEM 5. OTHER INFORMATION

On November 6, 2001, the boards of directors of the companies were reconstituted with the following individuals now comprising all of the incumbent directors:

For PE: Stephen L. Baum, Chairman, Chief Executive Officer and President of Sempra Energy; John R. Light, Executive Vice President and General Counsel of Sempra Energy; and Neal E. Schmale, Executive Vice President and Chief Financial Officer of Sempra Energy.

For SoCalGas: Frank H. Ault, Senior Vice President and Controller of Sempra Energy; Edwin A. Guiles, Group President - Regulated Business Units of Sempra Energy and Chairman of SDG&E and SoCalGas; and Debra L. Reed, President of SDG&E.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit 12 - Computation of ratios

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

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

(b) Reports on Form 8-K

There were no reports on Form 8-K filed after June 30, 2001.

SIGNATURE

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

PACIFIC ENTERPRISES

(Registrant)

Date: November 13, 2001

By: /s/ F. H. Ault

F. H. Ault
Sr. Vice President and Controller

SOUTHERN CALIFORNIA GAS COMPANY

(Registrant)

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By: /s/ E.A. Guiles

E.A. Guiles
President