(As filed October 30, 1998)

File No. 70-9333

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM U-1/A

Amendment No. 1
to
JOINT APPLICATION OR DECLARATION
UNDER THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Sempra Energy 101 Ash Street San Diego, California 92101	Frontier Pacific, Inc. 555 West Fifth Street, Suite 2900 Los Angeles, California 90013-1001

(Names of companies filing this statement and
addresses of principal executive offices)

None

(Name of top registered holding company parent)

Richard D. Farman President and Chief Executive Officer Pacific Enterprises 555 West Fifth Street, Suite 2900 Los Angeles, California 90013-1001	Stephen L. Baum President and Chief Executive Officer Enova Corporation 101 Ash Street San Diego, California 92101

(Names and addresses of agents for service)

The Commission is requested to send copies of all notices,
orders and communications in connection with
this Application or Declaration to:

Donald C. Liddell, Esq. David L. Huard, Esq. Pacific Enterprises 633 West Fifth Street, Suite 5200 Los Angeles, California 90071	Richard M. Farmer, Esq. Andrew F. MacDonald, Esq. William C. Weeden Thelen Reid & Priest LLP 40 West 57th Street New York, New York 10019

The Application or Declaration heretofore filed in this proceeding is hereby amended and restated in its entirety to read as follows:

ITEM 1. DESCRIPTION OF PROPOSED TRANSACTION.

1.1. Introduction and Description of Applicants' Business.

Sempra Energy ("Sempra") is an exempt holding company pursuant to Section 3(a)(1) of the Public Utility Holding Company Act of 1935, as amended (the "Act"). Sempra owns all of the common stock of Pacific Enterprises ("Pacific") and Enova Corporation ("Enova"), which are also exempt holding companies pursuant to Section 3(a)(1) of the Act.1/ Through a subsidiary, Frontier Pacific, Inc. ("Frontier Pacific"),2/ Sempra is proposing to acquire up to 90.1% of the membership interests of Frontier Energy LLC ("Frontier"), a North Carolina limited liability company formed to construct and operate a small gas

distribution system in North Carolina. The remaining membership interests in Frontier would be acquired by Frontier Utilities of North Carolina, Inc. ("Frontier Utilities"), a North Carolina corporation and an indirect, majority-owned subsidiary of ARB, Inc., a closely-held California corporation.3/

1/ See Sempra Energy, 67 SEC Docket 994 (June 26, 1998). Pacific (formerly Pacific Lighting Corporation) is exempt by order issued pursuant to Section 3(a)(1). See Pacific Lighting Corporation, 1 S.E.C. 275 (1936). Enova claims an exemption under Section 3(a)(1) pursuant to Rule 2. See File No. 69-393.

2/ All of the issued and outstanding common stock of Frontier Pacific is currently held by Sempra Energy, LLC, a California limited liability company whose membership interests are, in turn, held directly by Pacific and Enova. Prior to the date of the Commission's order in this proceeding, the stock of Frontier Pacific will be transferred to Sempra.

3/ ARB, Inc. is not now a "holding company" or an "affiliate" of any "holding company" or "public-utility company," as those terms are defined under Section 2 of the Act.

Pacific's predominant subsidiary, Southern California Gas Company ("SoCalGas"), purchases, transports and distributes natural gas in southern California. At December 31, 1997, Pacific reported consolidated total assets of $4.977 billion, of which approximately $3.154 billion consisted of net gas plant. For the year ended December 31, 1997, Pacific reported $2.738 billion in operating revenues (including revenues from transportation-only customers) and $184 million in net income.

Enova's principal subsidiary, San Diego Gas & Electric Company ("SDG&E"), provides electric and natural gas service in San Diego and surrounding areas. At December 31, 1997, Enova reported consolidated total assets of $5.2 billion, of which approximately $2.49 billion consisted of net electric plant and $449 million consisted of net gas plant. For the year ended December 31, 1997, Enova reported operating revenues of $2.2 billion (81.6% from electricity sales and 18.4% from gas sales (including revenues from transportation-only customers)), and $252 million in net income.

Sempra's non-utility subsidiaries include Sempra Energy Utility Ventures ("Sempra Ventures"), which is currently managing the development and construction of the Frontier gas system and other "green field" local gas distribution systems in the United States and Canada, and Sempra Energy Trading Corp. ("Sempra Trading"), which is engaged in marketing and trading physical and financial energy products, including natural gas, power and oil. Sempra Trading is the successor to AIG Trading Corporation, which was acquired by Pacific and Enova in December 1997. In August 1998, Sempra Trading completed its acquisition of CNG Energy Services Corp., the wholesale gas marketing and trading arm of

Consolidated Natural Gas Company, as a result of which Sempra Trading is now among the ten largest gas marketers and traders in the United States.

SoCalGas and SDG&E derive substantially all of their gas requirements from sources outside of California. Approximately 58% of their combined system gas requirements are met from production in the Permian Basin, which is located in west Texas, and the San Juan Basin, which is located primarily in New Mexico and Colorado in the "Four Corners" area. Most of the gas produced in these supply basins is delivered to California by El Paso Natural Gas Company ("El Paso") and Transwestern Pipeline Company ("Transwestern") under long-term transportation agreements. SoCalGas and SDG&E purchase their gas under a variety of long-term, short-term and daily contracts from producers in the two supply basins, as well as from gas marketers and brokers, including Sempra Trading. Sempra Trading also purchases most of the gas it sells in southern California from production in the Permian and San Juan Basins.

1.2 Description of Frontier and Its Properties.

By order issued January 30, 1996, Frontier Utilities was granted a final certificate of public convenience and necessity (the "Certificate Order") from the North Carolina Utilities Commission ("NCUC") to construct, test, market, own and operate a new natural gas distribution system in a four-county area in northwestern North Carolina comprised of Surrey, Watauga, Wilkes and Yadkin Counties (the "Four-County Area").4/ Subsequently,

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4/ In the Matter of Application of Frontier Utilities of North Carolina, Inc. for Certificate of Public Convenience and Necessity, NCUC Docket No. G-38, January 30, 1996 (Order Granting Final Certificate), 166 PUR 4th 565. The order was affirmed on appeal by the Supreme Court of North Carolina on a challenge by Piedmont Natural Gas Company, Inc., whose competing proposal the NCUC had rejected. State of North Carolina v. Piedmont Natural Gas Company, Inc., 488 S.E. 2d 591 (N.C. Sup. Crt. 1997).

by order dated August 16, 1996,5/ the NCUC added Ashe and Allegheny Counties, which are located in the same region, to Frontier Utilities' certificated territory, and by order dated March 27, 1997,6/ granted Frontier Utilities a certificate of convenience and necessity to construct and operate a gas distribution system in Warren County, which is to the east of the Four-County Area. By further order dated March 9, 1998 (the "Financing Order"), the NCUC approved various proposals by Frontier Utilities and Frontier relating to financing of construction of a gas system in the Four-County Area and Warren County, including the participation of Frontier Pacific as an equity investor in Frontier, and the transfer by Frontier Utilities to Frontier of the certificates to serve the Four-County Area, as well as Ashe, Allegheny and Warren Counties.7/ Copies of Frontier Utilities' application to the NCUC and the Financing Order are attached hereto as Exhibits D-1 and D-2, respectively.

Frontier commenced construction in the Four-County Area during the second quarter of 1998. Construction in Warren County will commence at a later date, subject to receipt of further NCUC approvals. When complete, the Four-County Area system will consist of approximately 140 miles of transmission mains, including a 40-mile lateral tap off the interstate pipeline

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5/ In the Matter of Commission Proceeding to Implement G.S. 62-36A(b1), NCUC Docket No. G-100, Sub. 69 (August 16, 1996). This was a generic proceeding in which the NCUC implemented a new law that required that the NCUC grant certificates to provide gas service to all unfranchised areas in North Carolina or, in the absence of any applications for such certificates, that the NCUC assign to the incumbent utilities in the state franchises covering all such uncertificated areas. Because of their proximity to the Four-County Area, the franchises for Ashe and Allegheny Counties were assigned to Frontier Utilities.

6/ In the Matter of Frontier Utilities of North Carolina, Inc. for Certificate of Public Convenience and Necessity, NCUC Docket No. G-38, Sub. 1, March 27, 1997 (Order Awarding Certificate and Approving Rates).

7/ Order Approving Final Financing Plan, Transfer of Certificates, and Security Bond and Preliminarily Approving Debt Financing, NCUC Docket Nos. G-38, Sub 3 and G-40 (March 9, 1998). Although Frontier has indicated that it intends to build out a system in Ashe and Allegheny Counties at such time as it becomes feasible to do so, the financing plan approved by the NCUC does not include the system to be built in those counties.

facilities of Transcontinental Gas Pipe Line Corp. ("Transco"), and at least 320 miles of distribution mains. Initially, Frontier will purchase all of its gas requirements from Sempra Trading pursuant to the terms of an agreement, dated September 17, 1998, from production in the San Juan and Permian Basins. Although Frontier will have the right to purchase gas from other suppliers in the future, it is anticipated that it will continue to derive at least 50% of its supplies from these two supply basins. Gas will be delivered to Frontier by Transco under a long-term transportation contract. Frontier is projecting that, by the end of the fifth year following commencement of construction, it will serve 13,250 residential, 1,054 small commercial, 300 poultry farm, and 55 large commercial and industrial customers. (Exhibit D-1, p. 10). As a public utility under North Carolina law, Frontier will be subject to regulation by the NCUC as to rates, service, securities issuances and other matters.

The Certificate Order contains various findings and conclusions as to technical issues, the financial feasibility of the Four-County Area system, and the public interest to be served. Two of the central issues in the proceeding concerned the optimum size of the Four-County Area system and the likelihood that customers would convert from propane and heating oil to natural gas. These issues were critical in the NCUC's evaluation of Frontier Utilities' proposal, which assumed that the proposed system could support traditional financing, and of the competing proposal made by Piedmont Natural Gas Company, Inc. ("Piedmont"), an existing franchised gas utility company in North Carolina, which was made contingent upon the availability of "expansion funds" provided for under North Carolina law.8/ With regard to the financial feasibility of Frontier Utilities' proposed system in the Four-County Area, the NCUC considered a

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8/ See N.C. Gen. Stat. Section 62-158 (Michie, 1997).

detailed market study prepared by an independent consultant (Heath and Associates) which evaluated the potential customers and loads in the Four-Country Area and the likelihood of converting these customers to gas at the rates and rate designs proposed by Frontier Utilities. During the hearings, witnesses for Heath and Associates and Frontier Utilities were cross-examined at length concerning the data used and assumptions made in the Heath and Associates study and an earlier study prepared by Frontier Utilities. Despite certain discrepancies between the Health and Associates study and Frontier Utilities' initial study as to likely number of customers, the configuration of the system, conversion rates and other matters,9/ the NCUC concluded that "the market study performed by Heath and Associates provides a fair and unbiased assessment of the potential customers and loads resulting from an extensive rural distribution system in the Four-County area at the rates that Frontier proposed to offer." (Certificate Order, p. 19).

1.3 Description of Frontier's Ownership Structure and Management Plan.

It is contemplated that Frontier Pacific and Frontier Utilities will each acquire 50% of the membership interests of Frontier, and that the economic interests of the members will equal their membership interests.10/ Under the Financing Order, the NCUC authorized the equity investments by the members of Frontier, including cash and in-kind contributions of pipeline

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9/ Heath and Associates forecast that the gas system would have 8,553 customers in year 10 and sales of 4 million dekatherms per year. Certificate Order, p. 13. Frontier Utilities offered testimony showing that it would be economically feasible to serve an additional 5000 customers outside of the areas included in the Heath and Associates analysis.

10/ An organizational chart showing the ownership structure of Frontier and its members is set forth at page 5 of Frontier Utilities' Application for Approval of Financing Plan (Exhibit D-1 hereto).

and other property, totaling approximately $12 million. In addition, the NCUC has given its preliminary approval for $40 million in debt financing by Frontier.

Under Frontier's Operating Agreement (attached hereto as Exhibit A-2), the economic interest of a member is defined as that member's interest in the profits and losses of Frontier and right to receive distributions from Frontier. The membership interest of a member means that member's economic interest, plus the right to participate in management of Frontier, including the right to vote. The Operating Agreement specifically contemplates that Frontier Pacific and Frontier Utilities may adjust or change their respective economic and membership interests whenever necessary in order, for example, to limit the percentage of overall voting rights held by a member. Pacific and Enova are seeking approval herein to acquire, indirectly through Frontier Pacific, up to 90.1% of the membership interests of Frontier, representing 90.1% of the voting interests in Frontier. This will enable Frontier Utilities, should it choose to do so, to maintain its percentage interest in Frontier's voting securities at below 10%.

It is anticipated that the day-to-day operations of Frontier will be under the control of its General Manager, who will be located at Frontier's corporate headquarters in Elkin, North Carolina. The General Manager will report to the President of Frontier, who will be located in San Diego, California. It is also anticipated that Frontier will be staffed by a combination of current employees of the members of Frontier and their respective affiliates and new hires from the local area in North Carolina.

As previously indicated, Sempra Ventures is overseeing the development and construction of the Frontier system. On an ongoing basis, Sempra Ventures and other subsidiaries of Sempra will provide Frontier with a variety of administrative and

management services. Specifically, it is anticipated that SoCalGas and SDG&E will provide services to Frontier in such areas as payroll, tax, insurance, accounting, human resources (compensation and benefits plan administration), regulatory support, procurement/materials and quality assurance programs, technical and design engineering, training and legal services.11/ Additional corporate support services, including finance and general administrative support, will be provided to Frontier by Sempra and Sempra Ventures. A fuller description of the kinds of support services that Sempra Ventures, SoCalGas and SDG&E intend to provide to Frontier is contained in Exhibit I hereto.

Thus, with the assistance and support of Sempra Ventures, SoCalGas and SDG&E, Frontier will be able to enter the natural gas business with an experienced management team in place. In accordance with one or more service agreements, services provided by Sempra Ventures and other utility and non-utility affiliates of Sempra will be directly assigned, distributed or allocated to Frontier by activity, project, program, work order or other appropriate basis.   Employees of the members and their affiliates will record transactions utilizing the data capture and accounting systems of Frontier. Such agreements are required to be filed with the NCUC.

Under the September 17, 1998 agreement between Frontier and Sempra Trading, Sempra Trading has agreed to supply Frontier's full requirements of gas. The agreement sets forth price and quantity terms, including a projection of Frontier's supply needs through 2000, and provides that gas supplied by Sempra Trading

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11/ Although there are some limitations on the types of affiliate services that SoCalGas and SDG&E may provide to Frontier under California's rules governing affiliate transactions (see Item 3.3, below), SoCalGas and SDG&E would not be barred from providing any of the services indicated.

must be contractually sourced in the Permian and San Juan supply basins for delivery at the Frontier/Transco interconnection in Owen County, North Carolina.

Sempra Ventures, in conjunction with Sempra Trading and Frontier's General Manager in North Carolina, will coordinate the purchase, scheduling and delivery of natural gas, transportation capacity and related financial risk management products. Such coordination will involve the development of annual and monthly gas acquisition plans for Frontier. In this connection, the General Manager will have access to the information available from electronic bulletin boards monitored by Sempra Trading12/ and will be able to communicate directly as necessary with personnel of Sempra Ventures and Sempra Trading on a day-to-day basis to schedule gas purchases and delivery based on anticipated projections of customer growth on the Frontier system, weather conditions, and market price volatility. Frontier's General Manager and Sempra Trading will meet prior to the commencement of each month to review options for supply purchases (i.e., long-term supply contracts or daily or "spot" market purchases). Such options will be evaluated in order to obtain the lowest cost of gas for Frontier.

In addition, Sempra Trading will assist Frontier in making nominations on the Transco system and other pipelines in accordance with approved schedules with a view to minimizing any penalties for over-utilization or under-utilization of the Transco pipeline system. Frontier will provide gas supply receipt information to Sempra Trading, which Sempra Trading will use to compare against the confirmed nominations received from

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12/ All interstate pipelines and many intrastate pipelines are required to post information on capacity availability and related services on electronic bulletin boards. Other market makers (e.g., brokers) may also post information on electronic bulletin boards as an aid to matching buyers and sellers. In some cases, there is a subscription fee charged for access to electronic bulletin boards.

Transco. Sempra Trading may also purchase from SoCalGas released capacity on the El Paso and Transwestern pipelines in transactions that are posted on electronic bulletin boards in accordance with FERC rules governing sales of released capacity. Such released capacity may be used to transport gas flowing either westward to California or eastward to Frontier's system.

The purchase, nomination, confirmation, transportation and dispatch of gas for ultimate consumption is a seven-day-a-week, 24-hour per day operation. Under Gas Industry Standards Board ("GISB") protocols adopted by FERC and implemented through pipeline tariffs,13/ most decisions and actions are based on a two-day nominations schedule in which the first day is referred to as the "nominations day" ("Nom Day") and the second day the "flow day" ("Flow Day"). Under this nominations process, in addition to monthly planning for base-load gas purchases, the General Manager of Frontier will advise Sempra Trading prior to 10:00 a.m. Eastern Time each day (the Nom Day) of Frontier's requirements for the following day (the Flow Day). Sempra Trading will then determine what gas supply is available to meet Frontier's requirements from the various supply basins which it regularly monitors through its contacts with producers throughout the United States and Canada. Sempra Trading will arrange to purchase gas from producers from the common supply basins that are accessible by Frontier and Sempra's other utility subsidiaries, principally the San Juan and Permian basins, and various hubs and market centers in the south and southwest.

13/ See Standards for Business Practices of Interstate Natural Gas Pipelines, FERC Order No. 587, 61 Fed. Reg. 39,053 (July 26, 1996); order denying rehearing, FERC Order No. 587-A, 61 Fed. Reg. 55,208 (October 25, 1996). The GISB standards govern nominations, allocations, balancing, measurement, invoicing, capacity release, and mechanisms for electronic communications between pipelines and their customers. Like other interstate pipelines, Transco has implemented these protocols through its tariff sheets. See Transcontinental Pipe Line Corporation, 78 F.E.R.C. P 61,210 (March 3, 1997) and 79 F.E.R.C. P 61,172 (May 5, 1997).

As available supply and available transportation capacity are matched, there are several intra-day nomination and confirmation opportunities which must be managed by Sempra Trading to make the most economical supply of gas available to Frontier and to address situations where supply or capacity imbalances may have occurred. This intra-day nomination process typically provides a gas utility company with opportunities to redirect gas supply or capacity or renegotiate the terms of contracts during the Nom Day, as well as to make spot market purchases. The second day (the Flow Day) also provides opportunities for nomination of additional supplies if required by Frontier or for sales of gas to others if Frontier's demand slackens. This intra-day balancing process will be made possible through Frontier's access to Sempra Trading's large portfolio of supplies and customers.

The nominations and intra-day balancing functions of a gas company requires the availability of personnel 24 hours per day who can manage contacts with producers and each of the pipelines required to complete the transportation route, as well as with various intermediaries (e.g., hub operators) who can accommodate the exchange of gas from one supply basin to another or the storage of gas for future use. Maintenance of the necessary contacts and the coordination of these activities requires a significant staff. For a utility the size of SoCalGas or SDG&E, this staff could number 50 or more people. Even a small utility, such as Frontier, would require a staff of between five to eight full-time employees in its gas supply department. Through its arrangements with Sempra Trading, Frontier will have access to personnel who will perform these functions and, therefore, will not need to incur the significant costs that would otherwise be associated with building an in-house gas management capability.

ITEM 2. FEES, COMMISSIONS AND EXPENSES.

The fees, commissions and expenses to be paid or incurred, directly or indirectly, in connection with the Transaction, inclusive of legal fees and expenses, are estimated at not more than $100,000.

ITEM 3. APPLICABLE STATUTORY PROVISIONS.

3.1 General Overview of Applicable Statutory Provisions.

Because Sempra is an exempt holding company, it will require approval of the SEC under Sections 9(a)(2) and 10 of the Act to acquire, directly or indirectly, 5% or more of the voting securities of Frontier, which will become a "gas-utility company" within the meaning of Section 2(a)(4) of the Act on or after the date on which it commences making residential and small commercial sales of gas. Further, following the acquisition of 10% or more of Frontier's voting securities, and the commencement by Frontier of residential and small commercial sales, Frontier will become a gas-utility subsidiary company of Sempra and Frontier Pacific. However, because Sempra will not derive "any material part of its income" from Frontier, and will remain "predominantly" a California holding company, its "intrastate" exemption under Section 3(a)(1) of the Act will not be affected.14/ Frontier Pacific, which will be reincorporated in North Carolina, does not own, directly or indirectly, 5% or more of the voting securities of any other public-utility company.

14/ Under the Operating Agreement, Frontier Pacific will have a 50% economic interest in Frontier. Based on current projections, the proportionate share of Frontier's income attributable to Sempra is expected to account for far less than 1% of the consolidated income of Sempra on a pro forma basis.

The relevant standards for approval of an application under Section 10 are set forth in subsections (b), (c) and (f) thereof.

Section 10(b) provides that, if the requirements of Section 10(f) are satisfied, the Commission shall approve an acquisition under Section 9(a) unless the Commission finds that:

> (1) such acquisition will tend towards interlocking relations or the concentration of control of public-utility companies, of a kind or to an extent detrimental to the public interest or the interest of investors or consumers;
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> (2) in case of the acquisition of securities or utility assets, the consideration, including all fees, commissions, and other remuneration, to whomsoever paid, to be given, directly or indirectly, in connection with such acquisition is not reasonable or does not bear a fair relation to the sums invested in or the earning capacity of the utility assets to be acquired or the utility assets underlying the securities to be acquired; or
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> (3) such acquisition will unduly complicate the capital structure of the holding company system of the applicant or will be detrimental to the public interest or the interest of investors or consumers or the proper functioning of such holding company system.

Section 10(f) provides that the Commission:

> shall not approve any acquisition . . . unless it appears to the satisfaction of the Commission that such State laws as may apply in respect of such acquisition have been complied with, except where the Commission finds that compliance with such State laws would be detrimental to the carrying out of the provisions of section 11.

Finally, Section 10(c) of the Act provides that, notwithstanding the provisions of Section 10(b), the Commission shall not approve:

> (1) an acquisition of securities or utility assets, or of any other interest, which is unlawful under the provisions of Section 8 or is detrimental to the carrying out of the provisions of Section 11; or
>
> (2) the acquisition of securities or utility assets of a public-utility or holding company unless the Commission finds that such acquisition will serve the public interest by tending towards the economical and the efficient development of an integrated public-utility system.

An "integrated public-utility system" is defined in Section 2(a)(29)(B), as applied to a gas utility system, to mean:

> . . . a system consisting of one or more gas utility companies which are so located and related that substantial economies may be effectuated by being operated as a single coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation: Provided, That gas utility companies deriving natural gas from a common source of supply may be deemed to be included in a single area or region.

For the reasons set forth below, Sempra believes that the requirements of Section 10(f) have been met; that its indirect acquisition of Frontier's voting securities will satisfy the integration standards under Sections 10(c) and 2(a)(29)(B); and that there is no basis for the Commission to make any of the negative findings enumerated in Section 10(b). As a preliminary matter to the discussion that follows concerning the integration standards of the Act, as applied to this transaction, however, Sempra believes that it is important to understand the current "state of the art" in the natural gas industry and to review the dramatic changes that have occurred in the gas industry since 1935, and especially in the past decade.

3.2 Historical Perspective on the "State of the Art" in the Natural Gas Industry in the United States.

Although natural gas has been used as a fuel for thousands of years, the growth of the natural gas industry in the United States can be traced in large part to the development of pipeline systems through which large volumes of natural gas could be transported from the wellhead (i.e., the gas producing areas) to distant markets.15/ In the early days of the U.S. natural gas

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15/ A more detailed history and analysis may be found in "Regulation of the Natural Gas Industry," Ed. by American Gas Association (Matthew Bender, 1997), Volume 1.

industry (1870-1930), natural gas was seldom transported more than 50 to 75 miles. In some areas, gas produced as an incident to oil drilling operations was simply burned, or "flared," in the oil fields, rather than being piped to nearby cities or towns. Eventually, efforts were made to find commercial uses for this "waste" gas, but the technological difficulties and cost of transporting gas long distances were limiting factors. Thus, in most communities where gas service was available, the source of supply was from locally manufactured gas or from a nearby oil field. The first iron pipeline was reportedly built in 1872 to transport "waste" gas to Titusville, Pennsylvania, from nearby oil fields, where it was used chiefly for street lighting and some industrial applications. The first long distance, high pressure, gas pipeline, consisting of two parallel 8-inch wrought iron lines approximately 120 miles in length, was constructed in 1891 by Indiana Natural Gas and Oil Company.

A. Developments in the 1920s and 1930s. As indicated, prior to the 1930s, natural gas service to cities and towns was quite often provided from only one local source or field. In many cases, little was known about the extent of gas reserves in a producing area, which tended to limit the willingness of investors to commit the large amounts of capital required to build pipelines to distant markets. By the 1920s, however, technological advances had been made in the manufacture of large diameter pipeline which could withstand high pressures. This made it technologically and economically feasible to construct long-distance gas pipelines which could move gas from the developing oil fields in Texas, Oklahoma and other Southwestern states to the population centers in the Midwest and eastern U.S. This was the first significant change in the "state of the art" in the gas industry.

In the 1930s, the first of what we now know of as the modern-day, long distance, pipelines were constructed to transport the "casinghead" gas that was being produced in the developing Texas oil fields to Midwest markets.16/ By 1934, utilizing improved pipeline and compression technologies, some 150,000 miles of high-pressure transmission lines were in place. Nevertheless, in 1935, when the Act was passed, the natural gas pipeline industry consisted of only two long interstate lines extending to the upper Midwest. For the most part, the pipeline industry in the U.S. still consisted of relatively short lines used to transport gas from local producing areas directly to nearby markets. Natural gas was generally unavailable in the more populous areas on the East Coast and in the Northeast, where local distribution gas companies, or "LDCs," continued to distribute low-Btu gas produced from coal.

For the most part, the interstate pipelines remained free from federal regulation until 1938, when the Natural Gas Act ("NGA") was passed.17/ Under the NGA, the Federal Power Commission ("FPC") was given broad authority to regulate interstate pipelines under a public utility model. This included, importantly, certificate authority over construction of pipelines and authority to set "just and reasonable" rates for sales of gas for resale (i.e., wholesale rates). For almost 50 years following passage of the NGA, there were few if any changes in the basic structure of the natural gas industry or the framework of federal regulation. The Federal Energy Regulatory Commission ("FERC"), the successor to the FPC, has characterized

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16/ In 1931, Natural Gas Pipeline Company of America ("NGPL") completed a 24-inch line more than one thousand miles long running from the producing areas in Texas to Chicago, and in 1936, Panhandle Eastern Pipeline Company completed a thousand mile pipeline that terminated in Detroit.

17/ 52 Stat. 821-833 (1938), 15 USC Sections 717-717W, as amended. In 1906, Congress had amended the Interstate Commerce Act to specifically exclude pipelines for the transportation of natural gas from the jurisdiction of the Interstate Commerce Commission. 30 Stat. 584 (1906). H.R. 5423, the original House bill introduced in 1935 which contained the Public Utility Holding Company Act and amendments to the Federal Power Act, also included, as Title III, provisions which would have subjected the interstate gas pipelines to federal regulation as common carriers. During the hearings on H.R. 5423, however, Title III was widely criticized as being unworkable, and was not reported out of committee.

the structure of the natural gas industry regulated under the NGA during this period as "simple:"

> The producers would sell their natural gas in the production area to the interstate pipeline at Commission-determined just and reasonable rates. The pipelines would *transport their purchased gas and their own production to the city gate for sale to local distribution companies (LDCs) at Commission-determined just and reasonable rates which recovered both the pipelines' cost of gas and cost of transmission.* In addition, the pipelines would sell gas to end users in non-jurisdictional sales with an appropriate allocation of costs to the non-jurisdictional services. Producer sales to LDCs or end users in the production area, with the pipeline providing only the transportation, were rare. The central features of the NGA-regulated natural gas industry were Commission-determined just and reasonable prices and interstate pipeline sales of gas for resale to LDCs at the city gate at those prices in transactions that combined or bundled into one package the pipelines' gas supply and transmission costs. (Emphasis added.) (Footnotes omitted.)18/

The "source of supply" of natural gas at the time the Act was passed and for most of the next 50 years must be understood in the context of the relationship that existed between the pipelines and LDCs: the pipelines were in almost all instances the exclusive suppliers to the LDCs, which had little opportunity to contract with producers or other sellers. This was the "state of the art" in the gas industry.

B. *Developments After World War II.* Although significant changes in the regulation of the industry were still many years away, the natural gas pipeline industry underwent rapid expansion in the decades after 1938, and especially following World War II, when the steel pipe manufacturing capacity in the U.S., which had been diverted to the war effort, was again available for pipeline fabrication. Also in this period, significant new gas discoveries were developed, particularly in West Texas and along the onshore and offshore Gulf Coast areas. Significantly, it was not until *after* World War II that the market for natural gas

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18/ See FERC Order No. 636, FERC Stats. & Regs. P30,939, "Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol," 57 Fed. Red. 13,267 at 13,270 (April 16, 1992), aff'd in part, United Distribution Cos. v. FERC, 88 F.3d 1105 (D.C. Cir. 1996).

developed to the point at which it could support gas exploration and production on a stand-alone basis, separate and apart from the economies associated with oil production.

When World War II ended, the consumption of natural gas was still concentrated within the six principal gas-producing states of Texas, Louisiana, California, Oklahoma, West Virginia and Kansas, which, in 1945, produced 87% and consumed 68% of all the natural gas marketed in the United States.19/ In the populous Mid-Atlantic Region, including North Carolina, where there was little or no indigenous supplies, natural gas was either not available or at most mixed with manufactured gas to upgrade its Btu content.

Proven reserves of natural gas in the U.S. totaled about 148 trillion cubic feet (TCF) at the end of 1945 and total annual marketed production was only about four TCF, of which more than half was produced in the four Gulf States. Thus, there were vast reserves, mostly in the Southwest, available to support the expansion of the interstate pipeline system. The primary limiting factor was the lack of the pipeline capacity needed to reach distant markets.

In 1947, Texas Eastern Transmission Corporation purchased and converted to gas the "War Emergency" "Big Inch" and "Little Big Inch" lines that were built during the war to transport oil. During the same period, other companies secured the necessary gas reserves and built large diameter pipelines to waiting markets, while many of those already in existence extended their systems. It was during this period in which the El Paso and Transwestern pipelines were built to transport gas from west Texas to the

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19/ See "Regulation of the Natural Gas Industry", supra n. 15, at Section 3.02. Louisiana, Texas, Oklahoma and New Mexico still account for approximately three-quarters of all domestic production. See Energy Information Administration, Natural Gas Annual - 1996, DOE/EIA-0131(96) (Washington, D.C., September 1997), p. 9.

rapidly growing California market, and in which Transco built a pipeline running from the Gulf Coast along the Eastern Seaboard to New York City.

By 1966, natural gas service was available in all of the 48 contiguous States and the District of Columbia. The gas industry was no longer a local business. The primary forces behind this development were the surplus of reserves in the Southwest, the low prices for such gas, the subsequent discovery and development of additional reserves in the Southwest and elsewhere, and the price advantage that natural gas enjoyed over other competing fuels, such as heating oil and propane, in most uses. Some of the price advantage that natural gas enjoyed over other fuels was inherent in the efficiency of transporting gas in high pressure pipelines with low associated labor costs.

As the LDCs converted from manufactured gas to natural gas, they in effect exited the supply side of the business in favor of becoming customers of the interstate pipelines. The pipelines transported their own gas and gas produced by others, which the pipelines purchased at the well-head, and re-sold such gas to LDCs at the city-gate and to large industrial customers. This development, particularly in the heavily populated areas along the Eastern Seaboard, created a large and significant purchaser group that had a vital interest in keeping the city gate price for gas at levels where retail prices were competitive with other fuels. For LDCs that had historically sold natural gas obtained from local sources, such as in the Appalachian Mountain producing basins and adjacent areas, the growth in demand after World War II quickly outstripped the availability of local supplies. These LDCs were among the first to seek gas from the more plentiful producing areas in the Southwest.

The 25-year period following World War II is sometimes referred to as the "Golden Age of Growth" in the natural gas industry. As indicated, during this period, there was a rapid expansion of the interstate pipelines systems from the Southwest and other producing areas in the West to Midwest and Eastern markets. Also, it was during this period that the FPC extended its jurisdiction and the comprehensiveness of its regulation in the gas industry, including asserting jurisdiction over gas production.20/ The FPC also developed comprehensive regulations for the certification of pipeline construction and operation pursuant to Section 7(c) of the NGA, as well as for rates and terms and conditions of services provided by interstate pipelines.

C. The 1970s - An Industry in Transition. In the 1970s, the natural gas industry was suddenly faced with the prospect of massive gas shortages, as gas demand in some markets significantly outstripped available production. During this period, the availability of natural gas to the interstate market was so significantly restricted that the principal issue presented to the FPC concerned the curtailment of deliveries by the interstate pipelines. In a sense, the "state of the art" became how to deal with the massive curtailments that threatened the very survival of the industry. The shortages, however, were not due to the unavailability of gas in the ground. Rather, at the artificially constrained well-head price established by the FPC, many producers were simply unwilling to produce gas for sale into the interstate market and to make the capital investment needed to develop new reserves. In response to the gas shortages of the 1970s, Congress, in 1978, enacted a group of statutes jointly referred to as the Natural Energy Acts. Among these acts

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20/ See Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954).

was the Natural Gas Policy Act of 1978 ("NGPA").21/ The NGPA set in motion the process for gradual de-control of well-head price regulation by the FERC. That process was completed in 1989, when Congress passed the Natural Gas Wellhead Decontrol Act,22/ which eliminated all well-head price and non-price controls.

Of particular importance to the current "state of the art," the NGPA also included provisions (Sections 311 and 312) authorizing certain sales and transportation in intra- and interstate commerce, which, as implemented through FERC regulations, has effectively merged the intra- and interstate transportation markets into a single "seamless" grid without unnecessary jurisdiction or restrictions.

This began an extremely rapid change in the "state of the art" which culminated in a revolutionary change in the previous paradigm: the "common source of supply" for LDCs was no longer purchasing gas from the pipeline at the city-gate at "just and reasonable" rates established by the FERC. LDCs and other purchasers could now contract directly with producers. The pipelines were becoming nothing more than transporters of gas owned by others.

D. The 1980s - the Move Towards Competition. The implementation of Sections 311 and 312 of the NGPA began a move to a more market-driven transportation sector for the natural gas industry. Building upon the market-responsive goals of Section 311, the FERC issued a series of orders, beginning with Order No. 436 in 1985 23/ and culminating in Order No. 636 in 1992, that

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21/ 92 Stat. 3350 (1978); 15 USC Section 3301, et. seq.

22/ 103 Stat. 157 (1989).

23/ FERC Stats. & Regs. P 30,665, "Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol," 50 Fed. Reg. 42,408 (October 18, 1985).

mandated "open access" transportation. This shift in regulatory policy sought to encourage competition within the natural gas industry. Under revised regulations, most recently promulgated in Order No. 636, many gas transactions that once required prior approval from the FERC now can begin as soon as the pipeline and shipper reach agreement. Transportation of natural gas in interstate commerce still requires FERC authorization, but that authorization usually takes the form of "blanket" certificate approvals under the terms and conditions established in Order No. 636.24/

With the issuance of Order No. 636, the FERC completed the process of transforming the supply end of the natural gas industry into a fully competitive industry. The FERC's stated policy goal was to promote competition among all natural gas suppliers, including interstate pipelines to the extent that they still act in a gas sales (or merchant) capacity. The FERC's primary objectives were two-fold: to enhance competition in the natural gas industry and to maintain an adequate and reliable supply.

Under Order No. 636, pipelines were required to "unbundle," or separate, their merchant function from their transportation function. The order requires that this unbundling take place at an upstream point, near the production area. Pipelines are now obligated to provide all transportation service on a basis that

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24/ Under the FERC's regulations, there are two distinct types of self-implementing transportation service. The first is commonly referred to as "Section 311 Transportation." Under this authority, interstate pipelines are authorized to commence transportation service on behalf of any intrastate pipeline or any LDC without any specific prior approval. The second type of self-implementing transportation is referred to as a Section 7 "blanket" certificate service. " Blanket" certificates are issued under Section 7 of the NGA and are available to interstate pipelines and end-users. Regulations governing both sets of transportation are included in Part 284 of the FERC's regulations (18 CFR Part 284). The FERC's regulations define "transportation" to include both storage and exchanges of natural gas.

is equal in quality for all gas supplies, whether purchased from the pipeline or from another gas supplier.25/ To assure comparability in the quality of service, pipelines are required to provide a variety of essential, or ancillary, transportation services, such as storage, on a non-discriminatory basis, and to implement capacity release programs so that firm shippers can release their firm capacity on a short or long term basis.26/

In the six years since Order No. 636, the contracting practices of LDCs and other purchasers have also changed dramatically. Prior to Order No. 636, LDCs generally purchased most of their gas under long-term, fixed-price, contracts. Although there was less price volatility under these contracts, the benefits of increased competition were lost. Since Order No. 636, active short-term markets have developed. Today, most LDCs depend on short-term supply contracts, including daily and sometimes intra-daily contracts with marketers and brokers arranged at market centers, for a significant percentage of their overall gas supply. Even the average length of long-term contracts has shortened considerably. Similarly, LDCs'

25/ Although Order No. 436, issued in 1985, provided for open-access, non-discriminatory, transportation service to enable LDCs and others to purchase gas directly from producers at the wellhead, the FERC subsequently concluded that firm transportation made available by the pipelines to LDCs and others was "inferior in quality to the firm transportation embedded within the pipelines' bundled, city-gate, firm sales service," in that there was no obligation on the pipelines' part to provide transportation-only customers with other essential services and facilities, such as storage, on a non-discriminatory basis. Order No. 636, 57 Fed. Reg. at 13,272. In Order No. 636, FERC mandated various changes in the terms and conditions that must be offered by an open-access pipeline in order to assure that all gas purchasers would receive comparable transportation service.

26/ Traditionally, LDCs and other shippers were required to reserve, on a long-term basis, enough "firm" capacity on the supplying pipeline to meet their maximum requirements. Pipeline capacity utilization was inefficient because there was no mechanism in place to allow for the shifting of reserved "firm" capacity from one pipeline customer to another at times when it was in excess of current needs. The capacity release mechanism contemplated by Order No. 636 was intended to correct this situation. It allows an LDC or other shipper (the "primary shipper") to permanently or temporarily release and sell some or all of its reserved "firm" capacity, which the pipeline must then offer to others. Conversely, it provides a prospective purchaser (the "replacement shipper") with access to "firm" capacity that would otherwise not be available to it. Although the primary shipper remains liable on its contract with the pipeline, it is entitled to a credit to the extent released capacity is resold to a replacement shipper. See Order No. 636, 57 Fed. Reg. at 13,284 - 13,286.

contracting practices for transportation capacity have changed dramatically. Today, most LDCs do not hold firm, long-term, capacity for their total gas needs. They have the option to obtain short-term capacity in the capacity release market, or to obtain capacity indirectly by purchasing gas that is bundled with transportation from marketers and other aggregators.27/

E. *The Development of Market Centers, Hubs and Pooling Areas.* Another important feature of Order No. 636 was FERC's pronouncement that it would not allow actions that would inhibit the natural development of market centers, hubs, and pooling areas.28/ In a study issued by the FERC's Office of Economic Policy in 1991,29/ which was cited in Order No. 636, the staff of the FERC had reported on the growing importance of market centers and recommended that there was a need to foster their development. The FERC staff believed that market centers were necessary to facilitate market-driven transactions between buyers and sellers while at the same time making unnecessary the

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27/ It is estimated that, based on full utilization of released capacity by replacement shippers, 36% of all gas delivered to consumers in the U.S. could have moved under short-term arrangements obtained in the capacity release market. See Energy Information Administration, "Deliverability on the Interstate Natural Gas Pipeline System," DOE/EIA-0618(98) (Washington, D.C., May 1998), pp. 83 - 85. For a general background discussion of the developments of short-term gas supply and transportation markets, see "Regulation of Short-term Natural Gas Transportation Services," FERC Notice of Proposed Rulemaking, 63 Fed. Reg. 42,982 (July 29, 1998).

28/ Market centers, hubs and pooling areas all serve a similar purpose, namely, to facilitate transactions between gas buyers and sellers through information exchanges, physical exchanges of gas, providing transportation related services (e.g., storage, parking), the aggregation of supplies by all merchants, etc. Market centers may or may not be associated with any physical facilities, but are situated so as to be easily accessed from many parts of the country. They can be used to arrange storage or transportation or other ancillary services. Hubs, in contrast, operate as the physical transfer points where several different pipelines are interconnected. At a hub, gas can be physically rerouted from one pipeline to another. Pooling areas, most often located in production areas, facilitate the aggregation of supplies from many producers. Title to gas frequently passes from the producers to the shippers (i.e., LDCs or other purchasers) in the pooling areas.

29/ "Importance of Market Centers," Office of Economic Policy, FERC (Washington, DC), August 21, 1991.

construction of additional high-cost facilities. In the view of the FERC staff, the organization of market centers would (i) help to eliminate the traditional receipt point inflexibility of the interstate pipelines by allowing shippers (i.e., buyers and sellers) to receive and deliver gas at any point on the pipeline where the receipt and delivery of gas is possible, (ii) provide better responses to supply disruption, (iii) eliminate difficulties in reselling long-term contracted gas, and (iv) foster the development of market intermediaries (brokers and traders), such as exist in other commodities markets, who would facilitate transactions among buyers and sellers in the market. Thus, the development, evolution and operation of market centers and hubs is at the very heart of the current, and radically different, "state of the art."

Of particular interest, the FERC staff identified several natural market centers and hubs which will be instrumental in the coordination of gas supply between SoCalGas and Frontier. These include (i) the Blanco, New Mexico, market center near the San Juan Basin; (ii) the Waha Hubs, near Midland, Texas, formed at the point where the Transwestern and El Paso pipelines interconnect with NGPL and numerous intrastate pipelines; (iii) the Katy Hub, in east Texas; and (iv) the Henry Hub, located in southern Louisiana.30/ At these market centers and hubs, gas can be bought, sold, exchanged for gas at another location, or stored. Services are provided by independent brokers at such points to arrange deals, and producers or owners

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30/ The FERC staff noted that the Waha hub is located at a point that is within 70 miles of 2.74 Bcf per day of deliverable gas production and nearly 1 Bcf per day of peak storage deliverability. The staff noted that, at the Katy Hub alone, 23 pipelines (including Transco) are interconnected within a radius of 70 miles of over 12 Bcf per day of deliverable gas production, and that there is nearly 17 Bcf per day of working storage capacity at the hub. Finally, at the Henry Hub in South Louisiana, the staff noted that a total of 28 pipelines interconnect within 50 miles of more than 19 Bcf per day of deliverable gas production. See also "North American Gas Market Centers 1994," produced by Hart's Gas Transactions Report.

of gas at these centers often have significant marketing staffs to maximize the value and liquidity of the commodity.

Pooling areas facilitate the transfer of title to gas at both production and market points. Transco, El Paso, and Transwestern all operate pooling areas on their systems. In addition to the operation of pooling areas by interstate pipelines, several marketing companies provide services by which interested buyers and sellers can exchange gas at such pooling points for a fee. At some market centers, hub services, such as parking, loaning, wheeling, and, in some instances, title transfer, are also available.31/

Why are market centers, hubs and pooling areas so vital to the current "state of the art?" The importance of these creative market mechanisms is clear. A producer in one producing basin may, through such mechanisms, sell gas to a buyer several pipeline systems away without the payment of additional transportation costs, thus making gas produced in one basin more competitive with gas produced in a geographically closer locale. This represents a significant change from the days throughout most of the last 50 years when LDCs typically bought all of their gas at the city-gate from the interconnecting pipeline. As an example, low cost San Juan Basin gas, combined with its tax incentives and creative transactional mechanisms, can be priced cheaper to a market in North Carolina than gas produced in the Gulf Coast or the Alabama Black Warrior Basin, which are both

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31/ "Parking" is essentially a short-term interruptible storage service. "Loaning" is a service by which a party with gas will provide the gas to another party with a specific date for the return of such gas at either that location or another location under mutually agreeable terms and conditions (in effect, the inverse of parking). "Wheeling" is the provision of transportation by a hub operator from one system to another system. Finally, title transfer services allow parties to exchange title to gas that is already within a pipeline system for gas that is at a different point on the same pipeline system or for gas that is on another pipeline system. No physical movement occurs.

physically closer to North Carolina. Such creative arrangements, however, are dependent upon the existence of significant physical interconnections and market centers between the production area and ultimate delivery point. While these conditions may not currently exist throughout all of the contiguous 48 States, they do exist throughout the southern tier of States, both west and east, all of which depend for a large percentage of their total gas supplies upon production in the Southwest producing basins.

F. The Development of "High Deliverability" Storage.

Another important development in the gas industry is in storage technology and the development of a market for "un-bundled" storage services. The ability to store gas has always been critical to the economic and efficient operation of a gas system because of the seasonal nature of demand, particularly by residential customers. Most "seasonal" storage is in depleted oil and gas fields, such as exist in the Appalachian region. In the last five years, however, there has been significant new development of so-called "high deliverability," or salt-dome, storage caverns, which in some cases are owned and operated independent of the pipelines. The importance of "high deliverability" storage is not so much in the absolute volume of the working storage capacity that they represent, but rather in their operational characteristics, which allow for rapid injection and withdrawals of gas ("cycling"). This provides LDCs with considerably more flexibility in responding to changes in demand without the need to maintain high inventory levels and enables LDCs to take advantage of price volatility.32/

32/ See Energy Information Administration, Natural Gas 1996: Issues and Trends, DOE/EIA-0560(96) (Washington, D.C., December 1996), p. 15; Energy Information Administration, Natural Gas Annual - 1996, DOE/EIA-0131(96) (Washington, D.C., September 1997), p. 21.

G. *New Pipeline Construction.* The nation's interstate pipeline system, which experienced such dramatic growth in the decades immediately following World War II, continues to expand at a significant rate, in terms of both long-haul capacity and interregional interconnections. Between 1990 and the end of 1997, capacity additions on the long-haul pipeline systems (viz. the pipelines running from the production areas to end markets) totaled 12.4 billion cubic feet (Bcf) per day, an increase of about 17%, while interregional capacity additions totaled 11.4 Bcf per day, or about 15%, in the same period. More than 40 projects were completed in 1997 alone.33/ Several new expansion projects have been announced to alleviate capacity constraints in those few areas of the country where they still exist. Moreover, as previously described, market centers and storage capacity are becoming increasingly integrated into the pipeline network. In summing up the current state of the nation's pipeline delivery system, taking into account completion by the end of the year 2000 of projects that will expand transportation capacity from the Rocky Mountain, New Mexico, and West Texas producing areas to Midwest and Northeast markets, the Department of Energy has observed that "the *interstate natural gas pipeline network will come closer to being a national grid where production from almost any part of the country can find a route to customers in almost any area*." (*Emphasis added*).34/

3.3 *The Standards for Approval under Section 10(c).*

A. *Section 10(c)(1).* Section 10(c)(1) provides that the Commission may not approve an acquisition that "is unlawful under the provisions of Section 8 or is detrimental to the carrying out

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33/ See Energy Information Agency, "Deliverability on the Interstate Natural Gas Pipeline System," DOE/EIA-0618(98) (Washington, D.C., May 1998), pp. 32 -34.

34/ Id. at p. 34.

of the provisions of Section 11." In this case, the transaction will not be unlawful under Section 8, as it will not lead to common ownership of gas and electric properties serving the same area in North Carolina. Nor will approval of the transaction be detrimental to the carrying out of the provisions of Section 11, which provides, in subsection (b)(1) thereof, that every registered holding company and its subsidiaries shall limit their operations "to a single integrated public-utility system . . . ." Section 11(b)(1) permits a registered holding company to own one or more additional integrated public-utility systems only if the requirements of Section 11(b)(1)(A) - (C) (the "ABC clauses") are satisfied. By its terms, however, Section 11(b)(1) applies only to registered holding companies and therefore does not preclude the acquisition and ownership of a combination gas and electric system by an exempt holding company, such as Sempra, whose ownership of both gas and electric operations in California is permitted and subject to "affirmative state regulation." See WPL Holdings, Inc., 40 SEC Docket 491 at 497 (February 26, 1988), aff'd in part and rev'd in part sub nom., Wisconsin's Environmental Decade v. SEC, 882 F.2d 523 (D.C. Cir. 1989), reaffirmed, 49 SEC Docket 1255 (September 18, 1991); Dominion Resources, Inc., 40 SEC Docket 847 (April 5, 1988). Accordingly, as long as the acquisition of Frontier by Sempra would have the integrating tendencies required by Section 10(c)(2), discussed below, it is of no consequence that other existing properties of Sempra (e.g., San Diego's electric system) would not form a part of the same integrated system as Frontier's gas properties.

The Commission has also previously held that a holding company may acquire utility assets that will not, when combined with its existing utility assets, make up an integrated system or comply fully with the ABC clauses, provided that there is de

facto integration of contiguous utility properties and the holding company is exempt from registration under Section 3(a) of the Act following the acquisition.35/ In this case, Sempra is requesting an order exempting it from the registration requirements under the Act pursuant to Section 3(a)(1). Further, there is and will continue to be following the transaction de facto integration of Sempra's gas and electric utility properties in southern California.

B. Section 10(c)(2). Under Section 10(c)(2), the Commission must affirmatively find that the indirect acquisition of the voting securities of Frontier by Sempra "will serve the public interest by tending towards the economical and the efficient development of an integrated public-utility system . . ., " which, as applied to a gas system, is defined in Section 2(a)(29)(B). The indirect acquisition of Frontier by Sempra will satisfy the integration standards of Sections 10(c)(2) and 2(a)(29)(B) for all of the following reasons:

- The indirect investment by Sempra in Frontier, and its ongoing involvement with Frontier's operations, will be instrumental to the development of a gas utility system in an area in which natural gas service is not now available.

- Frontier, SoCalGas and SDG&E will share a "common source of supply" (the San Juan and Permian Basins) and will be operated as a "single coordinated system."

- Frontier will achieve "substantial economies" in gas supply through the increased buying power that it will attain by being part of the larger Sempra system; Frontier and its customers will also benefit by gaining access to expertise and resources available in the Sempra system in such areas as procurement/materials management; finance and accounting; and gas system engineering and construction management.

- Taking into account the current "state of the art": the area or region served by Sempra's subsidiaries in California and Frontier will not be "so large as to impair . . . the advantages of localized management, efficient operation, and the effectiveness of

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35/ See Sempra Energy, 67 SEC Docket 994 at 998 (June 26, 1998), citing BL Holding Corp., 67 SEC Docket 404 at 408 (May 15, 1998); TUC Holding Co., et al., 65 SEC Docket 301 at 305-306 (August 1, 1997); and Gaz Metropolitain, Inc., 58 SEC Docket 190 at 192 (November 23, 1994).

regulation." To the contrary, the day-to-day operations of Frontier will be under the direction of its General Manager. The management of Frontier will be independent of, but coordinated with (in order to promote efficient operation), Sempra's other subsidiaries, and will be subject to effective local regulation by the NCUC. This project enjoys the strong support of the NCUC.

- Because of Frontier's size, Sempra will continue to qualify for exemption under Section 3(a)(1) as an "intrastate" holding company even after indirectly acquiring Frontier's voting securities. Under these circumstances, and because the acquisition of Frontier will have the integrating features required by Sections 10(c)(2) and 2(a)(29)(B), the Commission should approve the transaction.

1. *Given the Existence of a Common Source of Supply and Changes in the State of the Art in the Gas Industry, the Commission Should Find that Sempra's Existing Subsidiaries and Frontier Together Will Constitute an Integrated Gas System.*

Although the retail gas service areas of Frontier in North Carolina and of SoCalGas and SDG&E in California are separated by a substantial distance and are located in non-contiguous States, such factors, by themselves, are not determinative. On the contrary, it is clear that Section 2(a)(29)(B), which defines an "integrated" gas-utility system, does not require that the States comprising the "single area or region" even adjoin each other. In MCN Corporation, 62 SEC Docket 2379 (September 17, 1996), for example, the Commission approved an acquisition of an interest in a gas-utility company in Missouri by an exempt gas-utility holding company whose service area is located more than 500 miles distant in Michigan, a non-adjoining State. Moreover, Section 2(a)(29)(B) specifically contemplates that "gas utility companies deriving natural gas from a *common source of supply may be deemed to be included in a single area or region*." (Emphasis added). Thus, the Commission was given broad discretion to interpret the "single area or region" standard in a flexible manner that should take into account the tremendous changes that have occurred since

1935 in the production and transportation of natural gas. Likewise, in considering whether an "area or region" is so large as to impair "the advantages of localized management, efficient operation, and the effectiveness of regulation . . .," the Commission is called upon to consider the "state of the art" in the industry.

Because of the dramatic changes in the "state of the art" in the gas industry that have taken place in recent years, the distance between two LDCs has become much less relevant, particularly when compared to the days when LDCs depended for their supplies upon essentially local sources or upon the same interconnecting pipeline, in its merchant capacity. Thus, based on all of the facts and circumstances of this case, as more fully developed below, the Commission should conclude that the gas utility operations of SoCalGas and SDG&E in southern California and those of Frontier in western North Carolina together will be "confined to a single area or region in one or more States," and that such area or region will not be "so large as to impair the advantages of localized management, efficient operation and the effectiveness of regulation." It is important to underscore that such a conclusion is consistent with the literal terms of Section 2(a)(29)(B).

Moreover, in order to make the findings required by Sections 10(c)(2) and 2(a)(29)(B), as applied to the specific facts of this case, the Commission need not address or decide the broader question of whether an integrated gas market now exists throughout all of the 48 contiguous States or even whether every LDC that purchases its gas from the same supply basin could be part of one integrated gas system.

Common Source of Supply: Historically, in determining whether two gas companies share a "common source of supply," the Commission has attached greatest importance to whether the gas

supply of the two companies is derived from the same gas producing areas (or basins), recognizing that the most significant economies and efficiencies that two entities can achieve is through the coordination and management of gas supply. The Commission has also considered whether the two entities receive gas deliveries from a common pipeline. However, the Commission has properly found an integrated gas system to exist where two entities take delivery from different pipelines which originate in the same gas producing area and/or interconnect at various points along the transportation route. See MCN Corporation, supra, 62 SEC Docket at 2383-2384; American Natural Gas Company, et al., 43 S.E.C. 203 at 205-207 n. 5 (1966); Central Power Company, et al., 8 S.E.C. 425 at 431 (1941). These decisions, and especially MCN Corporation, reflect the fact that an LDC's gas supply is no longer purchased at the city-gate from the interconnecting pipeline. The key factor to be considered by the Commission, given the current "state of the art," is the "common source of supply."

As indicated, SoCalGas and SDG&E currently derive approximately 58% of their combined gas requirements from the Permian and San Juan Basins. Initially, Frontier's full requirements will be met by Sempra Trading from production in the same two supply basins. Long term, it is expected that Frontier will purchase at least 50% of its gas supplies from these basins. Further, although SoCalGas and SDG&E and Frontier will take delivery from different interstate pipelines (Transco in the case of Frontier and El Paso and Transwestern in the case of SoCalGas and SDG&E), those pipelines all transport gas that originates in the Permian and San Juan Basins. The "common source of supply"

is therefore in the Permian and San Juan Basins. In one case, the method of transportation is Transco, and, in the other case, El Paso and Transwestern.

The El Paso and Transwestern pipelines transport gas out of the Permian and San Juan Basins for ultimate consumption in both California and eastern U.S. markets.36/ Transco's interstate pipeline does not itself extend into either such basin. However, it intersects at various points in Texas with intrastate pipelines (including the Oasis, Valero-TECO and Valero-Lone Star pipelines), which transport gas from those basins to the Transco system. San Juan and Permian Basin gas also moves through the Henry Hub, on the Louisiana Gulf Coast, as well as the Katy Hub in Texas, where Transco and other pipelines transport it to Mid-Atlantic and East Coast markets. (See Exhibit E - Map of Gas Pipelines and Producing Areas). Accordingly, there is substantial evidence that SoCalGas, SDG&E and Frontier will share a "common source of supply," roughly equidistant from each of them.

It should be recognized that the concept of a "common source of supply" has a very different meaning today than it did in 1935. In 1935 and for most of the 50 years that followed, LDCs generally purchased natural gas at the city-gate directly from the interstate pipeline that served them at FERC (and earlier FPC) approved wholesale rates that reflected both the cost of the commodity and the related cost of transportation. Hence, two

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36/ In recent years, although production in the San Juan area has increased significantly, the demand for both San Juan and Permian Basin gas at the California border has declined due, in part, to the increased availability in California of cheaper gas from western Canada and the Rocky Mountain region. However, the decline in demand for Permian and San Juan Basin gas in the California market, which has led to significant capacity "turn-backs" on the El Paso and Transwestern systems, has been largely offset by growing demand elsewhere, primarily in eastern U.S. markets. To meet this demand, El Paso and Transwestern have both sought and received certificate authority from the FERC under Section 7 of the NGA for expansions in the San Juan area that now provide much better access from the eastern ends of their respective systems to various market centers and hubs in Texas, from which gas can be shipped to eastern U.S. markets. See El Paso Natural Gas Company, 70 FERC P 61,295 (1995); Transwestern Pipeline Company, 75 FERC P 61,107 (1996).

LDCs serving non-contiguous areas could in most instances demonstrate that they shared a "common source of supply" only if they purchased their gas from the same pipeline, in its capacity as both gas merchant and transporter. LDCs did not, and in most instances could not, purchase their gas in upstream markets and arrange separately with the pipeline for transportation. The "single area or region" served was therefore defined in terms of the pipeline delivery points (i.e., the city-gate), where the LDCs purchased their gas, rather than in terms of the upstream gas production areas or pipeline receipt points.

In contrast, today, most LDCs do not purchase their gas supply from the pipeline serving them. Instead, LDCs, and many industrial customers as well, purchase gas directly from producers (or independent marketers or other middlemen), and contract separately for transportation on the pipeline that serves them, as well as on other upstream pipelines that transport gas out of the producing basins.37/ Although transportation costs and pipeline capacity constraints are economic factors which may limit an LDC's ability to contract for gas produced in any particular supply basin, the legal impediments no longer exist, and LDCs, no matter where they are located, are entitled to non-discriminatory transportation service. The transportation arrangements entered into by two different LDCs are unimportant for purposes of determining whether or not they share a "common source of supply," inasmuch as the pipelines that serve them are no longer the suppliers in any event. The relevant inquiry should instead be whether the two LDCs purchase substantial quantities of gas produced in the same supply basins, and whether that gas is "deliverable" (i.e.,

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37/ By 1995, the Department of Energy could report that interstate pipeline gas sales were "virtually non-existent," and that transportation (as opposed to sales) accounted for 74% of all deliveries to industrial customers by local companies (LDCs and intrastate pipelines). See Energy Information Administration, Natural Gas 1996: Issues and Trends, DOE/EIA-0560(96) (Washington, D.C., December 1996), p. 17.

whether there is sufficient transportation capacity available in the marketplace to assure delivery on an economic and reliable basis).38/

State of the Art in the Gas Industry: As previously described, the natural gas industry has undergone fundamental changes, with the pronounced trend in the past decade towards increased competition in gas supply and the development of a seamless natural gas delivery system throughout most of the United States.39/ This trend is the direct result of several developments, including, most importantly, de-control of gas prices at the well-head; the "un-bundling" of the commodity and transportation functions of interstate pipelines; the construction of significant new pipeline capacity, which has eliminated transportation bottlenecks in most parts of the country; the emergence of gas brokers and marketers and development of an efficient gas futures market, which now enable LDCs and other large gas purchasers to manage price volatility and secure gas supplies without regard to its physical source; and increased inter-basin competition for sales to the market, due in part to the effects of imports into the U.S. of low-cost Canadian gas.40/ It is important to stress that the paradigm for

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38/ "Deliverability" may be defined in terms of the physical capacity of the U.S. natural gas pipeline network, as well as of the contractual structure governing the transportation of gas on that system, which is largely the product of Order No. 636. See Energy Information Administration, "Deliverability on the Interstate Natural Gas Pipeline System," DOE/EIA-0618(98) (Washington, D.C., May 1998), p. 79.

39/ As previously indicated, although there is substantial evidence that a fully integrated natural gas market now exists throughout most of the United States, that is not a question that this Commission would need to address in order to make the findings required by Sections 10(c)(2) and 2(a)(29)(B), as applied to the specific facts of this case.

40/ Canadian production, as a percentage of total U.S. consumption, increased in each of the ten years prior to 1996. In 1995, net imports of gas (mostly from Canada) accounted for 13% of all U.S. consumption. The western region of the U.S. received by far the largest share (41%) of all Canadian imports. See Energy Information Administration, Natural Gas Monthly, DOE/EIA-0130(96/10) (Washington, D.C., November 1996).

the gas industry today is fundamentally and irreversibly different than earlier this century.

The Commission has already taken notice of these and other regulatory and technological changes that have reshaped the natural gas industry. See "The Regulation of Public-Utility Holding Companies," Report of the Division of Investment Management (June 1995), pp. 29 - 31. In light of such changes, the Division of Investment Management has recommended that the Commission continue to interpret the "single area or region" requirement of Section 2(a)(29) flexibly to take into account technological advances, and that the focus of the SEC's inquiry under Section 10(c)(2) should be on whether a proposed acquisition would promote the economic and efficient development of a utility system and on whether the resulting system would be subject to effective regulation. Id. at 72 -74.

As discussed above, the traditional source of supply for both California and the Mid-Atlantic states is in the producing basins in the Southwest. The primary producing basins in the Southwest that can be accessed by both the Mid-Atlantic region and California include the Permian and San Juan Basins. Today, because LDCs in most States (including California and North Carolina) can purchase gas in these Southwest producing basins (or purchase gas pegged to production in those areas) from a producer or marketer at the city-gate off of the interstate pipeline system, there is significant competition for markets between producers in the San Juan and Permian Basins and producers in other U.S. and Canadian basins. For the California market, for example, gas produced in western Canada and the Overthrust producing areas in the Rocky Mountain region now provides stiff competition for the Southwest basin supplies. This basin-to-basin competition and the development of additional

interstate pipeline capacity through the construction of the Kern River pipeline and the expansion of Pacific Gas Transmission Company and Northwest Pipeline Corporation from Canada have, in fact, caused 2 Bcf/day of excess pipeline capacity to the California market.

The competition for the California market by other producing basins and pipelines was directly responsible for significant "turn-backs" on the El Paso and Transwestern systems in the mid-1990s.41/ It was in response to this competition and the need to find new customers for the "turned-back" capacity that El Paso and Transwestern have both expanded their systems out of the San Juan Basin in order to move gas to eastern markets, such that, today, there are periods when the net flow of gas out of the San Juan Basin is to the east rather than to the west. These actions were also driven by certain operational characteristics of San Juan Basin production which require producers to maintain high production levels without regard to demand in the California market.42/ Further, El Paso and Transwestern have incentives to discount transportation for gas transported to new markets in the

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41/ Under Order No. 636, the "restructuring rule," the "firm" sales contracts between a pipeline and its customers were converted into the rights to receive "firm" transportation. As these "firm" transportation contracts expire, however, some LDCs will elect to reduce or release that "firm" capacity that they previously reserved. Such capacity "turn-backs" have led to the situation in some parts of the country where available "firm" pipeline capacity exceeds customer commitments. Unless a pipeline can remarket "turned-back" capacity, it faces a potential loss of revenues. Following the adoption of Order No. 636, two of the largest capacity "turn-backs" were on the El Paso and Transwestern systems. As indicated, those companies responded to this situation by altering the utilization of existing pipeline capacity to move gas out of the Southwest producing areas to eastern markets, where such gas would be competitive with other available supplies. For a more detailed of discussion of the impact of pipeline capacity releases and the industry's response, see Energy Information Administration, Natural Gas 1996: Issues and Trends, DOE/EIA-0560(96) (Washington, D.C., December 1996), ch. 2.

42/ San Juan Basin gas is produced from coal seam formations. The technology used to produce gas from coal seam formations requires maintaining a steady state of production. The significant tax benefits granted to coal seam gas is an additional incentive for maintaining high production levels.

east, thus limiting delivery costs. As a result, San Juan Basin gas can be priced at a rate below its competitors in most other basins even with additional delivery costs.

The Attorney General of the State of California addressed the integrated pipeline market from an economic perspective in its Opinion on Competitive Effects of Proposed Merger between Pacific Enterprises and Enova Corporation, submitted to the California Public Utilities Commission ("CPUC") on November 20, 1997.43/ The Attorney General used a correlation and co-integration analysis to determine that FERC actions have created a network of transmission suppliers connecting purchasers at the wholesale level with middlemen and well operators at the production level. The Attorney General concluded that, from an economic perspective, markets are integrated where the price of supplies remain closely linked (taking into account transportation and other transaction costs) and that there is "direct" evidence that prices at delivery points within the four basin area (including the Permian and San Juan Basins) remain co-integrated within arbitrage bounds on a nearly national grid basis.

Due to the restructured natural gas transportation market, gas can be moved from the San Juan and Permian Basins to both California and North Carolina physically as well as contractually in a variety of ways. As discussed above, both Transwestern and El Paso access the Permian and San Juan Basins and have traditionally moved their gas west to California. SoCalGas is the largest holder of capacity on both of those systems and purchases a significant portion of its supply portfolio from those two basins. However, as indicated, natural gas from the

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43/ The Attorney General's Opinion has been filed as Exhibit D-9 in File No. 70-9033.

San Juan and Permian Basins also moves east and north to serve Midwest and Mid-Atlantic markets.

Both El Paso and Transwestern interconnect at numerous points in West Texas with major intrastate Texas pipelines including the Valero, Oasis, and other pipelines. Through these intrastate pipelines, gas is physically transported to the eastern half of the State of Texas where the intrastate pipelines connect with, among others, Transco. Thus, gas can and does physically flow from the Southwest producing basins which provide the principal supply of gas to SoCalGas and to the developing North Carolina market represented by Frontier.44/

While physical delivery is possible from the common supply basins to both SoCalGas and Frontier, more flexible and efficient transactions are available utilizing marketing tools created by the FERC in Order No. 636. As previously indicated, one of the more important outgrowths of FERC Order No. 636 has been the development of market centers, hubs and pooling points, which allows LDCs operating in a much larger area or region of the country to realize the operating economies and efficiencies from coordinated gas supply that were once thought to be achievable only by contiguous or nearly contiguous gas companies supplied by the same interstate pipelines. In fact, the opportunities to achieve operating economies may be even greater where the two companies seeking to combine have significantly different load profiles (e.g., non-coincident seasonal peaks, substantially different customer mix, different projected growth patterns, etc.).

44/ Further, El Paso and Transwestern interconnect with NGPL, the first major interstate pipeline company constructed in the United States, in west Texas through NGPL's major western trunkline. NGPL also accesses Gulf Coast reserves through its eastern trunkline which is connected by a major crossover through Oklahoma and north Texas to its western trunkline. On its eastern trunkline, NGPL interconnects at two points with Transco.

2. Coordinated Operation of Gas Properties.

As described in Item 1.3, above, Frontier initially will purchase all of its gas requirements from Sempra Trading from gas sourced in the Permian and San Juan Basins. Sempra Trading will also manage Frontier's gas transportation and storage arrangements. In this regard, it is important to note that Sempra Trading holds capacity on the Transco system and is among the largest purchasers of hub services (i.e., parking, loaning and wheeling) from SoCalGas. Hence, through Sempra Trading, Frontier will have access to a complete portfolio of gas supply, transportation, storage and related services. In addition, Sempra Ventures, SoCalGas and SDG&E plan to provide various other types of administrative, technical and operating services to Frontier. These arrangements are indistinguishable from those that the Commission considered in MCN Corporation.

Sempra Trading also sells significant volumes of gas to SoCalGas and SDG&E and to their respective transportation-only customers,45/ most of which it purchases in the San Juan and Permian Basins. Since January 1, 1997, Sempra Trading (and its predecessor, AIG Trading Corp.) has sold approximately 22 million MMBtu of gas directly to SoCalGas, and several times that amount to transportation-only customers of SoCalGas. Although this accounts for only a small percentage of the total through-put on the SoCalGas system (930 Bcf in 1997), it represents, by comparison, several times the estimated volumes of gas that will be required by Frontier when its system is fully developed. In the future, Sempra Trading will be able to achieve substantial economies by coordinating gas purchases in the two supply basins

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45/ In 1997, 65% of all gas delivered on the SoCalGas system was customer-owned. SoCalGas only provides the transportation service for these customers. Sempra Trading, which is based in San Diego, has aggressively pursued this market segment.

to meet the combined requirements of its three public utility affiliates, as well as of its other customers. Further, SoCalGas and SDG&E will continue to purchase significant volumes of gas from Sempra Trading to the extent that Sempra Trading is able to supply such gas at the lowest price then available to SoCalGas and SDG&E in the marketplace.

In MCN Corporation, it was indicated that CoEnergy Trading Company, MCN Corporation's gas marketing subsidiary, which already provided a portion of the gas requirements of the smaller of MCN Corporation's two gas utility subsidiaries in Michigan, also intended to supply a portion of the needs of the new partnership being formed in Missouri at such time as the gas purchasing needs of the partnership became significant enough for economic efficiencies to arise by having CoEnergy Trading Company buy gas on its behalf.46/ The Commission held in MCN Corporation that these arrangements were sufficient to satisfy the "single coordinated system" requirement of Section 2(a)(29)(B).47/ In the present case, Sempra Trading initially will supply Frontier's full requirements from gas sourced in the San Juan and Permian Basins at delivered prices which include transportation cost, transaction costs and balancing services required to meet all daily, monthly, and seasonal load swings. Although Frontier (like the new partnership in MCN Corporation) will always be able to purchase gas from unaffiliated suppliers in the future, it is anticipated that, because Sempra Trading purchases significant quantities of gas in the Permian and San Juan Basins for sale to existing customers in both California and the mid-Atlantic

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46/ See MCN Corporation, 62 SEC Docket at 2382, n. 6

47/ Id. at 2384.

region, including SoCalGas and SDG&E, and holds capacity on the Transco system, it will be able to achieve substantial economies by combining the needs of Frontier with those of SoCalGas and SDG&E and their respective transportation-only customers that Sempra Trading now serves.

Finally, the operations of Sempra's three public utility subsidiaries will be coordinated through joint planning and the free exchange of ideas and information that customarily takes place in any corporate family. In particular, it is expected that Frontier personnel will have ready access to personnel of SoCalGas and SDG&E through routine daily communications, joint management meetings, system-wide training programs and the like. While the frequency and importance of such intra-system contacts are difficult to estimate, it is nevertheless predictable that, over time, Frontier will become fully integrated into the corporate culture created by Sempra.

3. Frontier will Realize Significant Economies and Efficiencies from its Affiliation with the Much Larger Sempra System.

Section 10(c)(2) requires that the Commission find that a proposed acquisition will produce economies and efficiencies. Although some of the anticipated economies and efficiencies will be fully realized in the longer term, they are properly considered in determining whether the standards of Section 10(c)(2) are met. See American Electric Power Co., 46 SEC 1299, 1320-21 (1978). Further, although some potential benefits cannot be precisely estimated, they too are entitled to consideration. As the Commission has stated, "[s]pecific dollar forecasts of future savings are not necessarily required; a demonstrated potential for economies will suffice even when these are not precisely quantifiable." Centerior Energy Corp., 35 SEC Docket 769 at 775 (April 29, 1986). Finally, there is no requirement in Section 10(c)(2) that the specific dollar estimates of future

savings be large in relation to the gross revenues of the companies involved. See American Natural Gas Company, supra, 43 S.E.C. at 206-207.

In this case, there can be little doubt that significant benefits will be realized by Frontier as a result of becoming a part of the much larger Sempra system, particularly in the areas of gas supply, increased purchasing power, and the ability to utilize the expertise and resources available from Sempra's other subsidiaries. Exhibit I hereto outlines specific areas in which the affiliation of Frontier with Sempra is likely to produce substantial economies and efficiencies over time, and dollar estimates of such savings. Sempra has estimated that Frontier will realize total start-up cost savings of $1.8 million due to its integration into the Sempra system and ongoing annual operating cost savings of at least $300,000 per year. On a yearly basis, Sempra estimates that Frontier will save approximately 19% on its operating costs due to the affiliation. The total estimated savings are quite significant relative to the size of the transaction. Projected annual operating savings appear to be greater than those in the SEC's MCN Corporation decision, which involved an investment in a gas system of roughly comparable size to the Frontier system.

It should be emphasized that the savings that will be realized by Frontier will not be at the expense of California utility customers of SoCalGas and SDG&E. In this connection, the CPUC recently adopted affiliate transaction rules that permit corporate support services provided both to a California utility and to its affiliates, including affiliates outside California. See Opinion Adopting Standards of Conduct Governing Relationships Between Utilities and Their Affiliates, CPUC Decision No. 97-12-088, 1997 Cal. PUC LEXIS 1139 (December 16, 1997). For example, the CPUC rule permits such shared services as: payroll, taxes,

shareholder services, insurance, financial reporting, financial planning and analysis, corporate accounting, corporate security, human resources (compensation, benefits, employment policies), employee records, regulatory affairs, lobbying, legal, and pension management. Decision No. 97-12-088, App. A, mimeo, p. 11. All of the services described on Exhibit I are permitted under the CPUC's rules. To ensure that the use of shared services does not result in cross-subsidization, the CPUC specifically required that "[a]ny shared support shall be priced, reported and conducted in accordance with the Separation and Information Standards set forth herein, as well as other applicable Commission Pricing and Reporting requirements." Id. In the same decision, the CPUC adopted extensive accounting rules to prevent cross-subsidization. Id. at 14.

In addition to the specific estimates of savings that are provided above, Frontier will also avoid the cost of hiring the five to eight gas buyers/capacity specialists who would be needed if Frontier were to internalize the gas procurement function rather than contract with Sempra Trading for its full requirements and related services (i.e., scheduling nominations and balancing services). The cost of hiring five trained specialists, plus a secretary, including all payroll overheads, would conservatively aggregate at least $750,000 per year. Although there is obviously an offsetting cost associated with outsourcing the gas procurement function to Sempra Trading, it is believed that Frontier will achieve a significant net benefit from the arrangements contemplated.

4. The System Formed by the Affiliation of Sempra and Frontier will not be So Large as to Impair the Advantages of Localized Management, Efficient Operation, and the Effectiveness of Regulation.

The resulting integrated gas system to be formed by adding Frontier's gas system to the substantially larger SoCalGas and SDG&E systems will not be "so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation." As in MCN Corporation, this case involves the development and financing of a small, start-up, gas distribution system designed to serve a predominantly rural population. As described in greater detail in Item 1.3, the day-to-day operations of Frontier will be under the direct supervision of its General Manager. Its operations, however, will be coordinated with those of SoCalGas and SDG&E in order to provide operating efficiencies and savings. Local regulation is and will continue to be effective. In fact, every aspect of Frontier's development and financing has been or will be specifically considered by the NCUC, beginning with the NCUC's selection of Frontier's proposal for the new gas system over a competing proposal submitted by an existing North Carolina gas company. While Sempra will bring to the table much needed skills and expertise in the areas of construction and gas supply management, pipeline technology and maintenance, procurement, operating expertise, and marketing, among others, Frontier will maintain its separate corporate identity and local presence and have its own management and work force.

5. <u>The Indirect Acquisition of Frontier's Voting Securities Will Have No Effect on Sempra's Current Exemption under Section 3(a)(1).</u>

Frontier will be a small utility compared to SoCalGas and SDG&E and will account for only a de minimis amount of Sempra's income. (see fn. 14, above). The acquisition and ownership of

its voting securities by Sempra will therefore have no impact on the continuing entitlement of Sempra to its exemptions under Section 3(a)(1) of the Act. Given that there is substantial evidence that the acquisition will have integrating features (e.g., common source of supply, local management, realization of substantial economies and efficiencies through coordinated operation, strong local support and effective local regulation) and that exempt holding companies, like Sempra, are not subject to the strict integration standards of Section 11(b)(1), the Commission should have little reason to interpret the integration standards of Section 10(c)(2) and Section 2(a)(29)(B), as applied to this transaction, in a narrow or restrictive manner. In other recent cases involving acquisitions by exempt holding companies, such as Gaz Metropolitan, Inc., et al., TUC Holding, et al., and MCN Corporation, the Commission has exhibited a willingness to interpret the integration standards of Section 10(c)(2) flexibly, focusing instead on the demonstrated benefits of the transaction from the perspectives of both investors and consumers. It should do the same here.

3.4 Section 10(b).

Section 10(b) provides that, if the requirements of Section 10(f) are met, then the Commission shall approve a proposed acquisition unless it finds that the transaction would have any one of several enumerated adverse effects. In this case, there is no basis for the Commission to make any adverse findings under Section 10(b).

A. Section 10(b)(1). Section 10(b)(1) was intended to avoid "an excess of concentration and bigness" in the utility industry at the expense of competition while preserving the "opportunities for economies of scale, the elimination of duplicative facilities and activities, the sharing of production capacity and reserves and generally more efficient operations"

afforded by certain acquisitions. See American Electric Power Co., Inc., 46 S.E.C. 1299, 1309 (1978). The transaction proposed herein will not add meaningfully to the size of Sempra, which is much larger than Frontier and will derive only a de minimis part of its income from Frontier's operations. The approximately 15,000 residential, industrial and commercial customers that Frontier projects having at the end of its fifth year of operation represents about one-quarter of 1% of the approximately 6 million retail and industrial gas customers (including transportation-only customers) that SoCalGas and SDG&E now serve in California. On the other hand, the transaction will benefit Frontier's customers and create a modestly larger and more diverse asset and customer base, which will create opportunities for operating efficiencies.

Further, although the transaction proposed herein will result in creating a link between SoCalGas and SDG&E, on the one hand, and Frontier, on the other, it will not lead to the type of concentration of control over utilities, unrelated to operating efficiencies, that Section 10(b)(1) was intended to prevent.48/ In fact, far from limiting or restricting competition, the transaction proposed herein is the outgrowth of proceedings in North Carolina in which the NCUC carefully evaluated competing proposals to construct and operate a gas system in the Four-County Area. Finally, although the management interlocks that will be created are necessary and desirable in order to integrate Frontier fully into the Sempra system, Frontier will have its own local management team and work force.

48/ See Section 1(b)(4) of the Act (finding that the public interest and interests of consumers and investors are adversely affected "when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties . . . ").

B. Section 10(b)(2). The Commission may not approve the proposed transaction if it determines pursuant to Section 10(b)(2) that the consideration (including fees and expenses of the transaction) to be paid, indirectly, by Sempra in connection with the transaction is not reasonable or does not bear a fair relation to investment in and earning capacity of the utility assets underlying the securities being acquired. In this case, the equity investments by Frontier Pacific and Frontier Utilities in Frontier, a newly-formed entity with no preexisting business, have been expressly approved by the NCUC, which has also conducted extensive hearings on the overall economic feasibility of Frontier at the rates and rate design proposed by Frontier. The amounts to be invested were the result of direct, arms'-length, negotiations between private investors, and no fees to outside investment bankers will be paid.

C. Section 10(b)(3). Section 10(b)(3) requires the Commission to determine whether the transaction will unduly complicate the capital structure of Sempra or will be detrimental to the public interest, the interest of investors or consumers or the proper functioning of the Sempra holding company system. The intent of these requirements is to assure the financial soundness of the holding company system, with particular regard to the proper balance of debt and equity.

The transaction proposed herein will have a virtually undetectable impact on the capitalization and earnings of Sempra, and will not introduce any complexity into Sempra's capital structure. With regard to the latter, the debt and other obligations incurred or to be incurred by Frontier will not be recourse, directly or indirectly, to either SoCalGas or SDG&E.

Moreover, as set forth more fully in the discussion of the standards of Section 10(c)(2), supra, and elsewhere in this Application or Declaration, the transaction will create opportunities for Frontier to achieve substantial savings, chiefly in the areas of coordinated gas supply and economies associated with greater buying power and the availability of managerial and technical expertise that will be needed by Frontier. The transaction will therefore be in the public interest and the interest of investors and consumers, and will not be detrimental to the proper functioning of the resulting holding company system.

3.5 Section 10(f).

Frontier has obtained the required NCUC approvals for the equity investment by Frontier Pacific. The requirements of Section 10(f) have therefore been satisfied.

ITEM 4. REGULATORY APPROVALS.

The construction and financing of Frontier's gas distribution system is subject to the jurisdiction of the NCUC, which has issued various approvals referred to in Item 1. No other State or Federal commission has jurisdiction over any aspect of the transaction.

ITEM 5. PROCEDURE.

The Commission has published a notice under Rule 23 with respect to the filing of this Application or Declaration, and no hearing has been requested. Sempra and Frontier Pacific request that the Commission's Order be issued as soon as practicable, and that there should not be a 30-day waiting period between issuance of the Commission's order and the date on which the order is to become effective. Sempra and Frontier Pacific hereby waive a

recommended decision by a hearing officer or any other responsible officer of the Commission and consent that the Division of Investment Management may assist in the preparation of the Commission's decision and/or order, unless the Division opposes the Transaction.

ITEM 6. EXHIBITS AND FINANCIAL STATEMENTS.

(Previously filed, except as noted).

A - EXHIBITS.

A-1 Articles of Organization of Frontier Energy LLC.

A-2 Operating Agreement of Frontier Energy LLC.

D-1 Application of Frontier Utilities of North Carolina and Frontier Energy LLC for Approval of Final Financing Plan, to Transfer Certificates, and for Approval of Waiver of Security Bond (NCUC Docket Nos. G-38, Sub. 3 and G-40).

D-2 Order of the NCUC in Docket Nos. 38, Sub. 3, and G-40, dated March 9, 1998.

E Map of natural gas service areas of SoCalGas, SDG&E and Frontier, common supply basins, major interstate pipelines and market centers and hubs. (Paper format filing).

F-1 Opinion of counsel to Sempra Energy. (Filed herewith).

F-2 Opinion of special North Carolina counsel to Sempra Energy. (Filed herewith).

H Proposed form of Federal Register notice.

I Description of Economies and Efficiencies and Estimated Dollar Savings.

B. FINANCIAL STATEMENTS.

FS-1: Pacific Enterprises Consolidated Balance Sheet as of March 31, 1998 (incorporated by reference to the Quarterly Report on Form

10-Q of Pacific Enterprises for the fiscal quarter ended March 31, 1998, in File No. 1-0040).

FS-2: Enova Corporation Consolidated Balance Sheet as of March 31, 1998 (incorporated by reference to the Quarterly Report on Form 10-Q of Enova Corporation for the fiscal quarter ended March 31, 1998, in File No. 1-11439).

FS-3: Pacific Enterprises Consolidated Statement of Income for the quarter ended March 31, 1998 (incorporated by reference to the Quarterly Report on Form 10-Q of Pacific Enterprises for the fiscal quarter ended March 31, 1998, in File No. 1-0040).

FS-4: Enova Corporation Consolidated Statement of Income for the quarter ended March 31, 1998 (incorporated by reference to the Quarterly Report on Form 10-Q of Enova Corporation for the fiscal quarter ended March 31, 1998, in File No. 1-11439).

ITEM 7. INFORMATION AS TO ENVIRONMENTAL EFFECTS.

The transaction does not involve a "major federal action" nor will it "significantly affect the quality of the human environment" as those terms are used in section 102(2)(C) of the National Environmental Policy Act. The transaction that is the subject of this Application or Declaration will not result in changes in the operation of the Applicants or their respective subsidiaries that will have an impact on the environment. The Applicants are not aware of any federal agency that has prepared or is preparing an environmental impact statement with respect to the transaction.

SIGNATURE

Pursuant to the requirements of the Public Utility Holding Company Act of 1935, as amended, the undersigned companies have duly caused this statement filed herein to be signed on their behalf by the undersigned thereunto duly authorized.

SEMPRA ENERGY

By: /s/ Warren I. Mitchell

Name: Warren I. Mitchell
Title: Group President - Regulated Business Units

FRONTIER PACIFIC, INC.

By: /s/ Eric B. Nelson

Name: Eric B. Nelson
Title: President

Date: October 30, 1998

EXHIBIT INDEX

Exhibit	Description
F-1	Opinion of counsel to Sempra Energy.
F-2	Opinion of special North Carolina counsel to Sempra Energy.

October 30, 1998

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Sempra Energy, et al.
Application on Form U-1
SEC File No. 70-9333

Dear Ladies and Gentlemen:

On behalf of Sempra Energy and Frontier Pacific, Inc. (jointly, the "Applicants"), I have examined the Application on Form U-1, dated July 17, 1998, under the Pubic Utility Holding Company Act of 1935 (the "Act"), filed by the Applicants with the Securities and Exchange Commission (the "Commission") and docketed by the Commission in SEC File No. 70-9333, as amended by Amendment No. 1, dated October 30, 1998, of which this opinion is to be a part. The Application, as so amended, is hereinafter referred to as the "Application." Capitalized terms not defined herein have the meanings set forth in the Application.

As set forth in the Application, the Applicants propose to acquire directly or indirectly up to 90.1% of the membership interests of Frontier Energy LLC ("Frontier"), which will become a "gas utility company" within the meaning of the Act (the "Proposed Transaction").

I am an attorney licensed in the State of California and am counsel for the Applicants. I am familiar with the issuance of securities by Sempra Energy and its associate companies. I have examined copies, signed, certified or otherwise proven to my satisfaction, of the Application. In addition, I have examined such other instruments, agreements and documents and made such other investigation as I have deemed necessary as a basis for this opinion.

For the purposes of the opinions expressed below, I have assumed (except, and to the extent set forth in my opinions below, as to the Applicants) that all of the documents referred to in this opinion letter will have been duly authorized, executed and delivered by, and will constitute legal, valid, binding and enforceable obligations of, all of the parties to such documents, that all such signatories to such documents will have been duly authorized, that all such parties are duly organized

and validly existing and will have the power and authority (corporate, partnership or other) to execute, deliver and perform such documents and that such authorization, execution and delivery by each such party will not, and such performance will not, breach or constitute a violation of any law of any jurisdiction. Based upon the foregoing, I am of the opinion, insofar as the laws of California are concerned that:

(a) all California laws applicable to the Proposed Transaction will have been complied with.

(b) Sempra Energy is a corporation validly organized and duly existing under the laws of the State of California.

(c) The Applicants will legally acquire the membership interests of Frontier being acquired.

(d) Consummation of the Proposed Transaction will not violate the legal rights of the holders of any securities issued by the Applicants or any associate company thereof.

The opinion expressed above are subject to the following assumptions or conditions:

(a) The Commission shall have duly entered an appropriate order or orders granting and permitting the Application to become effective with respect to the Proposed Transaction.

(b) The Proposed Transaction shall be effected in accordance with required approvals, authorizations, consents, certificates and orders of any state or federal commission or regulatory authority with respect to the Proposed Transaction and all such required approvals, authorizations, consents, certificates and orders shall have been obtained and remain in full force and effect.

I hereby consent to the filing of this opinion as an exhibit to the Application and in any proceedings before the Commission that may be held in connection therewith.

Sincerely

/s/ Donald C. Liddell

Donald C. Liddell

DCL/mrr

EXHIBIT F-2

{Kilpatrick Stockton LLP letterhead}

October 30, 1998

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

RE: SEMPRA ENERGY, ET AL.
APPLICATION ON FORM U-1
SEC FILE NO. 70-9333

Dear Ladies and Gentlemen:

On behalf of Sempra Energy and the Applicant Frontier Pacific, Inc. (jointly, the "Applicants"), we have examined the Application on From U-1, dated July 17, 1998, under the Public Utility Holding Company Act of 1935 (the "Act"), filed by the Applicants with the Securities and Exchange Commission (the "Commission") and docketed by the Commission in SEC file No. 70-9333, as amended by Amendment dated October30, 1998, of which this opinion is to be a part. The Application, as so amended, is hereinafter referred to as the "Application". Capitalized terms not defined herein have the meanings set forth in the Application.

As set forth in the Application, the Applicants propose to acquire up to 90.1% of the membership interest of Frontier Energy, LLC ("Frontier") which will become a "gas utility company" within the meaning of the Act (the "Proposed Transaction").

The attorneys signing this letter on behalf of Kilpatrick Stockton LLP are attorneys licensed in the State of North Carolina and are counsel for the Applicants regarding state regulatory matters. We have examined copies, signed, certified or otherwise proven to my satisfaction, of the Application. In addition, we have examined such other instruments, agreements and documents and made such other investigation related to North Carolina state approvals, certificates, and licenses as we have deemed necessary as a basis for this opinion. We have also relied upon representations and statements of officials and agents of Sempra Energy and Frontier Utilities of North Carolina, Inc. regarding the Proposed Transaction that is the subject of the Application.

For the purposes of the opinions expressed below, we have assumed (1)(a) that all of the documents referred to in this opinion letter will have been duly authorized, executed and delivered by, and (b) will constitute legal, valid, binding and enforceable obligations of all of the parties to such

documents, (2) that all such signatories to such documents will have been duly authorized, (3) that all such parties are duly organized and validly existing and will have the power and authority (corporate, partnership or other) to execute, deliver and perform such documents, and (4)(a) that such authorization, execution and delivery by each such party will not, and (b) that such performance pursuant to such documents will not, breach or constitute a violation of any laws of any jurisdiction. Based upon the foregoing, we are of the opinion, insofar as the laws of North Carolina are concerned, that:

(a) All North Carolina laws applicable to the Proposed Transaction will have been complied with.

(b) Frontier Energy, LLC and Frontier Pacific, Inc. are validly organized and duly existing.

(c) The Applicants will legally acquire the membership interests being acquired.

(d) Consummation of the Proposed Transaction will not violate the legal rights of the holders of any securities issued by the Applicants or any associate company thereof, to the extent any such rights are subject to North Carolina law.

The opinions expressed above are subject to the following assumptions or conditions:

a. The Commission shall have duly entered an appropriate order or orders granting and permitting the Application to become effective with respect to the Proposed Transaction.

b. The Proposed Transaction shall be effected in accordance with required approvals, authorizations, consents, certificates and orders of any state or federal commission or regulatory authority with respect to the Proposed Transaction and all such required approvals, authorizations, consents, certificates and orders shall have been obtained and remain in full force and effect.

c. No act or event other than as described herein shall have occurred subsequent to the date hereof which could change the opinion expressed above.

In addition, we express no opinion regarding the effectiveness or enforceability of any particular terms, commitments, warrantees, guarantees, or other provisions of the underlying contracts, understandings, agreements, or other documents between or among the parties to the Proposed Transaction that may be separate or severable from the specific right and authority to acquire the membership interest that are the subject of the Application and that are the sole subject of this opinion letter. Further, this opinion herein is qualified by and is subject to, and we render no opinion with respect to, the limitations and exceptions to the enforceability of contracts and obligations generally, including without limitation: (a) the effect of bankruptcy, insolvency, reorganization, arrangement, moratorium, fraudulent transfer or conveyance, preference, equitable subordination (whether arising under State laws or the U.S. Bankruptcy Code), bulk sales or bulk transfer laws and other similar laws relating to or affecting the rights of creditors generally; (b) the effect of general principles of equity and similar principles, including, without limitation concepts of materiality, reasonableness, unconscionability, good faith and fair dealing and the possible unavailability of specific performance, injunctive relief or other equitable remedies, regardless of whether considered in a proceeding in equity or at law, and the effect of public policy; (c) the enforceability of the indemnification and contribution provisions of the Agreement and any ancillary agreements, (d) compliance or noncompliance with antifraud provisions of applicable state and federal statutes, rules and regulations concerning the issuance and sale of securities; and (f) the effect of North Carolina, federal or other laws relating to usury or permissible rates of interest or other charges for loans, forebearances or the use of money.

Our opinion is limited to the laws of the State of North Carolina and we express no opinion with respect to the laws of any other state or jurisdiction, including, but not limited to, federal securities, tax, trade regulation, or antitrust laws or regulations, or to any local laws or ordinances. By rendering our opinion, we do not undertake to advise you of any changes in the law that may occur after the date hereof. These opinions have been prepared at your request and they are intended solely for your use in connection with the Proposed Transaction that is the subject of the Application and may not be relied upon by any other party or entity.

We hereby consent to the filing of this opinion as an exhibit to the Application and in any proceedings before the Commission that may be held in connection therewith.

Very truly yours,

KILPATRICK STOCKTON LLP

/s/ Kilpatrick Stockton LLP
by M. Gray Styers, Jr.

MGSjr/tlf