

PACIFIC ENTERPRISES INC  
Form 10-Q  
November 01, 2007

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q  
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended September 30, 2007

Commission File Number	Name of Registrant, State or other jurisdiction of incorporation or organization, Address and Telephone Number	I.R.S. Employer Identification No.
1-40	PACIFIC ENTERPRISES (A California Corporation) 101 Ash Street San Diego, California 92101 (619) 696-2020	94-0743670
1-1402	SOUTHERN CALIFORNIA GAS COMPANY  (A California Corporation) 555 West Fifth Street Los Angeles, California 90013 (213) 244-1200	95-1240705

No Change

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 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.

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Yes X No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No X

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

Common stock outstanding:

Pacific Enterprises

Wholly owned by Sempra Energy

Southern California Gas Company

Wholly owned by Pacific Enterprises

## INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

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

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



## PART I. FINANCIAL INFORMATION

## ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

PACIFIC ENTERPRISES AND  
SUBSIDIARIES  
STATEMENTS OF CONSOLIDATED  
INCOME

(Dollars in millions)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2007	2006	2007	2006
	(unaudited)			
Operating revenues	\$ 819	\$ 812	\$ 3,168	\$ 3,145
Operating expenses				
Cost of natural gas	350	365	1,791	1,827
Other operating expenses	254	222	746	688
Depreciation	71	67	210	200
Franchise fees and other taxes	26	26	91	92
Total operating expenses	701	680	2,838	2,807
Operating income	118	132	330	338
Other expense, net	(1)	(1)	(4)	(3)
Interest income	15	13	40	52
Interest expense	(20)	(20)	(58)	(57)
Income before income taxes	112	124	308	330
Income tax expense	46	63	128	151
Net income	66	61	180	179
Preferred dividend requirements	1	1	3	3
Earnings applicable to common shares	\$ 65	\$ 60	\$ 177	\$ 176

See Notes to Condensed Consolidated Financial  
Statements.

PACIFIC ENTERPRISES AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

(Dollars in millions)	September 30, 2007 (unaudited)	December 31, 2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 140	\$ 211
Accounts receivable - trade	330	640
Accounts receivable - other	56	33
Interest receivable	--	10
Due from unconsolidated affiliates	119	63
Income taxes receivable	80	54
Deferred income taxes	24	43
Inventories	192	106
Other regulatory assets	39	41
Other	23	17
Total current assets	1,003	1,218
Other assets:		
Due from unconsolidated affiliates	456	448
Regulatory assets arising from pension and other postretirement benefit obligations	137	136
Other regulatory assets	101	95
Sundry	36	41
Total other assets	730	720
Property, plant and equipment:		
Property, plant and equipment	8,375	8,151
Less accumulated depreciation	(3,353 )	(3,248 )
Property, plant and equipment, net	5,022	4,903
Total assets	\$ 6,755	\$ 6,841

See Notes to Condensed Consolidated Financial Statements.





PACIFIC ENTERPRISES AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

(Dollars in millions)	September 30, 2007 (unaudited)	December 31, 2006
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable - trade	\$ 251	\$ 416
Accounts payable - other	113	114
Due to unconsolidated affiliates	92	102
Regulatory balancing accounts, net	113	167
Customer deposits	90	88
Other	332	305
Total current liabilities	991	1,192
Long-term debt	1,110	1,107
Deferred credits and other liabilities:		
Customer advances for construction	98	91
Pension and other postretirement benefit obligations, net of plan assets	167	172
Deferred income taxes	102	107
Deferred investment tax credits	34	36
Regulatory liabilities arising from removal obligations	1,030	1,019
Asset retirement obligations	685	655
Deferred taxes refundable in rates	233	221
Preferred stock of subsidiary	20	20
Deferred credits and other	281	291
Total deferred credits and other liabilities	2,650	2,612
Commitments and contingencies (Note 7)		
Shareholders' equity:		
Preferred stock	80	80
Common stock (600 million shares authorized;		

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84 million shares outstanding; no par value)	1,462	1,464
Retained earnings	467	391
Accumulated other comprehensive income (loss)	(5 )	(5 )
Total shareholders' equity	2,004	1,930
Total liabilities and shareholders' equity	\$ 6,755	\$ 6,841

See Notes to Condensed Consolidated Financial Statements.

PACIFIC ENTERPRISES AND SUBSIDIARIES  
 CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS

(Dollars in millions)	Nine months ended	
	2007	2006
	September 30,	
	(unaudited)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 180	\$ 179
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	210	200
Deferred income taxes and investment tax credits	22	2
Accretion of interest	4	5
Other	(5)	(4)
Quasi-reorganization resolution	--	12
Net changes in working capital components	30	476
Changes in other assets	12	3
Changes in other liabilities	(6)	8
Net cash provided by operating activities	447	881
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Expenditures for property, plant and equipment	(300)	(284)
Increase in loans to affiliates, net	(116)	(114)
Proceeds from sale of assets	2	9
Other	(1)	--
Net cash used in investing activities	(415)	(389)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Common dividends paid	(100)	(150)
Preferred dividends paid	(3)	(3)
Decrease in short-term debt	--	(88)
Net cash used in financing activities	(103)	(241)

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Increase (decrease) in cash and cash equivalents	(71 )	251
Cash and cash equivalents, January 1	211	90
Cash and cash equivalents, September 30	\$ 140	\$ 341

SUPPLEMENTAL DISCLOSURE OF CASH FLOW  
INFORMATION

Interest payments, net of amounts capitalized	\$ 48	\$ 45
Income tax payments, net of refunds	\$ 118	\$ 74

SUPPLEMENTAL SCHEDULE OF NONCASH  
INVESTING ACTIVITY

Decrease in accounts payable from investments in property, plant and equipment	\$ (11 )	\$ (5 )
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See Notes to Condensed Consolidated Financial Statements.

SOUTHERN CALIFORNIA GAS COMPANY AND SUBSIDIARIES  
STATEMENTS OF CONSOLIDATED INCOME

(Dollars in millions)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2007	2006	2007	2006
			(unaudited)	
Operating revenues	\$ 819	\$ 812	\$ 3,168	\$ 3,145
Operating expenses				
Cost of natural gas	350	365	1,791	1,827
Other operating expenses	255	222	746	687
Depreciation	71	67	210	200
Franchise fees and other taxes	26	26	91	92
Total operating expenses	702	680	2,838	2,806
Operating income	117	132	330	339
Other expense, net	--	--	(4)	(1)
Interest income	8	7	22	23
Interest expense	(18)	(19)	(53)	(53)
Income before income taxes	107	120	295	308
Income tax expense	44	59	122	139
Net income	63	61	173	169
Preferred dividend requirements	--	--	1	1
Earnings applicable to common shares	\$ 63	\$ 61	\$ 172	\$ 168

See Notes to Condensed Consolidated Financial Statements.



SOUTHERN CALIFORNIA GAS COMPANY AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

	September 30,	December 31,
(Dollars in millions)	2007	2006
	(unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 140	\$ 211
Accounts receivable - trade	330	640
Accounts receivable - other	53	33
Interest receivable	--	10
Due from unconsolidated affiliates	167	108
Income taxes receivable	20	--
Deferred income taxes	23	42
Inventories	192	106
Other regulatory assets	39	41
Other	25	18
Total current assets	989	1,209
Other assets:		
Regulatory assets arising from pension and other postretirement benefit obligations	137	136
Other regulatory assets	101	95
Sundry	12	19
Total other assets	250	250
Property, plant and equipment:		
Property, plant and equipment	8,372	8,148
Less accumulated depreciation	(3,353 )	(3,248 )
Property, plant and equipment, net	5,019	4,900
Total assets	\$ 6,258	\$ 6,359

See Notes to Condensed Consolidated Financial Statements.





SOUTHERN CALIFORNIA GAS COMPANY AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

(Dollars in millions)	September 30, 2007 (unaudited)	December 31, 2006
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable - trade	\$ 251	\$ 416
Accounts payable - other	113	114
Due to unconsolidated affiliates	61	74
Income taxes payable	--	13
Regulatory balancing accounts, net	113	167
Customer deposits	90	88
Other	331	304
Total current liabilities	959	1,176
Long-term debt	1,110	1,107
Deferred credits and other liabilities:		
Customer advances for construction	98	91
Pension and other postretirement benefit obligations, net of plan assets	167	172
Deferred income taxes	118	124
Deferred investment tax credits	34	36
Regulatory liabilities arising from removal obligations	1,030	1,019
Asset retirement obligations	685	655
Deferred taxes refundable in rates	233	221
Deferred credits and other	262	268
Total deferred credits and other liabilities	2,627	2,586
Commitments and contingencies (Note 7)		
Shareholders' equity:		
Preferred stock	22	22

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Common stock (100 million shares authorized; 91 million shares outstanding; no par value)	866	866
Retained earnings	679	607
Accumulated other comprehensive income (loss)	(5 )	(5 )
Total shareholders' equity	1,562	1,490
Total liabilities and shareholders' equity	\$ 6,258	\$ 6,359

See Notes to Condensed Consolidated Financial Statements.

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

(Dollars in millions)	Nine months ended September 30,	
	2007	2006 (unaudited)
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 173	\$ 169
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	210	200
Deferred income taxes and investment tax credits	23	3
Accretion of interest	4	5
Other	(2)	(4)
Net changes in working capital components	20	460
Changes in other assets	8	3
Changes in other liabilities	(1)	12
Net cash provided by operating activities	435	848
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Expenditures for property, plant and equipment	(300)	(284)
Increase in loans to affiliates, net	(107)	(83)
Proceeds from sale of assets	2	9
Net cash used in investing activities	(405)	(358)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Common dividends paid	(100)	(150)
Preferred dividends paid	(1)	(1)
Decrease in short-term debt	--	(88)
Net cash used in financing activities	(101)	(239)
Increase (decrease) in cash and cash equivalents	(71)	251
Cash and cash equivalents, January 1	211	90
Cash and cash equivalents, September 30	\$ 140	\$ 341

SUPPLEMENTAL DISCLOSURE OF CASH FLOW  
INFORMATION

Interest payments, net of amounts capitalized	\$	43	\$	41
Income tax payments, net of refunds	\$	118	\$	74

SUPPLEMENTAL SCHEDULE OF NONCASH  
INVESTING ACTIVITY

Decrease in accounts payable from investments in property, plant and equipment	\$	(11)	\$	(5)
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See Notes to Condensed Consolidated Financial Statements.

## **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

### **NOTE 1. GENERAL**

#### **Principles of Consolidation**

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 accompanying financial statements are, in one case, the Condensed Consolidated Financial Statements of PE and its subsidiary, SoCalGas, and, in the other case, the Condensed 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 Company (SDG&E). SoCalGas and SDG&E are collectively referred to as the Sempra Utilities.

#### **Basis of Presentation**

The Condensed Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) and 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.

Information in this Quarterly Report should be read in conjunction with the company's Annual Report on Form 10-K for the year ended December 31, 2006 (the Annual Report) and its Quarterly Reports on Form 10-Q for the quarters

ended March 31, 2007 and June 30, 2007.

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, except for the adoption of new accounting standards as discussed in Note 2.

Other operating expenses include operating and maintenance costs, and general and administrative costs, consisting primarily of personnel costs, purchased materials and services, and outside services.

SoCalGas accounts for the economic effects of regulation on utility operations in accordance with Statement of Financial Accounting Standards (SFAS) 71, *Accounting for the Effects of Certain Types of Regulation*.

## **NOTE 2. NEW ACCOUNTING STANDARDS**

Pronouncements that have recently become effective that have had or may have a significant effect on the company's financial statements are described below.

***SFAS 157, "Fair Value Measurements" (SFAS 157):*** SFAS 157 defines fair value, establishes criteria to be considered when measuring fair value and expands disclosures about fair value measurements. SFAS 157 does not expand the application of fair value accounting to any new circumstances. The

company applies recurring fair value measurements to certain assets and liabilities, primarily commodity and other derivatives.

SFAS 157: (1) establishes that fair value is based on a hierarchy of inputs into the valuation process (as described in Note 5), (2) clarifies that an issuer's credit standing should be considered when measuring liabilities at fair value, (3) precludes the use of a liquidity or blockage factor discount when measuring instruments traded in an actively quoted market at fair value, and (4) requires costs relating to acquiring instruments carried at fair value to be recognized as expense when incurred. SFAS 157 requires that a fair value measurement reflect the assumptions market participants would use in pricing an asset or liability based on the best available information. These assumptions include the risk inherent in a particular valuation technique (such as a pricing model) and the risks inherent in the inputs to the model.

The provisions of SFAS 157 are to be applied prospectively, except for the initial impact on three specific items: (1) changes in fair value measurements of existing derivative financial instruments measured initially using the transaction price under Emerging Issues Task Force (EITF) Issue No. 02-3, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities*, (2) existing hybrid financial instruments measured initially at fair value using the transaction price, and (3) blockage factor discounts. Adjustments to these items required under SFAS 157 are to be recorded as a transition adjustment to beginning retained earnings in the year of adoption.

The company elected to early-adopt SFAS 157 in the first quarter of 2007. There was no transition adjustment as a result of the company's adoption of SFAS 157. SFAS 157 also requires new disclosures regarding the level of pricing observability associated with financial instruments carried at fair value. This additional disclosure is provided in Note 5.

**SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115" (SFAS 159):** SFAS 159 allows measurement at fair value of eligible financial assets and liabilities that are not otherwise measured at fair value. If the fair value option for an eligible item is elected, unrealized gains and losses for that item are reported in current earnings at each subsequent reporting date. SFAS 159 also establishes presentation and disclosure requirements designed to draw comparison between the different measurement attributes the company elects for similar types of assets and liabilities. This statement is effective for fiscal years beginning after November 15, 2007. The company is in the process of evaluating the application of the fair value option and the effect on its financial position and results of operations.

**Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109" (FIN 48):** FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109,

*Accounting for Income Taxes.* FIN 48 addresses how an entity should recognize, measure, classify and disclose in its financial statements uncertain tax positions that it has taken or expects to take in an income tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. Additionally, the FASB issued FASB Staff Position (FSP) FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48*, which amends FIN 48 to provide guidance on how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. The company's implementation of FIN 48 as of January 1, 2007 was consistent with the guidance in this FSP.

The company adopted the provisions of FIN 48 on January 1, 2007. As a result, SoCalGas recognized a \$1 million decrease in retained earnings. Including this adjustment, the company had unrecognized tax benefits of \$33 million (of which \$32 million applied to SoCalGas) as of January 1, 2007. Of this amount,



\$26 million (of which \$25 million applied to SoCalGas) related to tax positions that, if recognized, would decrease the effective tax rate; however, \$21 million (all of which applied to SoCalGas) related to tax positions that would increase the effective tax rate in subsequent years.

As of September 30, 2007, the company had unrecognized tax benefits of \$29 million (all of which applied to SoCalGas). Of this amount, \$22 million related to tax positions that, if recognized, would decrease the effective tax rate; however, \$21 million related to tax positions that would increase the effective tax rate in subsequent years.

It is reasonably possible that the company's unrecognized tax benefits could decrease by up to \$3 million within the next 12 months due to the expiration of statutes of limitations on tax assessments and by up to \$22 million due to the potential resolution of audit issues with various federal and state taxing authorities.

Effective January 1, 2007, the company's policy is to recognize accrued interest and penalties on accrued tax balances as components of tax expense. Prior to the adoption of FIN 48, the company accrued interest expense and penalties as components of tax expense and interest income as a component of interest income. As of January 1, 2007, the company had accrued a total of \$2 million (all of which applied to SoCalGas) of interest expense. There was no material change to the company's accrued interest expense as of September 30, 2007. The company had no accrued penalties as of either January 1, 2007 or September 30, 2007. Amounts accrued for interest expense associated with income taxes are included in income tax expense on the Statements of Consolidated Income and in various income tax balances on the Consolidated Balance Sheets.

The companies are subject to U.S. federal income tax as well as income tax of state jurisdictions. The companies remain subject to examination by U.S. federal and major state tax jurisdictions only for years after 2001.

In addition, the companies have filed federal and state refund claims for tax years back to 1998. The pre-2002 tax years are closed to new issues; therefore, no additional tax may be assessed by the taxing authorities for these years.

### **NOTE 3. OTHER FINANCIAL DATA**

#### **Asset Retirement Obligations**

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The company's asset retirement obligations, as defined in SFAS 143, *Accounting for Asset Retirement Obligations*, and FIN 47, *Accounting for Conditional Asset Retirement Obligations, an interpretation of SFAS 143*, are discussed in Note 1 of the Notes to Consolidated Financial Statements in the Annual Report. Following are the changes in asset retirement obligations for the nine months ended September 30, 2007 and 2006:

(Dollars in millions)	2007	2006
Balance as of January 1*	\$ 669	\$ 505
Accretion expense	31	24
Liabilities incurred	1	--
Payments	(1)	--
Revision to estimated cash flows	--	1
Balance as of September 30*	\$ 700	\$ 530

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

**Pension and Other Postretirement Benefits**

The following tables provide the components of benefit costs for the three months and nine months ended September 30:

(Dollars in millions)	Pension Benefits		Other Postretirement Benefits	
	Three months ended		Three months ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Service cost	\$ 11	\$ 9	\$ 3	\$ 4
Interest cost	24	23	10	7
Expected return on assets	(25 )	(24 )	(10 )	(9 )
Amortization of:				
Prior service cost	1	2	(1 )	(1 )
Actuarial loss	(1 )	1	1	(1 )
Regulatory adjustment	(9 )	(10 )	4	1
Total net periodic benefit cost	\$ 1	\$ 1	\$ 7	\$ 1

(Dollars in millions)	Pension Benefits		Other Postretirement Benefits	
	Nine months ended		Nine months ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Service cost	\$ 31	\$ 30	\$ 14	\$ 13
Interest cost	72	71	33	27
Expected return on assets	(76 )	(73 )	(30 )	(28 )
Amortization of:				
Prior service cost	2	5	(4 )	(4 )
Actuarial loss	--	4	4	2
Regulatory adjustment	(27 )	(35 )	6	4
Total net periodic benefit cost	\$ 2	\$ 2	\$ 23	\$ 14

The company expects to contribute \$1 million to its pension plan and \$26 million to its other postretirement benefit plans in 2007. For the nine months ended September 30, 2007, the company made contributions of \$1 million and \$22 million to the pension plan and other postretirement benefit plans, respectively, including a negligible amount and \$7 million, respectively, for the three months ended September 30, 2007.

### **Capitalized Interest**

The company recorded a negligible amount and \$1 million of capitalized interest for the three months and nine months ended September 30, 2007, respectively, including the debt-related portion of allowance for funds used during construction. The company recorded \$1 million and \$2 million of capitalized interest for the three months and nine months ended September 30, 2006, respectively, including the debt-related portion of allowance for funds used during construction.

### **Comprehensive Income**

For the three and nine months ended September 30, 2007 and 2006, comprehensive income was equal to net income.

**Other Expense, Net**

Other Expense, Net consists of the following:

(Dollars in millions)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Regulatory interest, net	\$ (1)	\$ (2)	\$ (6)	\$ (5)
Allowance for equity funds used during construction	2	2	4	5
Sundry, net	(1)	--	(2)	(1)
Total at SoCalGas	--	--	(4)	(1)
Additional at Pacific Enterprises:				
Preferred dividends of subsidiary	--	--	(1)	(1)
Sundry, net	(1)	(1)	1	(1)
Total	\$ (1)	\$ (1)	\$ (4)	\$ (3)

**Income Taxes**

The effective income tax rates for the company were 41 percent and 51 percent (41 percent and 49 percent at SoCalGas), for the three months ended September 30, 2007 and 2006, respectively, and 42 percent and 46 percent (41 percent and 45 percent at SoCalGas), for the nine months ended September 30, 2007 and 2006, respectively. The lower effective tax rate for the three months ended September 30, 2007 was due to a higher deduction for basis differences in fixed assets. The lower effective tax rate for the nine months ended September 30, 2007 was due to a higher deduction for basis differences in fixed assets and a higher federal deduction for state taxes.

**NOTE 4. DEBT AND CREDIT FACILITIES****Committed Lines of Credit**

SoCalGas and its affiliate, SDG&E, have a combined \$600 million five-year syndicated revolving credit facility expiring in 2010, under which each utility individually may borrow up to \$500 million, subject to a combined borrowing limit for both utilities of \$600 million. At September 30, 2007, the company had no outstanding borrowings under this facility.

Additional information concerning this credit facility is provided in the Annual Report.

### **Interest-Rate Swaps**

The company periodically enters into interest-rate swap agreements to moderate its exposure to interest-rate changes and to lower its overall cost of borrowing.

#### *Fair value hedge*

During 2003, SoCalGas entered into an interest-rate swap that effectively exchanged the fixed rate on \$150 million of its \$250 million 4.375-percent first mortgage bonds maturing in 2011 for a floating rate for the remaining term of the bonds. At both September 30, 2007 and 2006, market value adjustments since inception of the hedge of \$1 million and \$3 million were recorded as an increase in fixed-price contracts and other derivatives (in Deferred Credits and Other) and as an offsetting decrease in Long-term Debt,

without affecting net income or other comprehensive income. There has been no hedge ineffectiveness on this swap.

## **NOTE 5. FINANCIAL INSTRUMENTS**

### **Interest-Rate Swaps**

The company periodically enters into interest-rate swap agreements to moderate its exposure to interest-rate changes and to lower its overall cost of borrowing. The company's fair value interest-rate swap is discussed in Note 4.

### **Natural Gas Contracts**

The use of derivative instruments is subject to certain limitations imposed by company policy and regulatory requirements. These instruments enable the company to estimate with greater certainty the effective prices to be received by the company and the prices to be charged to its customers. The company records realized gains or losses on derivative instruments associated with transactions for natural gas contracts in Cost of Natural Gas on the Statements of Consolidated Income. On the Consolidated Balance Sheets, the company records corresponding regulatory assets and liabilities related to unrealized gains and losses from these derivative instruments to the extent derivative gains and losses associated with these derivative instruments will be payable or recoverable in future rates.

### **Adoption of SFAS 157**

Effective January 1, 2007, the company early-adopted SFAS 157 as discussed in Note 2, which, among other things, requires enhanced disclosures about assets and liabilities carried at fair value.

As defined in SFAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). However, as permitted under SFAS 157, the company utilizes a mid-market pricing convention (the mid-point price between bid and ask prices) as a practical expedient for valuing the majority of its assets and liabilities measured and reported at fair value. The company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The company primarily applies the market

approach for recurring fair value measurements and endeavors to utilize the best available information. Accordingly, the company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The company is able to classify fair value balances based on the observability of those inputs. SFAS 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurement) and the lowest priority to unobservable inputs (level 3 measurement). The three levels of the fair value hierarchy defined by SFAS 157 are as follows:

**Level 1** Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 primarily consists of financial instruments such as exchange-traded derivatives and listed equities.

**Level 2** Pricing inputs are other than quoted prices in active markets included in level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These



models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Instruments in this category include non-exchange-traded derivatives such as over-the-counter forwards and options.

Level 3 Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value. At each balance sheet date, the company performs an analysis of all instruments subject to SFAS 157 and includes in level 3 all of those whose fair value is based on significant unobservable inputs. During the first nine months of 2007, the company had no significant level 3 recurring measurements.

The following table sets forth by level within the fair value hierarchy the company's financial assets and liabilities that were accounted for at fair value on a recurring basis as of September 30, 2007. As required by SFAS 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

Recurring Fair Value Measures  (Dollars in millions)	At fair value as of September 30, 2007			
	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Commodity derivatives	\$ 9	\$ 2	\$ --	\$ 11
<b>Liabilities:</b>				
Commodity derivatives	\$ 1	\$ --	\$ --	\$ 1
Other derivatives	--	1	--	1
Total	\$ 1	\$ 1	\$ --	\$ 2

Commodity derivatives include commodity derivative positions entered into to manage customer price exposures, and other derivatives include interest-rate management instruments.

The following table sets forth by level within the fair value hierarchy the company's financial assets and liabilities that

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were accounted for at fair value on a nonrecurring basis during the nine months ended September 30, 2007. The fair value measures classified as level 3 are calculated based on discounted expected future cash flows.

At fair value during the nine months ended

Nonrecurring Fair Value Measures (Dollars in millions)	September 30, 2007			Total
	Level 1	Level 2	Level 3	
Liabilities:				
Asset retirement obligations*	\$ --	\$ --	\$ 1	\$ 1

\* Update to asset retirement obligation costs as discussed in Note 3.

## **NOTE 6. REGULATORY MATTERS**

### **General Rate Case**

In April 2007, the company filed an amendment to its original 2008 General Rate Case application (2008 GRC) as filed in December 2006 with the California Public Utilities Commission (CPUC). The 2008 GRC application, as amended, establishes the authorized margin requirements and the ratemaking mechanisms by which those margin requirements would change annually effective in 2008 through 2013 (2008 GRC rate period). The amended 2008 GRC request represents an increase in the company's annual authorized margin of \$130 million, as compared to 2007 authorized margin.

As part of the General Rate Case process, applications are subject to review and testimony by various groups representing the interests of ratepayers and other constituents. In July 2007, the CPUC's Division of Ratepayer Advocates (DRA) submitted testimony to the CPUC proposing, among other things, reductions to SoCalGas' requested margin requirements by \$201 million. In addition, the DRA proposed a 5-year term as the applicable 2008 GRC rate period as compared to the 6-year term proposed by the company. Testimony submitted to the CPUC by certain other advocacy groups proposes, among other things, additional reductions in the requested margin requirements beyond those proposed by the DRA.

In July 2007, the company submitted rebuttal testimony to the CPUC responding to the DRA's and other advocacy groups' testimonies. Public hearings on the 2008 GRC were held in August 2007 and September 2007. A final decision is expected in the first quarter of 2008. The company has filed a request with the CPUC to make any decision on the 2008 GRC effective retroactive to January 1, 2008.

### **Utility Ratemaking Incentive Awards**

Performance-Based Regulation (PBR), demand-side management and Gas Cost Incentive Mechanism (GCIM) awards are not included in the company's earnings until CPUC approval of each award is received. All awards discussed below are on a pretax basis.

In July 2007, SoCalGas received approval of its 2006 Operational PBR shareholder award of \$1 million, which was included in the company's earnings in the third quarter of 2007. On November 1, 2007, SoCalGas received approval of its GCIM Year 12 application requesting a shareholder award of \$10 million, which will be recorded in the fourth

quarter of 2007. In October 2007, the DRA recommended approval of SoCalGas' GCIM Year 13 application, which was filed with the CPUC in June 2007, seeking a \$9 million shareholder reward. A final CPUC decision is expected in the first half of 2008.

In September 2007, the CPUC established a mechanism to financially reward or penalize the California investor-owned utilities (IOUs) for their performance on post-2005 energy-efficiency programs. The mechanism rewards or penalizes the IOUs based upon specific portfolio performance goals to reduce energy consumption. The program provides for three-year cycles, with the first three-year cycle covering 2006 through 2008. The company's maximum rewards and penalties, on a pretax basis, are \$20 million. Generally, the company will be entitled to rewards when the energy cost savings are 80-110 percent of goal. The company is subject to penalties when the savings are less than 65 percent of goal, with the maximum penalty reached when savings are 55 percent of goal. No incentive or penalty applies for performance between 65-80 percent.

## NOTE 7. COMMITMENTS AND CONTINGENCIES

### Legal Proceedings

At September 30, 2007, the company's reserves for litigation matters were \$77 million, of which \$74 million related to settlements reached in January 2006 to resolve certain litigation arising out of the 2000 - 2001 California energy crisis. The uncertainties inherent in complex legal proceedings make it difficult to estimate with any degree of certainty the costs and effects of resolving legal matters. Accordingly, costs ultimately incurred may differ materially from estimated costs and could materially adversely affect the company's business, cash flows, results of operations and financial condition.

Sempra Commodities, Sempra Generation and Sempra LNG, referred to in the following discussion, are business units of Sempra Energy.

#### *Continental Forge Settlement*

The litigation that is the subject of the January 2006 settlements is frequently referred to as the Continental Forge litigation, although the settlements also include other cases. The Continental Forge class-action and individual antitrust and unfair competition lawsuits in California and Nevada alleged that Sempra Energy and the Sempra Utilities unlawfully sought to control natural gas and electricity markets and claimed damages in excess of \$23 billion after applicable trebling.

The San Diego County Superior Court entered a final order approving the settlement of the Continental Forge class-action litigation as fair and reasonable in July 2006. The California Attorney General and the Department of Water Resources (DWR) have appealed the final order. Oral argument is expected to take place in 2008. The Nevada Clark County District Court entered an order approving the Nevada class-action settlement in September 2006. Both the California and Nevada settlements must be approved for either settlement to take effect, but Sempra Energy is permitted to waive this condition. The settlements are not conditioned upon approval by the CPUC, the DWR, or any other governmental or regulatory agency to be effective.

To settle the California and Nevada litigation, Sempra Energy agreed to make cash payments in installments aggregating \$377 million, of which \$347 million relates to the Continental Forge and California class action price reporting litigation and \$30 million relates to the Nevada antitrust litigation. The Los Angeles City Council had not

previously voted to approve the City of Los Angeles' participation in the January 2006 California settlement. On March 26, 2007, Sempra Energy and the Sempra Utilities entered into a separate settlement agreement with the City of Los Angeles resolving all of its claims in the Continental Forge litigation in return for the payment of \$8.5 million on April 25, 2007. This payment was made in lieu of the \$12 million payable in eight annual installments that the City of Los Angeles was to receive as part of the January 2006 California settlement.

Additional consideration for the January 2006 California settlement includes an agreement that Sempra LNG would sell to the Sempra Utilities, subject to CPUC approval, regasified liquefied natural gas (LNG) from its LNG terminal being constructed in Baja California, Mexico, for a period of 18 years at the California border index price minus \$0.02 per million British thermal units (MMBtu). The Sempra Utilities agreed to seek approval from the CPUC to integrate their natural gas transmission facilities and to develop both firm, tradable natural gas receipt point rights for access to their combined intrastate transmission system and SoCalGas' underground natural gas storage system and filed for approval at the CPUC in July 2006. In addition, Sempra Generation voluntarily would reduce the price that it charges for power and limit the places at which it would deliver power under its contract with the DWR. Based on the

expected contractual volumes of power to be delivered, this discount would have potential value aggregating \$300 million over the contract's then remaining six-year term.

Under the terms of the January 2006 settlements, \$83 million was paid in August 2006 and an additional \$83 million was paid in August 2007. Of the remaining amounts, \$25.8 million is to be paid on the closing date of the January 2006 settlements, which will take place after the resolution of all appeals, and \$24.8 million will be paid on each successive anniversary of the closing date through the seventh anniversary of the closing date, as adjusted for the City of Los Angeles settlement. Under the terms of the City of Los Angeles settlement, \$8.5 million was paid on April 25, 2007. The reserves recorded for the California and Nevada settlements by Sempra Energy, including SoCalGas, in 2005 fully provide for the present value of both the cash amounts to be paid in the settlements and the price discount to be provided on electricity to be delivered under the DWR contract. A portion of the reserves was discounted at 7 percent, the rate specified for prepayments in the settlement agreement. For payments not addressed in the agreement and for periods from the settlement date through the estimated date of the first payment, 5 percent was used to approximate Sempra Energy's average cost of financing.

#### *Other Natural Gas Cases*

In April 2003, Sierra Pacific Resources and its utility subsidiary Nevada Power filed a lawsuit in the U.S. District Court in Nevada against major natural gas suppliers, including Sempra Energy, the Sempra Utilities and Sempra Commodities, seeking recovery of damages alleged to aggregate in excess of \$150 million (before trebling). The lawsuit alleges a conspiracy to manipulate and inflate the prices that Nevada Power had to pay for its natural gas by preventing the construction of natural gas pipelines to serve Nevada and other Western states, and reporting artificially inflated prices to trade publications. The U.S. District Court dismissed the case in November 2004, determining that the Federal Energy Regulatory Commission (FERC) had exclusive jurisdiction to resolve the claims. In September 2007, the U.S. Court of Appeals for the Ninth Circuit (Ninth Circuit Court of Appeals) reversed the dismissal and the case is expected to return to the District Court for further proceedings.

Apart from the claims settled in connection with the Continental Forge settlement, there remain pending 13 state antitrust actions that have been coordinated in San Diego Superior Court against Sempra Energy, the Sempra Utilities and Sempra Commodities and other, unrelated energy companies, alleging that energy prices were unlawfully manipulated by the reporting of artificially inflated natural gas prices to trade publications and by entering into wash trades and churning transactions. In July 2007, the Superior Court stayed the portion of the proceeding involving all but three of the 13 individual plaintiffs who brought actions against the company because they are class members in the Continental Forge settlement class described above.

Pending in the U.S. District Court in Nevada are five cases against Sempra Energy, Sempra Commodities, the Sempra Utilities and various other companies, which make similar allegations to those in the state proceedings, four of which

also include conspiracy allegations similar to those made in the Continental Forge litigation. The court dismissed four of these actions, determining that the FERC had exclusive jurisdiction to resolve the claims. The remaining case, which includes conspiracy allegations, was stayed. In September 2007, the Ninth Circuit Court of Appeals reversed the dismissal and these cases are expected to return to the District Court for further proceedings.

*Other Litigation*

In 1998, SoCalGas converted its traditional pension plan for non-union employees to a cash balance plan. In July 2005, a lawsuit was filed against the company in the U.S. District Court for the Central District of California alleging that the conversion unlawfully discriminated against older employees and failed to



provide required disclosure of a reduction in benefits. In October 2005, the court dismissed three of the four causes of action and, in March 2006, dismissed the remaining cause of action. The plaintiffs have appealed the court's ruling.

### **Environmental Matters**

SoCalGas increased its environmental-related liabilities in the first quarter of 2007 by \$18 million, \$16 million of which is expected to be recoverable through rates, to reflect a change in estimate of expected cleanup costs at a former manufactured-gas plant site. Expected cleanup costs have risen due to increasingly stringent regulations by the California Department of Toxic Substances Control and due to technical challenges involved in excavating and removing contaminated soil while keeping existing businesses open.

### **NOTE 8. SUBSEQUENT EVENT -- SOUTHERN CALIFORNIA WILDFIRES**

In October 2007, major wildfires throughout Southern California destroyed many homes, damaged utility infrastructure and disrupted utility services. On October 21, 2007, Governor Arnold Schwarzenegger declared a state of emergency for seven California counties, including the County of San Diego and six counties within SoCalGas' service territory. The Sempra Utilities will each apply to the CPUC to recover any material incremental costs of restoring utility services and utility facilities damaged by the wildfires in cost recovery proceedings applicable to disaster events.

ITEM 2.

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

The following discussion should be read in conjunction with the financial statements contained in this Form 10-Q and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Risk Factors" contained in the company's 2006 Annual Report on Form 10-K (Annual Report).

**RESULTS OF OPERATIONS**

*Revenues and Cost of Sales*

During the nine months ended September 30, 2007, natural gas revenues increased compared to the corresponding period in 2006, primarily as a result of higher authorized revenues and higher refundable costs, offset by lower cost of natural gas. Under the current regulatory framework, the cost of natural gas purchased for customers and the variations in that cost are passed through to customers on a substantially concurrent basis. However, SoCalGas' gas cost incentive mechanism allows SoCalGas to share in the savings or costs from buying natural gas for customers below or above market-based monthly benchmarks. Further discussion is provided in Notes 1 and 8 of the Notes to Consolidated Financial Statements in the Annual Report.

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

Natural Gas Sales, Transportation and Exchange

(Volumes in billion cubic feet, dollars in millions)

Natural Gas Sales	Transportation and Exchange	Total
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	Volumes	Revenue	Volumes	Revenue	Volumes	Revenue
2007:						
Residential	173	\$ 1,915	1	\$ 3	174	\$ 1,918
Commercial and industrial	79	729	204	150	283	879
Electric generation plants	--	--	158	56	158	56
Wholesale	--	--	99	42	99	42
	252	\$ 2,644	462	\$ 251	714	2,895
Balancing accounts and other						273
Total						\$ 3,168
2006:						
Residential	176	\$ 2,009	1	\$ 4	177	\$ 2,013
Commercial and industrial	79	747	203	157	282	904
Electric generation plants	--	--	147	59	147	59
Wholesale	--	--	99	27	99	27
	255	\$ 2,756	450	\$ 247	705	3,003
Balancing accounts and other						142
Total						\$ 3,145

*Interest Income*

Interest income at Pacific Enterprises (PE) decreased by \$12 million (23%) in the nine months ended September 30, 2007 to \$40 million. The decrease in the nine months ended September 30, 2007 was primarily due to \$13 million in interest income recorded in 2006 at PE related to an insurance claim.

*Income Taxes*

Income tax expense was \$128 million and \$151 million (\$122 million and \$139 million for SoCalGas) for the nine months ended September 30, 2007 and 2006, respectively, and the effective income tax rates for the company were 42 percent and 46 percent (41 percent and 45 percent at SoCalGas), respectively.

Income tax expense was \$46 million and \$63 million (\$44 million and \$59 million for SoCalGas) for the three months ended September 30, 2007 and 2006, respectively, and the effective income tax rates for the company were 41 percent and 51 percent (41 percent and 49 percent at SoCalGas), respectively.

The decrease in expense for the three months and nine months ended September 30, 2007 was due primarily to a lower effective income tax rate. The lower effective tax rate for the nine months ended September 30, 2007 was due to a higher deduction for basis differences in fixed assets and a higher federal deduction for state taxes. The lower effective tax rate for the three months ended September 30, 2007 was due to a higher deduction for basis differences in fixed assets.

*Net Income*

Net income for SoCalGas increased by \$4 million (2%) in the nine months ended September 30, 2007 to \$173 million and by \$2 million (3%) in the three months ended September 30, 2007 to \$63 million. The increase for the nine months ended September 30, 2007 was primarily due to a lower effective income tax rate in 2007, offset by the favorable resolution of a natural gas royalty matter in 2006.

## **CAPITAL RESOURCES AND LIQUIDITY**

At September 30, 2007, the company had \$140 million in unrestricted cash and \$500 million in available unused credit on its committed line at SoCalGas, which is shared with SDG&E and is discussed more fully in Note 4 of the Notes to Condensed Consolidated Financial Statements herein. Management believes that these amounts and cash flows from operations and security issuances will be adequate to finance capital expenditures and meet liquidity requirements and other commitments. Management continues to regularly monitor SoCalGas' ability to finance the needs of its operating, investing and financing activities in a manner consistent with its intention to maintain strong, investment-quality credit ratings.

## **CASH FLOWS FROM OPERATING ACTIVITIES**

Net cash provided by PE's operating activities decreased by \$434 million (49%) to \$447 million for 2007. For SoCalGas, net cash provided by operating activities decreased by \$413 million (49%) to \$435 million for 2007. The changes were primarily due to a lower decrease in accounts receivable of \$297 million in 2007 compared to \$376 million in 2006, a \$137 million decrease in accounts payable in 2007 compared to

an increase of \$34 million in 2006, and a decrease of \$86 million in overcollected regulatory balancing accounts in 2007 compared to an increase of \$95 million in 2006.

For the nine months ended September 30, 2007, the company made contributions of \$1 million and \$22 million to the pension plan and other postretirement benefit plans, respectively.

#### CASH FLOWS FROM INVESTING ACTIVITIES

Net cash used in PE's investing activities increased by \$26 million (7%) to \$415 million for 2007. Net cash used in SoCalGas' investing activities increased by \$47 million (13%) to \$405 million for 2007. The changes were primarily due to an increase in capital expenditures for property, plant and equipment of \$16 million at both SoCalGas and PE, and an increase in advances to Sempra Energy of \$24 million at SoCalGas and proceeds of \$2 million from the sale of assets at PE compared to \$9 million in 2006.

Significant capital expenditures in 2007 are expected to include \$500 million for improvements to distribution and transmission systems. These expenditures are expected to be financed by cash flows from operations and security issuances.

#### CASH FLOWS FROM FINANCING ACTIVITIES

Net cash used in PE's financing activities decreased by \$138 million (57%) to \$103 million for 2007. Net cash used in SoCalGas' financing activities decreased by \$138 million (58%) to \$101 million for 2007. The changes were attributable to an \$88 million reduction of short-term debt in 2006 and \$50 million of higher common dividend payments made in 2006.

#### COMMITMENTS

At September 30, 2007, there were no significant changes to the commitments that were disclosed in the Annual Report, except for increases of \$698 million and \$18 million, respectively, related to new natural gas contracts and environmental commitments. The future payments under these contractual commitments are expected to be \$192 million for 2007, \$376 million for 2008, \$20 million for 2009, \$15 million for 2010, \$15 million for 2011 and \$98

million thereafter.

## **FACTORS INFLUENCING FUTURE PERFORMANCE**

Performance of the company will depend primarily on the ratemaking and regulatory process, natural gas industry restructuring, and the changing energy marketplace. Performance will also depend on the successful completion of capital projects which are discussed in various places in this report. These factors are discussed in Note 6 of the Notes to Condensed Consolidated Financial Statements herein.

### **Litigation**

Note 7 of the Notes to Condensed Consolidated Financial Statements herein and Note 9 of the Notes to Consolidated Financial Statements in the Annual Report describe litigation (primarily cases arising from the California energy crisis), the ultimate resolution of which could have a material adverse effect on future performance.

## Industry Developments

Note 6 of the Notes to Condensed Consolidated Financial Statements herein and Note 8 of the Notes to Consolidated Financial Statements in the Annual Report describe natural gas regulation and rates, and other pending proceedings and investigations.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Certain accounting policies are viewed by management as critical because their application is the most relevant, judgmental and/or material to the company's financial position and results of operations, and/or because they require the use of material judgments and estimates.

The company's significant accounting policies are described in Note 1 of the Notes to Consolidated Financial Statements in the Annual Report. One accounting pronouncement that has recently become effective and may have a significant effect on the company's accounting policies and estimates is described below and was adopted by the company effective January 1, 2007, as discussed in Note 2 of the Notes to Condensed Consolidated Financial Statements herein.

Description	Assumptions & Approach Utilized	Effect if Different Assumptions Used
<b>Income Taxes</b>	For a position to qualify for benefit recognition under FIN 48, the position must have at least a more likely than not chance of being sustained (based on the position's technical merits) upon challenge by the respective authorities. The term more likely than not means a likelihood of more than 50 percent. If the company does not have a more likely than not position with respect to a tax position, then the company may not recognize any of the potential tax benefit associated with the position. A tax position that meets the more likely than	Unrecognized tax benefits involve management judgment regarding the likelihood of the benefit being sustained. The final resolution of uncertain tax positions could result in adjustments to recorded amounts and may affect the company's results of operations, financial position and cash flows.
<i>Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48),</i> clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements. FIN 48 addresses how an entity should recognize, measure, classify and disclose in its financial statements uncertain tax		



positions that it has taken or expects to take in an income tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

not recognition shall initially and subsequently be measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon the effective resolution of the tax position.

Additional information related to accounting for uncertainty in income taxes is discussed in Note 2 of the Notes to Condensed Consolidated Financial Statements herein.

## **NEW ACCOUNTING STANDARDS**

Pronouncements that have recently become effective and have had or may have a significant effect on the company's financial statements are described in Note 2 of the Notes to Condensed Consolidated Financial Statements herein.

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

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

As of September 30, 2007, the total Value at Risk of SoCalGas' positions was not material.

### ITEM 4. CONTROLS AND PROCEDURES

Company management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Exchange Act Rules 13a-15(f). The company has designed and maintains disclosure controls and procedures to ensure that information required to be disclosed in the company's reports 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 company's management, including its Chief Executive Officer and Chief Financial Officer, 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. There have been no changes in the company's internal control over financial reporting during the company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the company's internal control over financial reporting.

The company evaluates the effectiveness of its internal control over financial reporting based on the framework in *Internal Control--Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Under the supervision and with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, the company evaluated the effectiveness of the design and operation of the company's disclosure controls and procedures as of September 30, 2007, the end of the period covered by this report. Based on that evaluation, the company's Chief Executive Officer and Chief Financial Officer concluded that the company's disclosure controls and procedures were effective at the reasonable assurance level.

## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

Except as described in Notes 6 and 7 of the Notes to Condensed Consolidated Financial Statements herein, 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.

#### ITEM 1A. RISK FACTORS

There have been no material changes from risk factors as previously disclosed in the company's 2006 Annual Report on Form 10-K.

ITEM 6. EXHIBITS

Exhibit 12 - Computation of ratios

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

12.2 Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends 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.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PACIFIC ENTERPRISES,  
(Registrant)

Date: November 1, 2007

By: /s/ Dennis V. Arriola  
Dennis V. Arriola  
Sr. Vice President and Chief Financial Officer

SOUTHERN CALIFORNIA GAS COMPANY,  
(Registrant)

Date: November 1, 2007

By: /s/ Dennis V. Arriola  
Dennis V. Arriola  
Sr. Vice President and Chief Financial Officer