Audit of the Affiliated Transactions Between South Jersey Gas Company and its Affiliates and a Comprehensive Management Audit of South Jersey Gas Company

Submitted to:

New Jersey Board of Public Utilities

Submitted by:

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September 2013

Volume II

Public Version – Confidential Materials Redacted

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2. Affiliate Overview and Analysis

This chapter contains an overview of SJI's organization structure and covers the relationships and transactions between SJG and its various affiliates. It also covers SJI's compliance with the affiliate rules and requirements of the Electric Discount and Energy Competition Act (EDECA) as well as follow-up on prior audit recommendations. SJG's two largest affiliate relationships in terms of amounts charged to its regulated operations are with SJI's parent organization and with SJI Services, LLC. Transactions involving the parent organization and SJI Services are covered in depth in chapters 3 and 4.

Summary of Findings

Overall

1. SJG's affiliates include service companies that provide corporate and administrative services, a company that provides joint meter reading services to SJG and Atlantic City Electric, companies that operate in the non-regulated retail and wholesale gas markets, and a company that develop energy and energy-related projects.
2. Aside from the service companies, which are discussed in separate chapters, the significant services (in terms of dollar amounts) provided by affiliates to SJG during the years 2009-2011 were as follows:
   - Gas provided by wholesale supplier South Jersey Resources Group (SJRG), provided on an arms-length basis through markets such as the New York Mercantile Exchange (averaging $53.6 million net commodity sales per year to SJG during the years 2009 through 2011).
   - Meter reading services provided by Millennium Account Services (MAS), provided based on a contract price (averaging $3.1 million per year in charges to SJG during the years 2009 through 2011). As discussed below, the transactional relationship between MAS and SJG is neither arms-length nor competitive.
3. SJG also billed its affiliates during the review period. The most significant charges by SJG to affiliates included the following:
   - Billings for reimbursement of items paid for by SJG on behalf of affiliates. A majority of these represented reimbursement of benefits payments, primarily health insurance and prescription drug plan payments SJG made on behalf of affiliates and affiliate employees (averaging $5.3 million annually during the years 2009-2011). Other items paid for by SJG on behalf of affiliates included cellular telephone services, fleet maintenance (for the appliance services affiliate), and credit union payments on behalf of affiliate employees.
   - Off-system gas sales by SJG to SJRG (averaging $5.5 million annually during the years 2009 through 2011).
4. SJG provides payment for 3rd party service providers whose services benefitted multiple SJI affiliates during the audit period (e.g. employee benefits for various SJI affiliates).

South Jersey Energy Solutions (Holding Company for Non-Regulated Subsidiaries)

1. South Jersey Energy Solutions (SJES) is the holding company for SJI's non-regulated businesses. The significant non-regulated businesses include South Jersey Energy (SJE), South Jersey Resources Group (SJRG), South Jersey Energy Services Plus (SJESP) and Marina Energy.
2. During the audit period, with the exception of SJE and SJESP, the employees of the non-regulated businesses worked for and received their paychecks from SJES. SJE's employees became part of SJES beginning in 2013.
3. SJES has eight departments, including Accounting, Business Development, "CPE," Executive, Marina Energy, Mass Markets, Open Flow Energy and South Jersey Resources Group. The number of employees in SJES grew from 41 at the end of 2008 to 76 in August, 2012.
4. Open Flow Energy (OFE) is a department within SJES and a division of the SJE legal entity. Its employees run a separate retail gas products "book of business" in Pennsylvania. OFE's operations include the Open Flow Energy and "CPE" departments of SJES.
5. During the review period SJES charged minor amounts of employee time to SJG. Amounts charged were $0 in 2009, $31,404 in 2010 and $48,615 in 2011. SJG charged SJES to obtain reimbursement of payments made on its behalf, including payments for SJES employee health insurance, prescription drug coverage and credit union payroll deductions, facilities rents, and employee time. Amounts charged were $900,109 in 2009, $1,120,031 in 2010 and $1,745,012 in 2011.

Marina Energy

1. Marina Energy develops and operates energy-related projects that use natural gas. It is a co-owner of Energenic, a business that develops landfill gas-to-electric projects. It provides gas-fired heating and cooling for the Borgata casino in Atlantic City, and through its 50% interest in LVE Partners, is helps operate energy projects in Las Vegas.
2. Although a separate legal entity, Marina operates as a department of SJES. Employees increased from six in 2009 to nine in August, 2012.
3. In 2010 SJG entered into a 15 year contract with Marina under which Marina provides solar electricity to SJG at 6 cents per Kwh plus escalation based on the CPI. Initially SJG issued an RFP to purchase solar panels. After Marina was awarded the bid to supply the panels, the transaction was restructured so that Marina kept the panels and sold the electricity to SJG. The restructuring effectively nullified the competitive bidding component of the transaction.
4. Under the solar electricity transaction as it was originally bid, SJG and its customers would have benefited from electricity produced by the panels which was essentially free but for the cost of the panels. SJG also would have realized tax credits and renewable. Under the restructured transaction, Marina and SJI keep the difference between the revenue charged to SJG and cost of the panels (depreciation and minor costs of maintenance). Marina and SJI also keep the tax credits. SJG's benefit consists of the difference between the price of electricity purchased from the grid, approximately 11 cents, and the 6 cents it pays to Marina. SJG also gets revenue from

Marina to lease roof space for the panels, which currently averages a little less than one cent per Kwh.

5. During the three year review period from 2009 through 2011, net income to Marina from the solar transaction with SJG was approximately $1.5 million, including renewable solar energy credits and investment tax credits, sales of electricity to SJG, and subtracting depreciation and minor amounts of other expenses. In contrast, the benefit of the transaction to SJG during the same three-year period was approximately $180,000 in electricity savings and revenue from leasing space to Marina for the panels.

South Jersey Energy (Non-Regulated Sales to Retail Customers)

1. South Jersey Energy (SJE) buys electricity and gas in the wholesale markets and sells to retail commercial and industrial customers. It also offers energy management services. During the review period electricity accounted for about two-thirds of total sales.
2. SJE's employee force increased from six at the beginning of 2009 to 10 as of August, 2012. It includes sales, energy analyst and operations management positions.
3. During the audit period, sales by SJE to SJG were limited to a new chiller that SJE supplied to provide heating and cooling to the Folsom headquarters building. Although SJE billed SJG, SJE's parent company, SJES, actually hired a design team consisting of engineering, mechanical and electrical firms to install the chiller. There were no competitive bids. It is not clear whether, or by how much, SJE and SJES profited from the chiller or why SJG could not have purchased the chiller and contracted for its design and installation. It is unclear why SJE charged SJG for the chiller when SJES appears to have hired the contractors to design and install it.
4. The proposal SJES provided to SJG for installation of the chiller quoted a "final installed price" of $490,100. The actual amount billed by SJE to SJG for the chiller was $613,954. Without competitive bidding, and because the final price was significantly higher than the proposal-quoted price, it does not appear that the price SJG paid was market-based.
5. Transactions between SJG and SJE also included charges by SJG to obtain reimbursement of payments made on SJE's behalf, including payments for SJE's employee health insurance, prescription drug coverage and employee time. SJG provided bill processing services for SJE's customers and charged SJE for the services. Total amounts charged were $235,121 in 2009, $244,492 in 2010 and $326,979 in 2011.

South Jersey Resources Group (Non-Regulated Pipeline Capacity, Storage and Risk Management)

1. South Jersey Resources Group (SJRG) provides a variety of services in the wholesale (pipeline and storage) markets, including gas trading and sales, storage management, peaking services, transportation capacity, producer services, portfolio management and commodity risk management. Customers include energy marketers, utilities and gas producers.
2. As of 2012, SJRG was divided into Texas and New Jersey marketing groups, each of which report to separate Vice Presidents. The Texas group concentrates on the Gulf Coast market, while the

New Jersey group concentrates mainly on the east coast markets and the Marcellus production region in Pennsylvania.

3. Organizationally, SJRG operates as a department within SJES. It grew from 9 employees at the beginning of 2009 to 16 employees in August 2012. Positions include gas traders, dispatchers and schedulers, and, for Texas operations, three gas accountants.
4. During the review period SJRG sold gas to SJG. According to SJRG, all gas purchased by SJG was obtained at market through a Nymex broker in arms-length transactions. Net gas commodity sales to SJG were $86.9 million, $33.5 million and $39.0 million in 2009, 2010 and 2011, respectively. Sales to SJG represented a small percentage of SJRG's revenue. SJG also made $3.8 million, $6.3 million and $6.6 million in off-system sales to SJRG in 2009, 2010 and 2011, respectively.

South Jersey Energy Services Plus (Appliance Services)

1. SJESP is not being billed for SJG garages where maintenance is performed on the appliance service vehicles.
2. From 2009 through 2011, SJESP was not charged for use of a store room at the utility's Swainton office.
3. While reviewing the Charge Outs from SJG to SJESP from 2009 to 2011, it appears that SJG double charged SJESP for billing services.
4. SJESP sold its warranty service contracts to HomeServe USA in 2011. The contracts were sold in order to take advantage of HomeServe's marketing initiatives in order to increase the number of contract customers.
5. SJESP has completed a right-sizing initiative in 2011 that reduced the employees for the affiliate by one-third to create a leaner and more efficient operation.
6. SJESP incurred a net operating loss in 2011. Revenues declined sharply during calendar year 2011. It is uncertain whether the right-sizing initiative will reduce costs sufficiently to avoid a net operating loss in the near future for SJESP.
7. Overland visited the SJESP website and found that the disclaimers required under EDECA Standards Section 14:4-3.5(k) were omitted from the front page of the website.
8. SJESP has a balanced scorecard for the entire affiliate that includes a broad set of measures by which the affiliate is measured. The goals in SJESP's balanced scorecard also contain several stretch goals.

Millennium Account Services (Meter Reading Services)

1. ACE and SJG solicited competitive bids for their meter reading services in 2012. In the initial round of responses, Millennium's bid was**[Begin Confidential]** **[End Confidential]** million (annual cost) while the lowest bid was **[Begin Confidential]** **[End Confidential]**million. After ACE and SJG asked the company with the lowest bid to re-submit its bid, the company declined. MAS then adjusted its initial bid to undercut the lowest bid from the initial responses in order to become the low cost bidder and obtain the meter reading services contract for the two utilities, effective 1/1/2013, for three years. The new meter reading services contract could potentially

save ACE and SJG ratepayers approximately **[Begin Confidential**] **[End Confidential]** per year through 2015 through the use of fair market value service rates.

2. During the audit period (2009-2011), Millennium appears to have had its prices and revenue set so that it maintains a certain profit margin. The net income before tax has been consistently **[Begin Confidential]** **[End Confidential]** million each year from 2009 to 2011.
3. The business relationship between MAS and SJG is not an arm's length relationship.
4. The price MAS charges SJG for meter reading is not based on any regulatory cost standard, is significantly higher than a regulated return on investment-based price and is not market-based.
5. It is generally understood that MAS provides SJG and ACE an economy of scale advantage by being able to read both electric and gas meters. However, the price charged for meter reading to these two utilities was significantly marked up over a regulated cost of service pricing model to the point where it was not clear whether SJG or ACE realized any of the economy of scale savings compared with the cost of reading their own meters.
6. MAS's pricing is not in compliance with EDECA section 14:4-3.5(t)(6) that states that services provided by a Related Competitive Business Segment (RCBS) that are "not produced, purchased or developed for sale on the open market…shall be priced at the lower of fully allocated cost or fair market value."
7. MAS complied with EDECA standards requiring the separation of accounting (books), information systems, physical assets, employees and management from its utility clients, ACE and SJG.
8. Overland's examination of MAS's operations led to the discovery of two separate agreements in 2011 where SJG was contracted to pay Millennium for placing utility advertising on the trucks used by Millennium while servicing their meter reading customers. These agreements appear to be in violation of the EDECA Standard prohibiting joint marketing activities of a gas public utility and its PUHC's RCBS in Section 14:4-3.5(o)(2).
9. A "termination for convenience" clause in the existing joint meter reading contract between MAS, ACE and SJG effectively transfers the risk of liquidation costs from MAS to ACE and SJG.

Compliance with EDECA Standards

1. South Jersey Energy Service Plus Plumbing Service (Plumbing), a subsidiary of South Jersey Energy Service Plus is treated as a RCBS, but is not listed as a RCBS in the South Jersey Gas Compliance Plan.
2. The SJG Compliance Plan for the EDECA Standards was last updated in 2011 and will be reviewed for updates on a yearly basis going forward.
3. SJG had a chiller replacement project granted to SJES without going through the competitive bid process. The utility stated that the chiller installation was complex and that using an outside vendor was not feasible. For this project, SJG appears to give SJES preference over non-affiliated companies (based on a timing issue) that is explicitly prohibited in the EDECA Standard 14:4-3.3(a)(2).
4. The chiller replacement project cost that SJES documented in a proposal to SJG was $490,100 while SJES billed the utility over $600,000 from December 2010 to August 2011 for the project.

It appears that the utility was charged more than the fair market value of the product and services provided according to the project proposal, which would be in violation of EDECA Standard 14:4-3.5(t)(2).

5. SJG granted a solar installation project to SJES. SJES used its subsidiary to do the installation and maintenance. SJES maintained ownership of the solar panels and the tax credits associated with them. The utility could have installed the solar panels and maintained ownership, thereby passing the tax credits for the solar panels along to ratepayers. Marina has earned a net income from the project since 2009, which shifted the income outside of the utility for the benefit of the shareholders.
6. Overland obtained a list of employee transfers from 2009 to 2011 and determined that the transfers were conducted in accordance with EDECA Standards 14:4-3.5(r)(2)-(4).
7. Overland requested the direct mail and advertising brochures used by SJG from 2009 to 2011. None of the material revealed any advertising associated with any of the affected affiliates listed above. We also requested the marketing and advertising plans for the affected affiliates mentioned above for 2009-2011 and found that none of the marketing and advertising materials included the utility.

Prior Audit Recommendations

1. Of the 136 recommendations that Liberty proposed, SJG agreed to take action to implement 118 of the recommendations, accepted 15 recommendations with some level of qualification, and disagreed with three of the recommendations.
2. One of the Liberty recommendations was to place the disclaimer that is required in Section 14:4-5.5(k) of the EDECA Standards on the opening page of the website of each RCBS affiliated with SJG. Overland reviewed the home pages of the websites that are listed as RCBS in SJG's Compliance Plan and found no disclaimer on SJESP's home page.

Recommendations

1. Payments by SJG on Behalf of Affiliates – Apart from off-system sales of gas, most of the billings by SJG to affiliates during the audit period were to obtain reimbursement for payments SJG made to vendors on behalf of the affiliates. Overland understands there are efficiencies achieved by having a single affiliate pay for vendor services provided to multiple affiliates. However, the parent company, SJI, or the service company, SJIS, should fund these payments and seek reimbursement from subsidiaries, not the utility.
2. Appliance Services – SJESP - SJESP should add the disclaimers to the front page of its website in accordance with EDECA Standards Section 14:4-3.5(k).
3. Cross Subsidization – SJESP - SJG should charge SJESP for its use of company garages to maintain SJESP vehicles. SJESP should also be charged for its use of a storeroom in SJG's materials and supplies storage facility.
4. Cross Subsidization – MAS - Overland recommends modifying the Services Agreement between SJG and MAS to remove the requirement that SJG bear any risk relating to any liquidation of

MAS. Specifically, the requirement that SJG pay "reasonable costs" in the event of a "termination for convenience" should be removed. If SJG successfully argues to the NJBPU that modifying the agreement is not possible, we recommend the NJBPU prevent such costs from being passed on to SJG's ratepayers by prohibiting SJG from recording them, should they be incurred, in regulated, above-the-line accounts.

5. Competitive Bidding – MAS – Given the circumstances under which MAS obtained its most recent contract to provide meter reading to SJG and Atlantic City Electric (ACE), we recommend the BPU do the following: 1) Enforce the "re-bid" price of **[Begin Confidential**] **[End Confidential]** cents per read, which essentially represents MAS's match of a lower initial bid by competitor Accu-Read, and ensure that it has not been adjusted to a higher price since the contract went into effect. 2) Prohibit MAS from "negotiating" with SJG to raise its price at the end of year three of the five year contract in order to recoup the revenue lost by having to resubmit its initial bid at a lower price. 3) Given the inherent conflict of interest between MAS and its utility customers created by common ownership, monitor all future MAS contract bid processes to ensure that they are competitive and impartial, or limit the amount of meter reading expense incurred from MAS that SJG records in above-the-line (regulated) accounts to either a) a price based on cost plus a regulated investment return or b) the inflation-adjusted amounts in the re-bid price-per-read submitted in the current contract.
6. EDECA Compliance and Competitive Bidding – Millennium Account Services - Given that MAS's owners have had complete control of MAS's pricing and that the pricing has never complied with the traditional regulatory pricing standard for affiliate services (lower of cost or market), Overland recommends SJG document and demonstrate the benefits it currently receives from its relationship with MAS. Specifically, we recommend SJG file testimony and cost-benefit data in its next rate proceeding supporting the assertion that, under the pricing and terms of its current Services Agreement, SJG continues to benefit in the form of a net savings from paying MAS to read its meters.
7. EDECA Compliance and Competitive Bidding – Millennium Account Services - EDECA Section 14:4-3.5(t)(6) requires that "transfers of services [to a utility] not produced, purchased or developed for sale on the open market" be priced at "the lower of fully allocated cost or fair market value." Through ACE and SJG's process of soliciting competitive bids in 2012, MAS adjusted the rates charged to the two utilities for meter reading services to reflect current fair market value. However, in order to fully comply with the EDECA regulation in this section, Overland recommends that MAS determine what its fully allocated cost would be to provide meter reading services to SJG and charge the utility the lower of fully allocated cost or fair market value, ensuring compliance with this EDECA standard. If MAS is unable to comply with the standard, Overland further recommends that the NJBPU prevent amounts charged to SJG that exceed the lower of fully allocated costs or fair market value from being passed on to SJG's ratepayers by requiring SJG to record the excess charges below-the-line.
8. Prior Audit Recommendations - SJG should encourage the BPU to rule on relevant, outstanding issues from the 2005 audit and any matters that are contested in the current audit. For any

recommendations not implemented, the company should file a status report with the BPU every three months until a final decision is rendered.

9. EDECA Standards - SJESP Plumbing Service - South Jersey Energy Service Plus Plumbing Service should be listed as an RCBS in the SJG Compliance Plan.
10. EDECA Standards - Millennium Account Services - Overland recommends that SJG list Millennium Account Services as an RCBS in SJG's Affiliate Standards Compliance Plan.
11. EDECA Standards - Millennium Account Services - Overland recommends that SJG terminate any joint advertising and marketing agreements that it has with MAS (including utility advertising shown on the side of MAS vehicles) in order to be in compliance with EDECA Standard 14:4-3.5(o)(2).

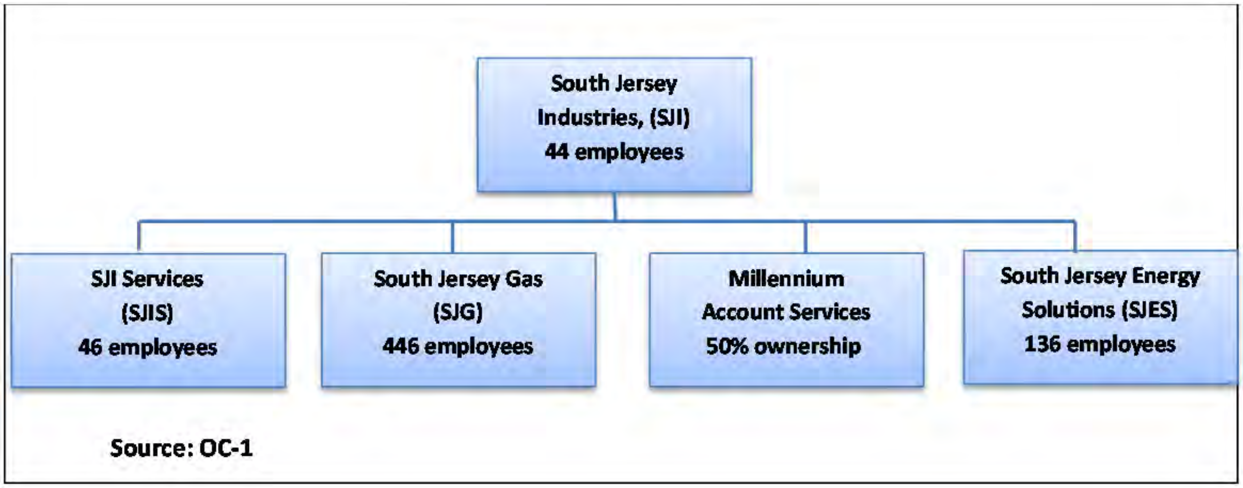
SJI's Organization Structure

SJI is the parent company and a holding company for South Jersey Gas and various non-regulated affiliates. SJI is involved generally in the following three types of businesses:

- Regulated Gas Distribution – South Jersey Gas provides gas distribution services based on cost-regulated rates to customers in southern New Jersey.
- Non-Utility Retail Energy – Several non-utility subsidiaries provide non-utility services to retail customers, including Marina Energy (thermal energy for heating, cooling and electric power), South Jersey Energy (non-utility gas marketing and consulting) and South Jersey Energy Service Plus (appliance and HVAC installation and maintenance services).
- Non-Utility Wholesale Energy – Another group of non-utility subsidiaries, including South Jersey Resources Group and South Jersey Exploration, provide services in wholesale markets.

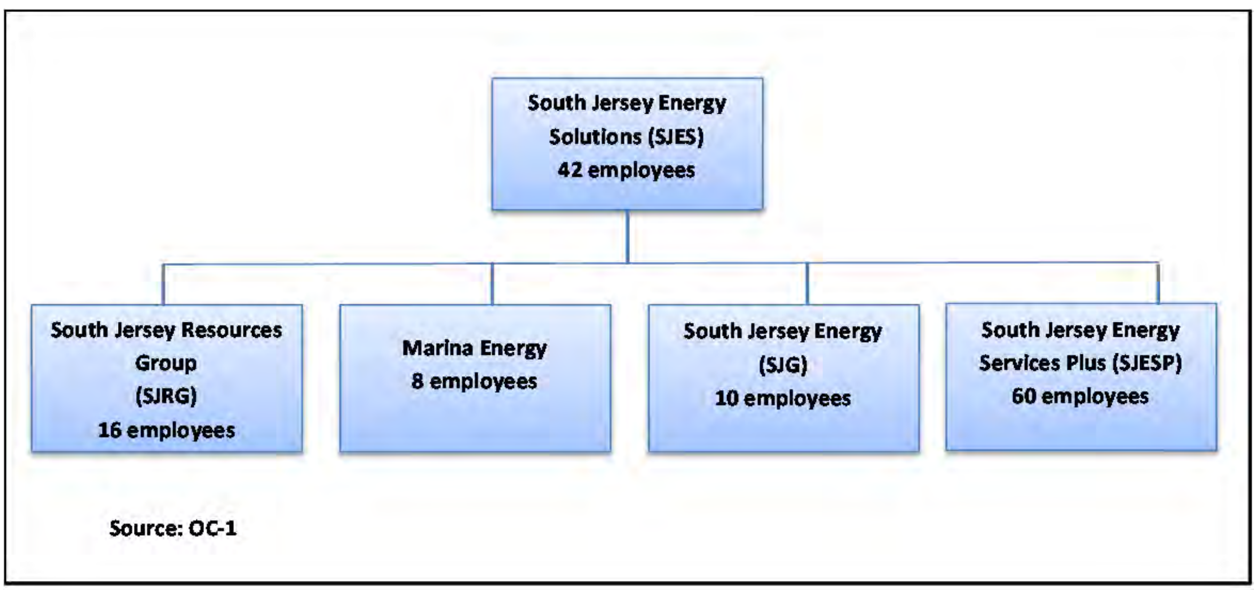
Below are two high-level organization charts of SJI's legal organization, emphasizing subsidiaries with active operations during the review period. Employee counts shown in these charts are as of the end of 2011. A more complete listing of the entities in SJI's legal structure is shown in Attachment 2-1.
The first chart below shows SJI's first-tier subsidiaries. These include South Jersey Gas (SJG), which provides regulated gas distribution services, South Jersey Energy Solutions (SJES), a holding company for SJI's non-regulated operations, SJI Services (SJIS), a service company providing administrative services to SJI subsidiaries, and Millennium Account Services (MAS), a company that reads meters for its owners' (SJI and Connectiv Solutions) utility subsidiaries (SJG and Atlantic City Electric). In addition, SJI maintains an organization at the parent level which provides corporate-level services to subsidiaries. Although MAS has its own employees, because they work for a joint venture of SJI and Connectiv Solutions, they do not participate in the same compensation and benefit plans as employees of SJI's wholly-owned subsidiaries and they do not report through SJI's management structure.

Table 2-1 – South Jersey Industries Legal Organization



SJES is the holding company and managing entity for most of SJI's non-regulated businesses. Subsidiaries with significant active operations during the review period include Marina Energy, which develops and operates energy ventures that utilize natural gas, South Jersey Energy, (SJE) which markets natural gas and provides energy management services to large retail customers, South Jersey Resources Group (SJRG), which markets gas storage, commodity and transportation in the wholesale market, and South Jersey Energy Services Plus (SJESP), which provides unregulated appliance services primarily within SJG's regulated service territory.

Table 2-2 - South Jersey Energy Solutions Legal Organization



Each of SJI's non-regulated entities, and the relationships between them and SJG, are discussed below.

South Jersey Industries (SJI)

In addition to being the parent company, SJI acts as a service company providing various corporate functions (corporate accounting, treasury and cash management, strategic and financial planning, internal auditing and others) to subsidiaries. SJI's top executives also reside in the parent organization and are charged to subsidiaries. SJI's parent organization had 47 employees as of August, 2012.

Transactions with SJG

SJI Charges to SJG – SJI's functional organization and its affiliate relationships with and charges to SJG and other affiliates are covered in Chapter 3.

SJG Charges to SJI – The following table summarizes costs charged by SJG to SJI's parent organization during the review period.

Table 2-3 – South Jersey Industries, Charges from South Jersey Gas

South Jersey Industries Charges from South Jersey Gas			
Category	**2009**	**2010**	**2011**
Benefits	784,375	912,837	1,180,854
Compensation	1,548	32,543	52,230
Facilities	164,920	154,420	214,760
Other Equipment	10,747	8,555	1,265
Other Payments	397,920	287,272	200,102
Time Allocation	322,292	382,219	403,809
Other	8,873	44,673	79,481
Total	**1,690,674**	**1,822,518**	**2,132,501**
Source: OC-58			

Benefits costs consist primarily of medical and prescription drug payments attributable to parent organization employees that were paid for by SJG and billed to the parent company. Benefits also include Supplemental Employee Retirement Plan (SERP) payments attributable to SJI executives, also paid for by SJG. The category "Time Allocation" consists of costs charged by SJG employees for time spent on corporate activities. "Facilities" costs include the cost of office space owned by SJG and occupied by SJI employees.

SJI Services (SJIS)

SJIS includes approximately 50 employees providing administrative services, consisting primarily of human resources and information technology, to other SJI affiliates. We reviewed costs directly charged and allocated to SJG from SJIS. The process through which costs are collected and distributed by SJIS to affiliates is complex and involves a number of manual steps. SJIS, including its functional organization and its charges to SJG and other affiliates is covered in Chapter 4.

Transactions with SJG

SJIS Charges to SJG – Charges for administrative services provided by SJIS to SJG are the subject of Chapter 4.

SJG Charges to SJIS - The following table summarizes charges by SJG to SJIS during the audit period.

Table **2-4** – SJI Services, LLC, Charges from South Jersey Gas

SJI Services, LLC Charges from South Jersey Gas			
Category	**2009**	**2010**	**2011**
Benefits	861,680	974,840	992,171
Compensation	-	-	-
Facilities	255,108	249,732	237,944
Other Equipment	1,320	1,535	1,850
Other Payments	150,590	233,251	148,426
Time Allocation	373,600	406,581	336,558
Other	12,826	25,831	109,518
Total	**1,655,124**	**1,891,771**	**1,826,466**
Source: OC-58, with some amounts changed by SJG in comments to Overland' Draft Report			

Charges consist mainly of employee benefits for SJIS employees. These consist primarily of medical insurance (Blue Cross) prescription drug payments (Caremark) made by SJG and attributable to SJI Services employees and "Union Payroll-Payroll Cos." Facilities costs consist of charges for office space. The "Time Allocation" category in 2009 includes loaded labor charges for SJG employees working on SJIS projects and matters, including accounting, tax and union personnel.

South Jersey Energy Solutions (SJES)

SJES is the holding company for SJI's non-regulated businesses: South Jersey Energy (SJE), South Jersey Resources Group (SJRG), South Jersey Energy Service Plus (SJESP) and Marina Energy (Marina). SJES also has groups of employees who run Marina, SJRG and parts of SJE. Effective in 2013, SJE's 10 employees will become part of SJES, at which point SJES will house the employees of all non-regulated businesses except SJESP.[1] The functional structure of Energy Solutions during the review period is summarized below:[2]

[1] Response to Discovery, OC-347-C.

[2] Based on the employee organization as reflected in data provided in Response to Discovery, OC-5 and job descriptions as provided in Response to Discovery, OC-71.

Table 2-5 – South Jersey Energy Solutions, LLC, Employees by Department

South Jersey Energy Solutions, LLC Employees By Department					
Department	**Dec-08**	**Dec-09**	**Dec-10**	**Dec-11**	**Aug-12**
ACCOUNTING - SJE SOLUTIONS	5	6	10	12	15
BUSINESS DEVELOPMENT	2	2	2	2	3
CPE					3
EXECUTIVE - SJE SOLUTIONS	3	3	4	5	7
MARINA ENERGY - SJE SOLUTIONS	6	6	7	8	9
MASS MARKETS	10	11	13	15	15
OPEN FLOW ENERGY	6	6	8	8	8
SOUTH JERSEY RESOURCES GROUP	9	11	13	16	16
Total	**41**	**45**	**57**	**66**	**76**
Source: OC-5					

- Accounting – SJE Solutions – The Accounting department is responsible for the general ledger, financial planning and financial reporting functions of SJES and its subsidiaries. It is also responsible for the invoicing and billing process for commercial and industrial transportation accounts and the collection processes for SJE and SJESP. The managers in the Accounting department report to SJES's "Treasurer", an employee of the SJES Executive department.[3] The department more than doubled in size between the beginning of 2010 and August, 2012.
- Business Development – This department provides business development and sales promotion services for SJES businesses. As of August, 2012 it included a Manager, Project Development and Construction working primarily on project development for Marina Energy, an Inside Sales Representative responsible for promoting products and services primarily to SJE's customers and a Manager, Strategic Planning and Marketing (no job description provided). The Business Development department and the Mass Markets department, described below, appear to have similar responsibilities for SJE sales.
- "CPE" – This department consists of three Account Executives whose responsibilities appear to relate to Open Flow Energy, the Pennsylvania division of SJE. They promote energy-related products and services, analyze customer energy consumption and develop customized packages of services for customers. They are located in Hershey, PA and report to the AVP of Business Development for SJE, an employee of the Mass Markets department.
- Executive – SJES – As of August, 2012, SJES Executive department positions included Michael Renna, President (or Chief Operating Officer), Kenneth DePriest, Senior Vice President, Vice President, Non-Core, Christine Mari-Mazzola, Vice President, Retailer Marketing, David Robbins, Treasurer (or Vice President – Controller)[4] and two new "Vice Presidents", Gregory Nuzzo and Stephen Poniatowicz, both added in 2012. The company did not provide requested job

[3] Another title for the Treasurer, according to data responses for which he was responsible, is Vice President & Controller.

[4] Organizational data refers to David Robbins as SJES' "Treasurer." In data responses answered by Mr. Robbins, he is listed as SJES' "Vice President & Controller." Employees of the SJES Accounting function all report to this position.

descriptions for SJES executives.[5] In addition to the SJES departments described here, Michael Renna, SJES President (or COO, as listed in some data responses), is responsible for oversight of a number of corporate initiatives involving SJES subsidiaries, including land and mineral rights, drilling, gathering and marketing in the Marcellus Shale region of Pennsylvania (South Jersey Exploration), combined heat and power opportunities, solar and landfill gas opportunities (Marina).[6] The number of SJES executives more than doubled between the beginning of 2010 and August, 2012. The increase is likely indicative of SJI's view of future growth opportunities.

- Marina Energy – Marina is a separate subsidiary of SJES. Marina's employees are technically employees of SJES and form a department within SJES. Marina's functional responsibilities are described in a later section of this chapter.
- Mass Markets – Mass Markets is headed by Joseph Scheufele, AVP of Business Development-SJE. It consists of Account Executives, Commercial Sales Representatives, a Manager, Industrial Accounts and a Manager, Business Development. Mr. Scheufele, who answered a data request about Mass Markets, stated "[t]he only SJES affiliate that operates in the 'Mass Markets' or 'Residential Markets' is South Jersey Energy Services Plus (SJESP)."[7] The response did not explain why Mr. Scheufele's job title refers to affiliate SJE, rather than SJESP, or why a department which Mr. Scheufele referenced as "Residential Markets" employs a Manager, *Industrial Accounts* and five *Commercial* Sales Representatives. Overland is not confident that all 15 of the sales-oriented employees of the Mass Markets department serve SJESP, as implied by the company's data response. Notwithstanding the response, it appears likely that employees in the Mass Markets department provide services to SJE as well as to SJESP.
- Open Flow Energy (OFE) – OFE is a division of SJE, but its employees work for SJES and it comprises a department of SJES. OFE is located in Pennsylvania and employees are responsible for a separate Pennsylvania retail gas "book of business."[8] OFE includes a sales function and a small "back office" function located in Hershey, PA. Positions include a Vice President, non-Core, General Manager – Sales, Sales Coordinator, Senior Scheduler, Commercial Account Sales Representative, Energy Analyst, Junior Analyst and Senior Accountant. A separate "CPE" department, described above, is also part of OFE.
- South Jersey Resources Group (SJRG) – Although it appears from organizational data that its employees receive paychecks from SJES, SJRG, like Marina, is a subsidiary of SJES responsible for SJI's non-regulated wholesale businesses (gas transportation, pipeline capacity and storage). Functional responsibilities for the SJRG department's employees are covered in a later section of this chapter.

[5] None of the job descriptions for Executive department positions are included among the job descriptions provided in Response to Discovery, OC-71.
[6] Response to Discovery, OC-89.
[7] Response to Discovery, OC-348.
[8] Response to Discovery, OC-347.

Transactions with SJG

Transactions between SJES and SJG consisted primarily of the following:

- Employee health benefits for SJES employees paid for by SJG and billed to SJES.
- Other vendor payments made by SJG on behalf of SJES and billed to SJES, for services such as cellular telephone, telecommunications voice and data circuits and credit cards for "key employees."
- Loaded labor charges for time spent by various SJG employees on SJESP matters and projects.
- Loaded labor charges for time spent by SJESP employees on SJG matters.

Charges from SJES to SJG – The following table summarizes the charges from SJES to SJG during the review period. The cost of employee-charged time in 2010 and 2011 is associated with Michael Halter, an SJES Vice President. The Company stated that Mr. Halter manages SJI's Environmental Affairs Department, which has provided environmental remediation services to SJG since 2010.[9] Mr. Halter billed his time associated with environmental remediation directly to SJG.

Table 2-6 – South Jersey Energy Solutions, Affiliate Charges to SJG

South Jersey Energy Solutions Affiliate Charges to SJG			
Category	**2009**	**2010**	**2011**
Employee-Charged Time	-	31,404	37,194
Oracle "OPN"	-	-	7,746
Other	-	-	3,675
Total	**-**	**31,404**	**48,615**
Source: OC-57, "DR #57 SolutionstoGas2009-2011 (DR57).xls"			

Charges from SJG to SJES - The following table summarizes charges by SJG to Energy Solutions during the audit period.

Table **2-7** – South Jersey Energy Solutions, Charges from South Jersey Gas

South Jersey Energy Solutions Charges from South Jersey Gas			
Category	**2009**	**2010**	**2011**
Benefits	572,378	619,537	819,397
Compensation	59,914	78,863	201,706
Facilities		10,500	10,500
Other Equipment	21	11	
Other Payments	147,186	231,730	411,905
Blank	27,486	72,235	164,660
Other	174,693	303,977	576,565
Time Allocation	93,124	107,154	136,844
Total	**900,109**	**1,120,031**	**1,745,012**
Source: Response to Discovery, OC-58			

[9] Response to Discovery, OC-452. Prior to 2010, the Environmental Affairs function was housed within SJG, so there were no intercompany charges to SJG.

Benefits charges consist almost entirely of medical insurance and prescription drug payments to vendors Blue Cross and Caremark paid for on behalf of SJES employees by SJG. Facilities consist of "office rent" in 2010 and 2011. "Other" includes of vendor payments made by SJG and charged to SJES for reimbursement. Among the largest vendor payments in this category are Magellan Hill (a telecommunications carrier management company) and Verizon Wireless. Also included in the category "Other" is a "Hyperion allocation of software cost" which grew from approximately $43,000 in 2009 to $114,000 in 2011, and a "Lawson cost allocation" averaging approximately $39,000 during the years 2009-2011. "Time Allocation" consists of a "credit union payroll deduction" averaging approximately $80,000 annually and "management cost" averaging $32,000 annually.

Marina Energy, LLC (Marina)

Marina develops and operates energy-related projects, including combined heat and power projects that use natural gas. Its largest project provides heating, cooling and emergency power for the Borgata Hotel-Casino in Atlantic City. Marina is also a co-owner of Energenic, which develops landfill gas-to-electric projects in different parts of the U.S. Energenic owns a number of entities through which it develops energy projects and conducts business.[10] Marina also owns a 50% equity interest in LVE Energy Partners, which built and operates a district energy system and a central energy center for a resort in Las Vegas, NV.[11]

Marina operates as a department of SJES. Between the years 2009 and 2012 its staff increased from six to nine employees. As of August, 2012 it included a Vice President, Business Development, two Project Managers, a Manager, Operations, a Contracts and Compliance Manager, an Environmental Manager, a Supervisor, Energy and Performance and an Office Administrator.

Transactions with SJG

Charges from Marina to SJG – In 2010 SJG entered into a 15 year contract with Marina under which it pays Marina approximately $60,000 annually to provide solar electric power to SJG at 6 cents per Kwh, with annual escalations based on the consumer price index. SJI indicates that this was a negotiated price and was "below the market price," which SJI asserts to be "over $0.11 per Kwh."[12] Payments by Marina to SJG to lease roof space for the panels bring the effective price down to about 5.3 cents per Kwh.

The project to provide solar electricity to SJG's Folsom and McKee City facilities was initially bid to supply solar panels to SJG, but after the SJES won the bid to supply the panels, the bidding process was rendered moot when the project was restructured so that an SJES subsidiary (Marina) would own the panels and sell the electricity, instead of the panels, to SJG.[13] By having Marina, rather than SJG own the

[10] Response to Discovery, OC-1.
[11] Response to Discovery, OC-1.
[12] Response to Discovery, OC-400-B.
[13] The project was restructured with the effect of transferring some of its benefits from SJG to SJI in spite of the fact that SJI asserts (OC-400-C) that the purchase was initiated and approved by SJG, and not by SJI or SJES.

panels, the profit produced by charging SJG for electricity, as well as the solar tax credits that go with owning the panels, are retained by SJI and shareholders, rather than flowing to SJG and potentially to its customers. Marina's profitability is reduced by about $7,300 annually due to lease payments it makes to SJG for space on the roof of its buildings; however, it is not clear whether or how the benefit of the lease revenue flows to SJG's regulated customers.

The details of the solar arrangement with Marina are noteworthy because, together with MAS and its meter reading services, they demonstrate a pattern of designing affiliate transactions involving SJG so that at least some of the benefits, in an amount decided by SJI, flow to SJI's shareholders, rather than to regulated ratepayers.[14] The table below, which summarizes Marina's income from the SJG solar project during the review period, demonstrates, in terms of investment tax and solar renewable energy credits, the significance of having unregulated Marina, rather than regulated SJG, own the solar panels that supply electricity to SJG buildings. As shown, the benefits of having Marina own the panels, particularly in terms of tax and renewable solar energy credits that exceed $2 million over the three-year review period, significantly outweigh the benefits to SJG in terms of savings on electricity, which amount to approximately $180,000 for the same period.

Table 2-8 – Marina Energy, Income Statement – SJG Folsom & McKee City Solar Project

[Begin Confidential]

Marina Energy
Income Statement - SJG Folsom & McKee City Solar Project

Item	2009	2010	2011

[End Confidential]

The following table summarizes charges from Marina to SJG during the audit period. It is also noteworthy that although SJG is buying electricity and does not own the solar panels, Marina nevertheless charged SJG $12,500 for a "solar application fee" in the year the panels were installed.

[14] SJG could just as easily have captured the tax credits and the entire cost savings associated with them by contracting with a panel supplier directly to own the solar generating equipment.

Table 2-9 – Marina Energy, Affiliate Charges to SJG

Marina Energy Affiliate Charges to SJG			
Category	**2009**	**2010**	**2011**
Solar Electricity	525	59,975	61,018
Solar - Application Fee		12,500	
Total	**525**	**72,475**	**61,018**
Source: OC-57, "DR #57 SolutionstoGas2009-2011 (DR57).xls"			

Charges from SJG to Marina - The following table summarizes charges by SJG to Marina Energy during the audit period.

Table 2-10 – Marina Energy, Charges from South Jersey Gas

Marina Energy Charges from South Jersey Gas			
Category	**2009**	**2010**	**2011**
Gas Transport	329,668	330,436	175,248
Time Allocation	42,628	59,276	157,536
Other	30,036	28,363	47,869
Total	402,332	418,074	380,653
Source: OC-58			

A majority of the charges from SJG to Marina consist of gas transportation. "Time Allocation" consists of management costs charged by SJG employees to Marina. SJG described the management costs as tax services, including tax compliance, accounting, research and planning.[15] Other charges consist primarily of vendor payments to Infrastructure LLC, Wright Express Financial, Bank of America (credit card) and Verizon Wireless. "Other" also includes approximately $7,000 annually in 2010 and 2011 for space leased to Marina for solar panels, and $33,090 credit (bill reduction) to Marina in December, 2011 for "Phase II Solar."[16]

South Jersey Energy (SJE)

SJE brokers electricity and gas for commercial and industrial retail customers and provides energy management services to commercial and industrial customers. It produces income by buying energy in the wholesale market, repackaging it and reselling it in the retail market. For example, SJE sometimes absorbs the price risk (which it hedges) from buying energy for a period of time and allows its customers to lock in fixed, but somewhat higher-than-wholesale prices. Industrial customers make up a large percentage of SJE's sales, and casinos are also among its largest customers.[17] About two-thirds of sales

[15] Response to Discovery, OC-769-B.

[16] Per response to Overland discovery request OC-769-C, Marina was responsible for 50% of the cost of installing certain concrete and asphalt work in front of the McKee City plant. According to SJG, a December 2011 charge from "Infrastructure LLC" for $54,126 and a $33,090 credit for "Phase II Solar" (a net charge of $21,036) both relate to this work at the LNG plant.

[17] Interview, Louis DiCicco, November 13, 2012.

are electricity and the remainder is gas.[18] SJE obtains electricity from a variety of suppliers and sells it to customers primarily in New Jersey, New England and Pennsylvania. A majority of the gas SJE sells is obtained from SJRG; however, other suppliers are used for sales to customers outside of New Jersey. Approximately half of SJE's gas sales are to customers within SJG's service territory.[19]

SJE is headed by a General Manager who reports to the President, South Jersey Energy Solutions. At the beginning of 2009 SJE had five employees, including two employees responsible for billing who reported to SJES' Treasurer. By 2012 SJE's force level had nearly doubled. SJE employees in August 2012 included two operations managers (one gas and one electric), three Energy Analysts and two Senior Consultants. Analysts and consultants are responsible for pricing, scheduling and purchasing, making sure products are hedged, and tracking individual state requirements; for example, ensuring compliance with renewable portfolio standards.[20] SJE also employs a Manager – Business Expansion, a Sales Coordinator – Commercial Accounts and a Manager, Gas Procurement.

Table 2-11 – South Jersey Energy Company, Employees

South Jersey Energy Company Employees					
Employee Department	**Dec-08**	**Dec-09**	**Dec-10**	**Dec-11**	**Aug-12**
SOUTH JERSEY ENERGY CO.	6	7	8	10	10
Total	**6**	**7**	**8**	**10**	**10**
Source: OC-5					

In addition to its New Jersey operations, SJE has operations in Pennsylvania conducted by Open Flow Energy (OFE). OFE purchases gas from local producers and sells to commercial and small industrial customers in northwestern Pennsylvania. It is considered a division of SJE for legal purposes, but its employees form a department of SJES and are discussed above.[21] Beginning in 2013, the remaining SJE employees, shown in the table above, will be moved to SJES.

Transactions with SJG

Charges from SJE to SJG – Charges from SJE to SJG during the review period consist entirely of a bill for the installation of an "electric centrifugal chiller" that replaced an existing "direct-fired natural gas absorption chiller" used to provide heating and air conditioning at the Folsom headquarters building.[22] Even though the billing to SJG was from SJE, it was apparently SJES which proposed to "engineer, procure and construct a replacement chiller and upgrade the electrical service for SJI's headquarters at . . . Folsom." [23] It appears that SJES hired a design/build team comprised of Concord Atlantic Engineering,

[18] Interview, Louis DiCicco, November 13, 2012.
[19] Interview, Louis DiCicco, November 13, 2012.
[20] Interview, Louis DiCicco, November 13, 2012.
[21] Response to Discovery, OC-347-C. As explained by the company, when SJES was formed in 2006 existing SJE employees were left at SJE based on the recommendation of the legal department. When OFE was acquired, SJI put its employees into SJES, which houses most of SJI's non-utility employees.
[22] Response to Discovery, OC-430.
[23] Response to Discovery, OC-430, "DR #430-3-South Jersey Energy Services Proposal.pdf.

Broadley's Mechanical and Premier Electric. There were apparently no competitive bids, either with respect to the installed chiller purchased by SJG from its affiliate, or with respect to the construction services that SJES acquired from the three contractors. It is not clear whether, or by how much, SJES profited from acting as contractor for the installation or why SJG could not have hired the design/build team and installed the chiller itself. Finally, although the proposal SJES provided to SJG states the "total installed price" of the chiller was supposed to be $490,100, transactional data provided in response to discovery shows that SJG actually paid $613,954, as shown below.

Table 2-12 – South Jersey Energy, Affiliate Charges to SJG

South Jersey Energy Affiliate Charges to SJG			
Category	**2009**	**2010**	**2011**
Chiller Replacement	-	74,380	539,574
Total	**-**	**74,380**	**539,574**
Source: OC-57, "DR #57 SolutionstoGas2009-2011 (DR57).xls"			

Charges from SJG to SJE - The following table summarizes charges by SJG to SJE during the audit period.

Table 2-13 – South Jersey Energy, Charges from South Jersey Gas

South Jersey Energy Charges from South Jersey Gas			
Category	**2009**	**2010**	**2011**
Benefits	104,646	132,771	154,717
Bill Processing	68,752	71,412	76,208
Time Allocation	47,759	29,566	52,996
Other	14,963	10,743	43,058
Total	**236,121**	**244,492**	**326,979**
Source: OC-58			

Benefits charges consist almost entirely of medical insurance and prescription drug payments to vendors Blue Cross and Caremark paid for by SJG on behalf of SJE employees. SJG charges SJE for bill processing. Time Allocation includes charges by SJE employees for their time as well as credit union payroll deductions.

South Jersey Resources Group (SJRG)

SJRG conducts business in the wholesale gas markets. It provides gas trading, and sales, storage management, peaking services, transportation capacity, producer services, gas portfolio management services and commodity risk management services. [24] Its customers include energy marketers, electric and gas utility companies and natural gas producers, but they do not include end users (gas consumers). Examples of the services provided by SJR include:[25]

[24] Response to Discovery, OC-350-A.
[25] Response to Discovery, OC-350-B.

- Storage Management – SJR holds over 8 BCF of storage on three pipelines.[26] To capture the seasonal value of this service, SJR purchases gas in the summer and sells during peak days in the winter.
- Peaking Services – SJR sells peaking services to utilities and co-generation plants that allow customers to call on supply only on the days they need gas.
- Transportation Services – SJR has capacity to move gas to and from different locations, allowing them to capture margin on basis differentials.
- Producer Services – SJR has several long-term gas supply deals with Marcellus producers. SJR handles balancing and ensures daily gas flows.

SJRG has a variety of customers. Much of its supply is sourced to the Marcellus region of Pennsylvania and the gulf coast. Among its large customers is the FPL Group, which owns a 750 megawatt plant in Philadelphia. Affiliate SJE, acting as an aggregator to supply retail services, is also a large customer.[27] Other significant customers include Direct Connect, National Fuel Distributors and Hess Corp.

SJRG functions as a department of SJES. It employs a Vice President in Bedford, Texas and a General Manager, Trading, in Hammonton, New Jersey. As of August 2012, SJRG's employees also included six Gas Traders and Schedulers, four Gas Dispatchers, a Gas Dispatch Trainee and three Gas Accountants. Although they are listed as part of one SJES department, SJRG's employees report through various management organizations.[28] The Gas Vice President, Gas Dispatchers and Gas Traders in Texas report to Christine Mari-Mazzola, a Vice President in the SJES Executive department. The Gas Accountants, located in Texas, report to the Director of Accounting Operations in the SJES Accounting department. The New Jersey Gas Traders and Gas Dispatchers report to Gregory Nuzzo, who is also a Vice President in the SJES Executive department. SJRG's force level doubled from 8 to 16 employees between 2008 and 2012.

Transactions with SJG

Charges from SJRG to SJG - Charges from SJRG to SJG consist of sales of the gas commodity. SJRG operates under FERC rules which govern the exchange of information and pricing among affiliates. It is not permitted to share pipeline capacity with SJG.[29] SJRG stated that when SJG purchases gas sourced to them, it is purchased through a Nymex broker, and SJRG does not participate.[30] Gas commodity prices in these transactions are the market prices available in the Nymex exchange. SJRG stated that it bills out "$80 million to $90 million per month" to various customers.[31] Based on the amounts in the table below, net commodity sales to SJG represent a relatively small percentage of SJRG's business.

[26] Interview, Gregory Nuzzo, November 14, 2012.
[27] Interview, Gregory Nuzzo, November 14, 2012.
[28] Analysis of organizational data, Response to Discovery, OC-5.
[29] Interview, Gregory Nuzzo, November 14, 2012.
[30] Interview, Gregory Nuzzo, November 14, 2012.
[31] Interview, Gregory Nuzzo, November 14, 2012.

Table 2-14 – South Jersey Resources Group, Affiliate Charges to SJG

South Jersey Resources Group Affiliate Charges to SJG			
Category	**2009**	**2010**	**2011**
Net Gas Commodity Sales	86,921,860	33,539,719	40,457,527
Citibank margin reimbursement	-	-	(1,474,875)
Total	**86,921,860**	**33,539,719**	**38,982,652**
Source: OC-57, "DR #57 SolutionstoGas2009-2011 (DR57).xls"			

Charges from SJG to SJRG - The following table summarizes charges by SJG to SJR during the audit period.

Table 2-15 – South Jersey Resources, Charges from South Jersey Gas

South Jersey Resources Charges from South Jersey Gas			
Category	**2009**	**2010**	**2011**
Off System Sales	3,782,154	6,244,195	6,532,070
Time Allocation	35,864	28,036	51,197
Other	6,817	19,555	24,842
Total	**3,824,834**	**6,291,786**	**6,608,109**
Source: OC-58			

Charges from SJG to SJRG consist primarily of off system gas sales. Time Allocation charges consist entirely of management cost.

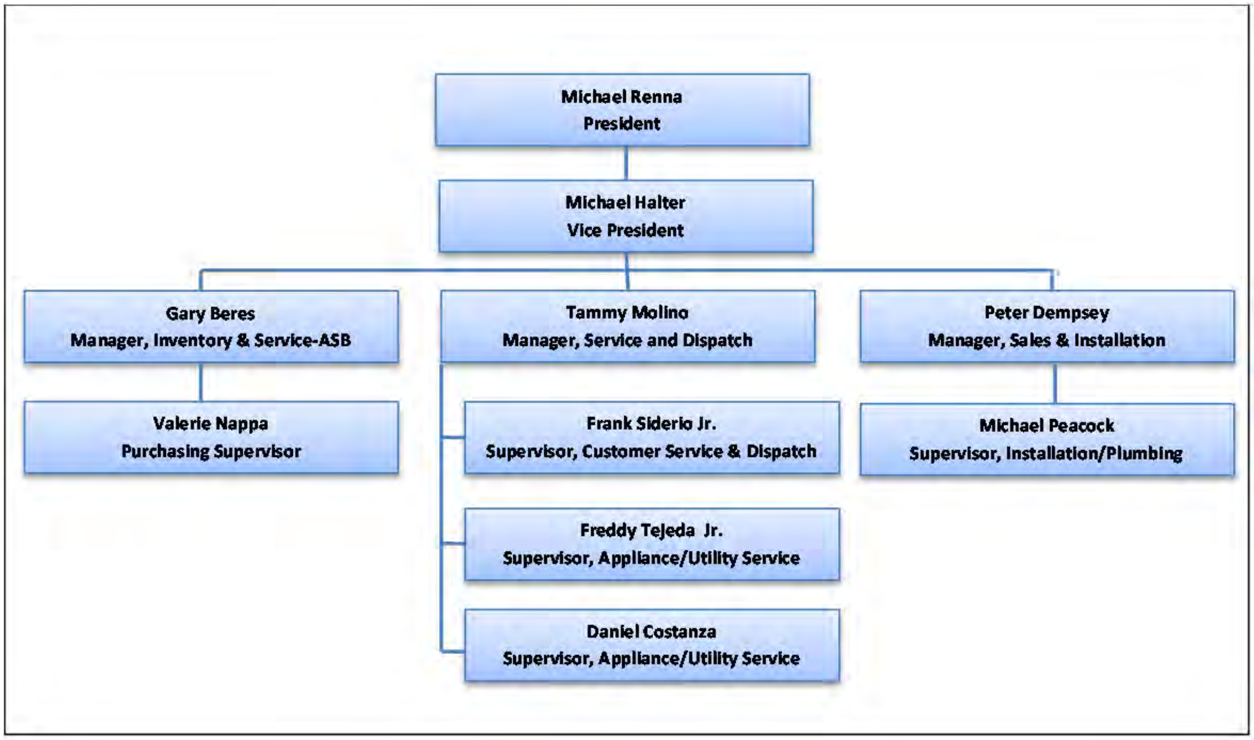
South Jersey Energy Services Plus (SJESP) and SJESP Plumbing

SJESP is a subsidiary of SJES. It installs residential and small commercial heating and air conditioning systems, provides plumbing services and provides appliance services under warranty through a subcontractor arrangement. SJESP Plumbing (Plumbing) is a wholly-owned subsidiary of SJESP, set up to provide plumbing services to SJESP.[32] Plumbing is led by Michael Peacock, a Supervisor in the appliance services organization, who has an ownership share in the subsidiary. He supervises three SJESP Plumbing employees, including one who is also a licensed plumber. He also supervised HVAC installation crews during a portion of the audit period.

The chart below summarizes SJESP's management organization as of August, 2012. The President, Michael Renna, and the Vice President, Michael Halter, are employees of SJES' Executive department. The other management employees in the chart are employees of SJESP or Plumbing.

[32] Plumbing is a pass through entity, meaning that it does not record net income on its books. All revenues and expenses of this subsidiary are carried on the financial statements of SJESP (Interview, Michael Halter, Sept. 24, 2012).

Table 2-16 – SJESP Appliance Services Organization



The following table summarizes SJESP's employees by department.

Table 2-17 – SJI Energy Services Plus/SJI Plumbing, Employees by Department

SJI Energy Services Plus / SJI Plumbing Employees By Department					
Employee Department	**Dec-08**	**Dec-09**	**Dec-10**	**Dec-11**	**Aug-12**
ADMINISTRATION	5	5	4	2	1
APPLIANCE SERVICE PARTS	6	6	6	5	4
CUSTOMER SERVICE & DISPATCH	11	11	12	6	6
INSTALLATION	27	25	25	14	14
SJESP ATLANTIC	13	10	10	7	9
SJESP CAPE MAY	6	7	7	7	6
SJESP CUMBERLAND	5	4	4	2	2
SJESP GLASSBORO	10	10	10	8	6
SJESP WATERFORD	9	9	9	4	3
Subtotal Energy Services Plus	**92**	**87**	**87**	**55**	**51**
PLUMBING SERVICES-SJESPS	6	6	5	5	4
Subtotal Plumbing Services	**6**	**6**	**5**	**5**	**4**
Total	**98**	**93**	**92**	**60**	**55**
Source: OC-5					

Sale of Appliance Service Contracts

SJESP sold its service contracts for appliance warranty repairs to HomeServeUSA Corp. (HomeServe) on March 8, 2011.[33] As shown in the table above, the workforce dropped significantly after the sale to

[33] Response to Discovery, OC-337.

HomeServe. The objective of the transaction was to increase the number of service contract customers. Since the sale, HomeServe has been responsible for the service contract customer service and marketing. Although the service contracts are now owned by HomeServe, SJESP continues to be responsible for communicating with customers, making appointments and performing repairs under the contracts.

The sale of rights associated with the appliance warranty repair contracts to HomeServe USA is accomplished through three separate service agreements: a Master Agreement (MA) between HomeServe and SJESP, a Marketing Services Agreement (MSA) between HomeServe and SJG, and an Administrative Services Agreement (ASA) between HomeServe and SJG. According to the company, SJESP has observed a **[Begin Confidential**] **[End Confidential]** increase in appliance service contracts since entering into the agreement. All terms have an initial period of 15 years for service contracts and 5 years for repair work.[34]

[Begin Confidential]

[End Confidential]

At HomeServe's expense and through SJG's third party vendor, SJG provides direct mailing of HomeServe marketing materials to utility customers under the MSA. SJG reviews and approves materials submitted by HomeServe for direct mail advertising campaigns. **[Begin Confidential]**

[End Confidential]

SJESP Compliance with EDECA

As a "related competitive business segment," SJESP is subject to various rules under EDECA. Issues relating to EDECA are discussed below.

<u>Training</u> - All SJESP employees receive applicable affiliate standards training. SJG has a Communication Plan that identifies which employees need to have the Standards communicated to them. The methods of communication range from face-to-face meetings to memorandums to web portal training.

<u>Separation</u> - EDECA Standards require SJESP to maintain operations that are discrete from utility operations. SJESP is separate from SJG in the following respects:

[34] Appliance Services Interview, September 24, 2012 with Michael Halter.
[35] Response to Discovery, OC-263.

- SJESP is a separate legal subsidiary of SJI subsidiary SJES. It is not a subsidiary of SJG and is not owned in whole or in part by SJG.
- SJESP has its own books and financial statements. Financial results are consolidated with SJES and SJI. There is no consolidation of financial results between SJESP and SJG.
- SJESP is functionally separate from SJG. It has a separate employee organization that reports through SJES to SJI, the parent. [36] SJESP's employee organization does not report through SJG.
- SJESP employees do not share space with SJG. Appliance service technicians are home-based employees and do not require dedicated space in SJG's offices or operation centers. Appliance service technicians generally do not perform the same tasks as the utility technicians. The exception is where appliance service technicians who have the expertise can repair safety related issues with gas lines on the customer side of the gas meter. [37]
- SJESP has relied on HomeServe to provide customer service since early in 2011. SJG represents that HomeServe has no access to SJG's customer database.[38]
- SJESP has its own parts storeroom, consisting of a "small room . . . used to store parts for its Service Department employees." However, the room is located in an SJG facility.

SJESP and SJG share the following:

- Under the ASA, discussed above, SJG bills and collects for HomeServe. As such, although HomeServe and SJESP have no access to SJG's data, SJG has access to HomeServe / SJESP customer data. SJG stated that "any New Jersey licensed HVAC company that services and/or installs primarily natural gas equipment within the South Jersey Gas service area, or a company that utilizes New Jersey licensed HVAC contractors to perform these services, is eligible to have SJG perform billing services for service contracts and/or time and material service work."[39]
- SJG also bills and collects for SJESP. While reviewing the Charge Outs from SJG to SJESP from 2009 to 2011, it appears that SJG double charged SJESP for billing services.[40]
- SJESP relies on SJG, SJI and SJIS to provide various shared administrative and "back office" services, including human resources, accounting, billing, risk management and marketing (for HVAC installations). [41]
- SJESP's appliance parts storeroom is housed in a building used by SJG. SJESP leases this space from the utility.[42] During the audit period (2009-2011), SJESP was not charged a portion of the building expense where the storeroom is located.[43]

[36] Response to Discovery, OC-5.
[37] Appliance Services Interview, September 24, 2012 with Michael Halter.
[38] Response to Discovery, OC-441.
[39] Response to Discovery, OC-438.
[40] Overland inquired of SJI why there are two separate lines charging the same amount of billing service fees in the SJG Charge Out spreadsheet to SJESP. SJI responded (via email from Chris Moschella on 4/16/13) that the spreadsheets Overland was provided as a Response to Discovery, OC-57 and OC-58 were manually compiled and not representative of the actual amounts of intercompany charged billed through the accounting system. Overland has requested the intercompany billings of SJI in several data requests and the information provided by SJI has been unreliable.
[41] Interview, Michael Halter, Sept. 24, 2012.
[42] Response to Discovery, OC-439.
[43] In the Response to Discovery, OC-439, SJI stated that SJESP was charged for building space at SJG's Swainton facility for use of space for the purpose of storing parts for SJESP's Service Department employees. Overland reviewed the SJG charge

- Although SJESP does not have access to SJG's customer data, it does use other SJI information systems used by SJG, including Lawson (time entry), and Hyperion (budgeting).
- SJESP's vehicles are serviced in garages located in SJG's operations centers. SJESP was not billed during the audit period for utility garages where maintenance was performed on appliance service vehicles.
- During the audit period, SJESP leased 14 vans from the utility. The lease expense of these vans went from $33,291.27 in 2009 to $8,821 in 2011. As of April 30, 2011, SJESP terminated all leased vehicle agreements with the utility.[44] Since that time, SJESP has held leases with Automotive Rentals, Inc. (ARI) and GE Capital Penske Leasing.[45] SJESP also owns a couple of vehicles as well.[46]
- SJESP uses the multi-colored flame logo that is found on any products that relate to South Jersey Industries, including South Jersey Gas, the utility. SJESP is not required to pay the parent any fee for the use of the logo. However, to abide by EDECA Standard 14:4-3.5(k), SJESP discloses that the affiliate is not the same as the gas utility, is not regulated by the NJBPU, and buying SJESP products is not a requirement for receiving quality regulated services from the utility.[47]

Transactions with SJG

Charges from SJG to SJESP - The following table summarizes charges by SJG to SJIS during the audit period.

Table 2-18 – South Jersey Energy Services Plus & Plumbing, Charges from South Jersey Gas

South Jersey Energy Services Plus & Plumbing Charges from South Jersey Gas			
Category	**2009**	**2010**	**2011**
Benefits	1,448,788	1,430,667	1,417,647
Bill Processing	57,368	61,937	50,455
Billing Service Fee	57,368	61,937	50,455
Gasoline	46,235	53,574	74,846
Penske	173,711	173,093	155,297
Verizon Wireless	41,476	85,434	77,131
Wright Express Financial	6,684	193,084	187,862
Time Allocation	373,783	340,985	309,700
Other	379,870	214,764	182,428
Total	**2,585,283**	**2,615,476**	**2,505,820**
Source: OC-58			

outs to SJESP from 2009 to 2011 in the Response to Discovery, OC-58 and noticed that there was no charge from SJG to SJESP on the spreadsheets provided for the space that SJESP leases from the utility at Swainton. In an email provided by Chris Moschella on 4/16/13, he stated that SJG Accounting was not aware of the use of space in the Swainton office by SJESP until December 2012 when the utility billed SJESP for a full year's lease expense ($2,793.35). The utility continues to bill SJESP for use of the Swainton office in 2013.

[44] Response to Discovery, OC-409.

[45] Response to Discovery, OC-444.

[46] Appliance Services Interview, September 24, 2012 with Michael Halter.

[47] Response to Discovery, OC-443.

SJG billed SJESP for health and prescription drug benefits for its employees, for SJESP's share of amounts for vehicle maintenance provided by Penske, for SJESP's share of cellular telephone service provided by Verizon Wireless, for its share of gasoline used at SJG operating centers. Most of the amounts labeled as "time allocation" were credit union payroll deductions. "Bill Processing" and "Billing Service Fee" are associated with the fee charged by SJG to bill amounts to SJESP customers.[48] As shown, the amounts appear twice, which, as discussed above, makes it appear that SJG overcharged SJESP by billing them twice for the same thing.

Charges from SJESP to SJG – According to data supplied by the company, SJESP did not supply products or services to SJG during the years we reviewed (2009-2011).[49] Given the nature of services provided by SJESP, it is reasonable to expect that SJESP would not have charged SJG for services during the review period.

Appliance Service Profitability, Pricing, and Potential for Cross-Subsidization by SJG

The following table summarizes the financial results of the ASB for the year ended December 31, 2009, 2010, and 2011.

Table 2-19 – South Jersey Energy Service Plus, LLC, Summary of Financial Results

[Begin Confidential]

South Jersey Energy Service Plus, LLC Summary of Financial Results			
	12 Months Ended 12/31/09	12 Months Ended 12/31/10	12 Months Ended 12/31/11

[End Confidential]

[48] The fact that they are identical in amount for each of the three years is what led us to believe they might represent a duplicate charge for the same service.

[49] Response to Discovery, OC-57.

SJESP's Income - **[Begin Confidential]**

[End Confidential]

SJESP's Pricing – **[Begin Confidential**]

[End Confidential]

Potential for Cross-Subsidization – Given its current status as a separate affiliate, the risk that SJESP is being cross-subsidized by SJG is lower than it was in years past when the appliance service business was a non-regulated segment within the utility. Our analysis indicates that SJESP was charged for most of the services and assets provided to it by SJG and other affiliates, including:

- Payments made by SJG and SJI on its behalf for items such as employee benefits, outsourced vehicle maintenance services, cellular telephone service and corporate credit cards;
- Billing services provided by SJG;
- Administrative services, such as information technology and human resources, provided by SJIS; and
- SJES' share of corporate services, such as executive, corporate accounting and finance, and similar services, provided by SJI.

Although it was charged for most services, we noted that SJG failed to charge SJESP for its use of SJG's garages for vehicle maintenance and for the use of a room in an SJG building to store appliance service parts; however, we believe the amounts that would have been involved had SJESP been charged for these items on a fully-distributed cost basis would have been relatively small. We did not perform an in-depth analysis of the billing services provided by SJG to determine whether they were priced on a fully-

[50] Appliance Services Interview, September 24, 2012 with Michael Halter.
[51] Response to Discovery, OC-522.
[52] Ibid.
[53] Response to Discovery, OC-263.
[54] http://sjesp.homeserviceplans.com/catalog/cms.php?page_id=11.
[55] Response to Discovery, OC-440.

distributed cost basis. However, assuming that billing services were provided to SJESP at a price available to non-affiliates, it is unlikely they were significantly cross-subsidized by SJG. Aside from the relatively small examples above in which SJG failed to charge SJESP, we did not find significant costs shared by SJESP and other SJI affiliates that were not charged, either directly or through an allocation, to SJESP. We did not identify evidence of any significant cross-subsidization of SJESP services by SJI, SJG or any of their affiliates.

Competitive Advantages and Disadvantages of Utility Affiliation – Notwithstanding the lack of significant cross-subsidies, SJESP obtains a competitive benefit from its association with SJG. Even though the appliance service function does not reside within the utility, SJESP is able to use the same multi-colored flame logo that is used by the utility. The logo recognition by customers who are seeking appliance repair services is greater for SJESP than it would be for its competitors. The multi-colored flame logo also carries with it a level of trust and security that a large, stable corporation can provide. SJESP does not compensate the parent company for the use of the logo.

SJESP also benefits from SJI's size, which is associated primarily with SJG. SJG serves approximately 350,000 customers in Southern New Jersey.[56] SJESP customers are largely found within SJG's service territory and are a likely target for marketing campaigns conducted by HomeServe. The potential footprint of SJESP covers a large territory, thereby providing an opportunity to take advantage of certain economies of scale.

SJESP's affiliation with SJG could be a disadvantage in certain circumstances. For example, SJG's monopoly status or a negative customer experience with SJG could deter customers who need appliance services from contacting SJESP. However, given that SJI and SJG generally enjoy a good relationship with their customers and the general public, this is unlikely to be a major concern. As a subsidiary of SJI, SJESP incurs a share of certain corporate expenses, including executive salaries, shareholder and director expenses, legal and other costs that a stand-alone appliance service company might not incur. The addition of these costs to SJESP's operating expenses might constitute a "disadvantage;" however, the share of SJESP's cost that they represent is insignificant enough that they do not pose a concern, especially when offsets, such as the economies of scale provided by SJG, are considered.

Millennium Account Services, LLC (MAS)

MAS is a joint venture between SJES and Conectiv Solutions (a subsidiary of Pepco Holdings). Its business purpose is to read meters for utilities South Jersey Gas and Atlantic City Electric, which have overlapping territories and are also owned by SJI and Conectiv, respectively. Unlike the employees of other SJI affiliates, Millennium's employees, who are primarily meter readers, are not employees of SJI. MAS is managed through an executive committee consisting of two representatives from each of its owners, SJI and Conectiv Solutions. Executive committee representatives from SJI currently include Joseph Scheufele, AVP, Bus Dev-SJE (Non-Core), and David Robbins, Jr., Treasurer. Messrs. Sheufele and

[56] South Jersey Industries 10-K, 2011.

Robbins, Jr. are employed by South Jersey Energy Solutions, LLC (SJES).[57] The highest ranking employee and company officer is Joseph A. Scaffidi, Vice President.[58]

Overland audited MAS during the affiliate transactions and management audit of Atlantic City Electric that was issued in 2009. Most of the information in this chapter uses the information from that report and updates the information where appropriate.

Organization and Operations

As of August 2012 MAS had 88 employees, consisting of 78 direct service employees (presumably meter readers out in the field) and 10 support staff.[59] MAS has regional offices in Sewell (Gloucester County), Greenfield (Cape May County), Cardiff (Atlantic County) and Vineland (Cumberland County). MAS read 11.4 million meters in 2009, 11.6 million in 2010, and 11.7 million in 2011. In addition to providing meter reading services for electric and gas utilities, the website states that MAS's business experience includes:

- Mobile Advertising;
- Service Delivery;
- Customer Surveying;
- Meter Reading Consulting;
- Retrofitting Gas ERTs (Encoded Radio Transmitter);
- Reading of Water Meters; and
- Customer Meter Reading and Billing.

Furthermore, the website states that MAS is positioned to provide these services throughout the continental United States, though currently they only service a few counties in New Jersey.[60]

MAS Service Agreements

There have been several updates of the original Services Agreement between MAS, ACE and SJG since 1999. However, since the beginning of 2009, there have only been extensions to the agreement for each year. Since the beginning of 2009, the fee billed by MAS for reading a gas meter has gone from**[Begin Confidential]** **[End Confidential]** per meter for the 12 month period ending January 31, 2010 to**[Begin Confidential]** **[End Confidential]** for the 12 month period ending January 31, 2012. The terms of the extension that was to end on January 31, 2012 was extended on a month-to-month basis, while ACE and SJG conducted a competitive bid process for joint meter reading services.[61] The current Services Agreement calls for a minimum performance standard for meter reads of 98% for ACE (electric meters) and 95% for SJG (gas meters).[62]

[57] Response to Discovery, OC-5.
[58] Response to Discovery, OC-59-3.
[59] http://www.millenniumaccountservices.com/info2.htm Visited 12/3/12.
[60] Ibid.
[61] Response to Discovery, OC-448.
[62] Response to Discovery, OC-767.

__Contract Renewals and Competitive Bidding__ – Since joint meter reading between ACE and SJG was initiated in 1999, MAS has been the only company to perform the service. The income provided by MAS to its owners would be lost if another company provided the service; however, the costs to the utilities and their ratepayers could be lower. An audit report by Liberty Consulting, dated March 31, 2003, recommended that ACE and SJG solicit bids for meter reading services, and that the lowest-priced qualified bidder be selected to provide the service. ACE and SJG sent an RFP for meter reading services to five vendors in October, 2006. Only one vendor responded with a proposal, and the vendor was not selected. Three other vendors acknowledged the RFP, but declined to bid. Only one of the vendors had a presence in a nearby state.

In 2012, near the end of the most recent contract period, ACE and SJG sent out another RFP to provide joint meter reading service. ACE served as the lead for sending out the proposal and received the bids. This time, four companies (including MAS) provided initial responses with cost proposals to the RFP. The estimated annual meter costs from the four bidders ranged from **[Begin Confidential]** **[End Confidential]** It is unclear whether any RFPs were initiated between 2006 and 2012.

MAS's bid under the 2012 RFP was **[Begin Confidential]** **[End Confidential]**. The low bidder was Accu-Read, with a bid of**[Begin Confidential**] **[End Confidential]**. ACE and SJG asked Accu-Read to resubmit its bid, which ACE / SJG stated would be considered the "final" bid, but Accu-Read declined. SJG stated that the reason the company declined to resubmit was due to a concern that it had about potential unionization of its workforce. MAS also sent a second bid to ACE and SJG. MAS's second bid reflected a lower price-per-read (**[Begin Confidential]** **[End Confidential]** in the resubmission vs. **[Begin Confidential]** **[End Confidential]** in the initial bid) and showed estimated annual meter costs of **[Begin Confidential**] **[End Confidential]** below the initial low bid submitted by Accu-Read. However, the lower price bid was limited to the first three-years of the five-year contract. As a result of Accu-Read declining to submit a second bid, the new meter reading services contract, which became effective January 1, 2013, was awarded to MAS.[63] The table below summarizes the components of the Accu-Read and MAS bids.

[63] Response to Discovery, OC-573.

Table 2-20- MAS's 2012 Meter Reading Bids

[Begin Confidential]

MAS's 2012 Meter Reading Bids									
		Accu-Read		Millennium					
2012 Meter Read RFP Analyis: Summary of Bid Costing Using Latest 12 month Actual Usage - February 2011-January 2012		Original Bid		Scenario 1 (Original Bid)		Scenario 2 (Original Bid)		REBID	
	Usage	Rate	Dollars	Rate	Dollars	Rate	Dollars	Rate	Dollars

[End Confidential]

Overland believes MAS's ownership by the parent companies of its only two significant customers creates a conflict of interest to the extent that the owners' income streams and the very existence of their profitable joint venture are at stake. Under existing circumstances, it appears unlikely that a company other than MAS would ever be contracted to perform meter reading for ACE and SJG. The fact that MAS, which initially submitted a bid significantly higher than Accu-Read, was given a chance to revise its bid while Accu-Read was asked to resubmit its low initial bid appears to undermine the bidding process and suggests that conflict of interest may have prevented Accu-Read from being awarded the contract.[64]

Although Accu-Read did not receive the contract, assuming that adjustments or changes to MAS's lower resubmitted price do not occur, Accu-Read's bid may serve to reduce the cost of meter reading services for the first three years of the current five year contract.[65] The savings potential, absent potential post-award revisions to MAS's resubmitted bid price, could be as much as **[Begin Confidential] [End Confidential]** per year for ACE and SJG combined. The BPU should monitor the contract to ensure that MAS's *revised* bid pricing is maintained during the contract period and to ensure that the entire savings to SJG from the lower prices in years one through three are not reversed through price increases in contract years four and five.[66]

[64] Assuming there was no legitimate reason not to have accepted Accu-Read's bid, and assuming, as prior audits have recommended, that MAS was classified as an RCBS, it also appears to violate EDECA subsection 14:4-3.3(d)(2), which requires that services provided to a utility by an RCBS be subject to competitive bidding.

[65] Response to Discovery, OC-767.

[66] For example, in its second bid, MAS was compelled to lower its price-per-read by approximately 15 cents, from 71 cents to 56 cents. The BPU should monitor the contract to ensure that MAS does not "negotiate" to raise the price-per-read to 86 cents, or higher, in contract years four and five, to make up for the loss caused by having to re-bid at a lower price.

Summary of Financial Results

The following table summarizes MAS's financial results during the audit period.

Table 2-21 – Millennium Account Services, Summary-Level Income Statements

[Begin Confidential]

Millennium Account Services Summary-Level Income Statements Years 2009, 2010, 2011 ($000s)			
	2009	2010	2011

[End Confidential]

The table above shows consistent financial results across the 2009 to 2011 period. MAS's compelled match of Accu-Read's low initial bid for the contract beginning in 2013 may put some pressure on MAS's operating income over the next three years. During this period MAS distributed **[Begin Confidential]**

[End Confidential]

This approximates half of MAS's operating income during the period. No distributions were made to SJG.

Transactions with SJG

Charges from MAS to SJG – Charges consisted of meter reading services provided to SJG, as follows:

[67] Response to Discovery, OC-574.

Table 2-22 – Millennium Account Services, Affiliate Charges to SJG

[Begin Confidential]

Millennium Account Services			
Affiliate Charges to SJG			
	2009	**2010**	**2011**

[End Confidential]

Charges from SJG to MAS - The only significant charges from SJG to MAS during the audit period were billings for payments made to benefits providers (primarily health insurance and prescription drug plan) made by SJG on behalf of MAS employees, for which MAS reimbursed SJG.

Table 2-23 – Millennium Account Services, Charges from South Jersey Gas

Millennium Account Services			
Charges from South Jersey Gas			
Category	**2009**	**2010**	**2011**
Benefits	857,409	957,190	898,904
Other	6,745	3,859	72
Total	**864,154**	**961,050**	**898,976**
Source: OC-58			

MAS Compliance with EDECA Standards

It has been recommended in several audits that MAS be classified as an RCBS for the purpose of applying the EDECA affiliate rules. SJG has agreed with the recommendation, though MAS continues not to be listed as an RCBS in the most recent version of the SJG Compliance Plan. The following discussion summarizes the applicability of key EDECA areas to MAS and MAS's compliance with the rules in those areas.

1. Separation – MAS's accounting, physical assets and employees are effectively separated from SJG. Separation is sufficient to prevent the co-mingling of operations.
2. Transfer Pricing - EDECA section 14:4-3.5(t)(6) states that services provided to a New Jersey utility by an RCBS that are "not produced, purchased or developed for sale on the open market…shall be priced at the lower of fully allocated cost or fair market value." As discussed at length above, MAS's pricing was not in compliance with this EDECA transfer pricing requirement.
3. Management Separation - None of MAS's employees have duties connected with SJG. Oversight of MAS is provided by two executive committee members, Joseph Scheufele, AVP, Bus Dev-SJE (Non-Core), and David Robbins, Jr., Treasurer, neither of whom are employees of SJG. However,

as discussed above, the management of SJG and MAS are effectively linked through SJI, the holding company that owns 100% of SJG, and a 50% interest in MAS.

4. Access to SJG Information Systems - MAS indicated that it maintains its own accounting and operational information systems. It does not share customer information systems with SJG.[68] SJG stated that Millennium has limited access to the utility's customer information system. MAS is able to view the meter information screen in the utility's customer information system. MAS also has restricted access to update certain fields of data within the system that contain meter reading information.[69]

5. Marketing and Promotion - Overland's examination of MAS's operations led to the discovery of two separate agreements in 2011 where SJG was contracted to pay Millennium for placing utility advertising on the trucks used by Millennium while servicing their meter reading customers.[70] These agreements appear to be in violation of the EDECA Standard prohibiting joint marketing activities of a gas public utility and its PUHC's RCBS in Section 14:4-3.5(o)(2). However, these advertisements do not appear to have the intention of providing an unfair advantage to Millennium, or the utilities it serves, as the utilities are already effectively captive customers of Millennium and Millennium presently only conducts meter reading services for SJG and ACE. MAS does not provide advertising services to ACE.[71]

6. Transfer of Risk - The current Joint Meter Reading Services Agreement contains a provision for SJG to contribute to the "reasonable costs" claimed by MAS if the agreement is terminated for convenience.[72] Overland's interpretation is that this could permit MAS to charge SJG for shutdown costs should MAS cease operations within a contract period triggered, for example, by something like the implementation of automated meter reading. As discussed above under the Summary of Recommendations, we recommend this transfer of risk from MAS to SJG be eliminated from the Services Agreement. Should SJG claim that the agreement cannot be amended, we recommend that the NJBPU prohibit SJG from recording any such costs, should they be incurred, in "above-the-line" accounts (that is, in accounts that record expenses funded by SJG's ratepayers).

7. Charges for Utility Services Provided to MAS - Overland reviewed the financial statements of MAS and the affiliate charges from SJG and discovered that SJG initially pays for the employee benefits for Millennium.[73] There is a potential for cross-subsidization of Millennium's employee benefits by SJG, as the amount billed by SJG was lower than the expense recorded on Millennium's income statement during 2011.[74]

8. Employee and Asset Transfers - There were no employee or asset transfers between SJG and MAS during the audit period.

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[68] Response to Discovery, OC-577.
[69] Response to Discovery, OC-576.
[70] Response to Discovery, OC-453.
[71] Response to Discovery, OC-578.
[72] 2007 Millennium Joint Agreement and SOW 2007 and Response to Discovery, OC-767.
[73] Response to Discovery, OC-58.
[74] Response to Discovery, OC-58 and OC-450. For example, in Table 2-21 MAS has an employee benefits expense of $940K in 2011, while the 2011 SJG Charge Out spreadsheet shows a charge of approximately $899K to Millennium for employee benefits in 2011.

9. Market Impact – MAS exists only to serve the affiliated utilities of its two owners. In 2006, an attempt to issue an RFP to permit other meter reading companies to compete to provide the service to ACE and SJG yielded no proposals. ACE and SJG solicited competitive bids for meter reading services in 2012. The results of the solicitation were discussed above. Effectively, MAS provides a joint utility service to two utilities not connected with one-another by ownership. Its market impact does not extend beyond the meter reading function of the two utilities.

Compliance with EDECA Standards

In 2000, New Jersey implemented the Electric Discount and Energy Competition Act (EDECA). EDECA includes rules governing affiliate relations, competition, accounting and reporting for utilities that provide retail services in competitive markets. The rules regulate certain aspects of the relationship between New Jersey utilities and their affiliates that provide competitive non-regulated retail services (services to end users). EDECA was crafted to ensure that affiliates providing non-regulated retail products or services are not given cost, resource, or marketing advantages by virtue of their affiliation with the utility. More specifically, EDECA serves to ensure that non-regulated affiliates do not obtain an unfair advantage in New Jersey markets by selling at an artificially low price due to subsidy by the utility or its holding company; by gaining access to utility resources, such as customer lists, that are not available to competitors; or by creating an impression that what they sell are utility products or services, thereby trading on the utility's name and reputation.

South Jersey Gas maintains a Compliance Plan for the EDECA Standards.[75] The Compliance Plan has been reviewed and updated every three years with the most recent updates being in 2011, 2008 and 2005. Going forward, SJG plans to review the Compliance Plan every year and also throughout the year after significant changes to the Standards.[76] SJI provides education to its employees on affiliate standards and rules compliance by using memoranda, in-person training sessions, and web-based training sessions.[77]

"Affected Affiliates"

Affected affiliates are affiliates of SJG that SJI has determined provide competitive retail services in New Jersey, and are therefore subject to EDECA's Affiliate Standards. SJI calls their affected affiliates "related competitive business segments" (RCBSs), listing the following affiliates as RCBSs as they relate to South Jersey Gas Company:

- South Jersey Industries – SJI is an energy services holding company for utility and non-regulated businesses, which offers solutions to global warming through renewable energy, clean technology and efficiency. SJI had 45 employees as of 12/31/11.
- South Jersey Energy Company – SJE is a licensed, deregulated energy supplier for commercial, industrial, and residential customers. The Company acquires and markets natural gas and

[75] Response to Discovery, OC-59.
[76] Interview with Mr. Steven Cocchi, Director of Rates and Revenue Requirements, 9/27/12.
[77] Response to Discovery, OC-67.

electricity to retail end users and provides total energy management services to help commercial and industrial facilities to reduce their overall energy costs. SJE had 10 employees as of 12/31/11.

- South Jersey Energy Service Plus – SJESP is a non-regulated business that provides heating and air-conditioning installation and service as well as appliance repairs. SJESP had 55 employees as of 12/31/11. South Jersey Energy Service Plus Plumbing Service is a subsidiary of SJESP and is also treated as an RCBS, even though it is not listed as such in the December 2011 Compliance Plan.[78]
- South Jersey Resources Group – SJRG is a wholesale gas and risk management business, which supplies natural gas to retail marketers, utility businesses and electricity generators in the mid-Atlantic and southern regions of the country. SJRG had 16 employees as of 12/31/11.
- Marina Energy – Marina specializes in the design, construction and operation of moderate to large-scale energy projects for the commercial, industrial, and institutional markets.[79] Marina had 8 employees as of 12/31/11.
- Millennium Account Services, LLC – Millennium is a partnership between SJI and Conectiv Solutions, LLC. The affiliate reads SJG's utility customers' meters on a monthly basis for a fee. This affiliate was originally not considered to be an RCBS.[80] However, at the conclusion of the most recent management audit, SJI agreed to treat Millennium as an RCBS.[81]

SJG's Overall Compliance with EDECA

The four broad areas covered by the EDECA rules are: nondiscrimination, information disclosure, separation of resources, and provision of competitive products and services. Below is a general discussion of SJG's overall compliance with EDECA rules in these key areas.

- Nondiscrimination – EDECA requires that SJG refrain from discriminating against a competitor in favor of an affiliate. SJI has a detailed plan to communicate EDECA's nondiscrimination rules to the appropriate employees in the company. The methods of communication include handouts, memoranda, oral presentations, and training sessions.

The gas utility did award three projects to its affiliates during our audit period from 2009 to 2011. Overland analyzed these projects to ensure that the EDECA standards of non-discrimination were not violated in any of the project agreements. The three projects are discussed briefly below:

1. Solar Panel Installation (SJG Corporate Office) – The utility sent out an RFP to six companies, including its affiliate, SJES. Three companies submitted proposals including SJES. The utility chose SJES based on the fact that its technical specifications for its solar panels were better than the other two companies in three key areas. Furthermore, a review was conducted by

[78] Response to Discovery, OC-423.
[79] 2011 SJI 10-K.
[80] Ibid.
[81] Response to Discovery, OC-422.

the SJG Compliance Officer prior to final approval.[82] This project appears to be in compliance with the EDECA standards.

While the project appears to be in compliance with EDECA standards, it does not appear to benefit the ratepayers of the utility. SJES used their subsidiary Marina Energy LLC to install and maintain the project. Marina maintained ownership of the solar panels along with the income tax credits for installation and the Solar Renewable Energy Credits (SRECs) associated with the power produced from them. Marina paid the utility a rental fee for the space used by the solar panels. Marina also sold the energy produced from the solar panels to the utility at $.06/kWh in 2010, which is a significant discount from fair market value. Overland reviewed the revenues and expenses from the project and found that Marina had earned a net income of approximately **[Begin Confidential**] **[End Confidential]**million during the audit period (2009-2011)[83] by taking advantage of the income tax credits for the solar installation as well as the SRECs. Setting aside the cost of installing the solar panels, this project could have benefitted the utility ratepayers more if the utility had ownership of the solar panels as well as the tax credits and SRECs associated with them. The gas company chose to allow Marina Energy to have ownership of the panel for several reasons:

- SJG is not exposed to the volatility of the SREC market.
- SJG has reduced exposure to the retail electric market through the discounted price it pays for solar energy to Marina.
- SJG is not responsible for the administrative burden of tracking and trading SRECs and operating and maintaining the solar panels and auxiliary equipment.[84]

2. Cooling Tower Replacement (SJG Corporate Office) – The utility received a response from its RFP for this project from three companies. The utility chose its affiliate, SJES, due to the affiliate providing additional products and services that were deemed important in replacing the cooling tower.[85] This project appears to be in compliance with the EDECA standards.
3. Chiller Replacement (SJG Corporate Office) – The utility did not competitively bid this project. It only received and accepted a proposal from SJES. SJG claims that, due to a compressed time frame in which the project needed to be implemented as well as the complexity involved in this installation, using an outside vendor was not feasible.[86] For this project, SJG appears to give SJES preference over non-affiliated companies (based on a timing issue) that is explicitly prohibited in the EDECA Standard 14:4-3.3(d)(2).

   Overland also believes that this transaction between SJG and SJES is in violation of EDECA Standard 14:4-3.5(t)(2) which states, "Transfers from a related competitive business segment of the public utility holding company to the electric and/or gas public utility of

[82] Response to Discovery, OC-430.
[83] Response to Discovery, OC-504.
[84] Response to Discovery, OC-430.
[85] Ibid.
[86] Ibid.

services produced, purchased or developed for sale on the open market by the related competitive business segment of the public utility holding company shall be priced at no more than fair market value." SJES does provide energy services to the open market and the chiller replacement project would fall under services that are similar to what SJES would typically provide. Overland found that the amount that was proposed to SJG by SJES and its subcontractors to provide the product and services related to the chiller replacement would be $490,100.[87] However, when Overland reviewed SJI's intercompany billings, Overland found that SJES billed SJG the following amounts for the Chiller Replacement Project:

Table 2-24 – Chiller Replacement Project Billings

Chiller Replacement Project Billings	
Date	Amount
December 2010	$74,380.00
January 2011	9,025.00
June 2011	490,100.00
August 2011	40,449.20
Total	$613,954.20
Source: Response to Discovery, OC-57.	

It appears that the utility was billed for an amount that was greater than the proposed price (fair market value) of the products and services associated with the installation of the chiller, which would be a violation of EDECA Standard 14:4-3.5(t)(2).

- Information Disclosure - EDECA restricts the conditions under which a utility can provide customer or non-customer, non-public information to affiliates subject to EDECA. Generally, customer information can only be provided with the customer's consent. Also, generally, non-customer, non-public information cannot be made available unless it is made public (i.e., made available to non-affiliates under the same conditions made available to the affiliate). SJG's Compliance Plan discusses the conditions under which SJG's affected affiliates may obtain information from the utility. These appear to be in compliance with EDECA.
- South Jersey Gas has procedures in place to ensure that supplier lists are updated on a timely basis. The utility also includes practical examples of information that can be disclosed to customers regarding the utility affiliates that does not discriminate against the affiliate's competitors.
- Separation of Resources – All SJI subsidiaries, including SJG, and all affiliates that maintained a business relationship with SJG, maintained books separate from SJG (and each other) during the audit period. The SJI CFO and SJG VP & COO verified that SJG is not utilizing joint corporate services to circumvent the affiliate standards regulations described in Section 14:4-3.5(j).[88] Furthermore, the Corporate Counsel and Secretary verified that SJG is not utilizing shared officers and directors in violation of the affiliate standards regulations described in Section 14:4-

[87] Response to Discovery, OC-430.
[88] Response to Discovery, OC-59, part 3 of 3 2011 SJG Compliance Plan, December 2011, page 91.

3.5(q)(2)(i).[89] Overland verified that the Board of Directors and Executive Officers for the utility and its competitive affiliates do not currently contain the same individuals.[90] Management responsibility for SJG resides within the utility and is effectively separated from non-utility operations. Overland also obtained a list of employee transfers from 2009 to 2011[91] and determined that the transfers were conducted in accordance with EDECA Standards 14:4-3.5(r)(2)-(4).

- Overland requested the direct mail and advertising brochures used by SJG from 2009 to 2011. None of the material revealed any advertising associated with any of the affected affiliates listed above.[92] We also requested the marketing and advertising plans for the affected affiliates mentioned above for 2009-2011 and found that none of the marketing and advertising materials included the utility.[93]
- Competitive Products and/or Services – During the time period of this audit, there were no competitive services offered by South Jersey Gas.[94] All competitive products and services are provided through non-utility SJI affiliates.

The New Jersey BPU received three separate letters from an independent contractor in New Jersey notifying the BPU of potential violations of the EDECA Standards. The contractor pointed out the following circumstances that could be in violation of the Standards.

1. The contractor asserted that Michael J. Renna holds numerous officer positions with the gas utility and its non-regulated affiliates, which would be a violation of EDECA Section 14:4-3.5(q). Overland has reviewed the organization chart provided by SJG in the response to data request OC-5 as well as the documentation that the contractor attached to his letter containing the company's officer profile for Michael Renna. Overland found no instance where Mr. Renna was employed during our audit period as an executive officer of SJG.
2. The contractor asked the BPU to ensure that the agreement between SJESP and HomeServe had received all of the required BPU approvals. Overland discussed the contracts with the NJBPU and the NJBPU stated that they did not review the contract agreements between SJESP, SJG and HomeServe. In addition, the NJBPU did not indicate whether any approvals were required for the agreement between the aforementioned parties.[95]
3. The contractor also expressed a concern regarding HVAC Licensing Laws in New Jersey. He wanted gas utilities to be prohibited from being able to perform services on the customer side of the gas meter. The HVAC Licensing Laws are outside the scope of our audit, but the letter provides insight into the perceived competitive advantage held by a utility in providing HVAC and appliance services. These perceived advantages are discussed in more detail in the Appliance Services section of this Chapter.

[89] Response to Discovery, OC-5, 9 part 3 of 3 2011 SJG Compliance Plan, December 2011, page 92.
[90] Overland reached this conclusion after reviewing the response to OC-14 UPDATE.
[91] Response to Discovery, OC-9.
[92] Response to Discovery, OC-70.
[93] Response to Discovery, OC-61.
[94] Response to Discovery, OC-121.
[95] Based on email correspondence with the NJBPU, April and May 2013.

Prior Audit Recommendations

In May 2005, Liberty Consulting submitted its Focused Audit of Affiliated Transactions and Management Audit of the South Jersey Gas Company to the New Jersey BPU (Docket No. AX04040277). Liberty proposed a total of 136 recommendations. SJG agreed to take action to implement 118 of the recommendations, accepted 15 recommendations with some level of qualification, and respectfully disagreed with three of the recommendations.[96]

Overland reviewed the status of SJG's implementation of the recommendations made in the prior audit as reported by the company. We focused on the recommendations that are still relevant to this report and those recommendations that SJG respectfully disagreed with.

- Prior audit recommendations - Gas Supply. There were 39 recommendations related to gas supply. SJG claimed to have implemented all of them, with only three modifications. The modifications are explained below.
  - GS-20 recommended that SJG establish a mechanism for making marketer assets available to continue serving customers upon market exit or bankruptcy. SJG feels that this is a broad recommendation that should be considered by all gas marketers and the BPU. Its implementation would not solely affect SJG.
  - GS-22 recommended that SJG develop procedures and ground rules for negotiating flex-rate contracts. SJG agreed with the concept of the recommendation. However, it thought the recommendation unnecessary to implement as each flex-rate contract has different circumstances, and it would be difficult to apply general procedures and ground rules to those types of contracts.
  - GS-38 recommended that SJG re-evaluate and re-formulate marketing goals for interruptible service customers. SJG agreed with the intent of the recommendation and developed a mix of programs to provide these customers with the best service under the tariff that meets their needs.
- Prior audit recommendations - Cost Allocations and Affiliate Relations Audit Recommendations. There were 12 recommendations concerning cost allocations and affiliate transactions. Most of the recommendations were proposed to improve the methods of assigning costs to affiliates receiving the benefits of these costs. There were specific recommendations for SJG to improve their methods for allocating tax benefits from the ESOP and 401(k) plans, use a competitive bidding process to determine the provider of meter shop services, simplify and improve billing of common services, assure proper identification of the use and cost responsibility for the Lawson information system, and simplify the collection and reporting of inter-company charging.[97] The creation of SJIS in January 2006 helped to implement many of these recommendations.

[96] Response to Discovery, OC-146.
[97] Ibid.

There were no recommendations in this area that SJG disagreed with. However, there were three recommendations where SJG suggested clarifications and/or exceptions to the proposed actions to be taken for implementation.

- CA-4 recommended that tax benefits from SJI's ESOP and 401(k) Plan be distributed in a way that reflects which entities cause the benefit and by how much and that SJG should revise their 2004 financial statements. Although SJI agreed to implement the recommendation, it elected not to revise the 2004 financial statements.
- CA-8 recommended that SJG not enter into relationships with affiliates where they would provide utility services to SJG. SJG believes that this relationship could take place with approval of the NJBPU.
- CA-12 recommended that a full-time employee be assigned the tasks of assuring that costs distributions among SJG affiliates are performed in a timely manner. SJG believes that general management and system oversight is a more efficient way of implementing this recommendation.[98]

- Prior audit recommendations - EDECA Affiliate Standards. There were 35 recommendations related to EDECA Standards.[99] Most involved proposed changes to the SJG Compliance Plan. The changes also included an improvement in training and communicating the affiliate standards to various employee groups within SJI. Overland reviewed the Compliance Plan to determine whether the recommendations that were made in the Liberty Report were incorporated into the most recent Compliance Plan. Overland found that the recommendation were generally incorporated with the following exceptions:
  - ED-14 stated that the Compliance Plan should be changed to require the involvement of the rates and regulatory affairs department in customer assignments. Overland did not see where this was addressed in the most recent version of the SJG Compliance Plan.
  - ED-25 stated that a disclaimer that is required in Section 14:4-5.5(k) of the EDECA Standards should be on the opening page of the website of each RCBS affiliated with SJG. Overland reviewed the home pages of the websites that are listed as RCBS in SJG's Compliance Plan and found no disclaimer on SJESP's home page.[100]

  SJG also disagreed with two of the recommendations in this area. The recommendations they disagreed with and their reasons why are described below.

  - ED-1 recommended that SJG treat SJE energy services, HVAC installations by SJESP, energy product development and plant management operation by Marina, meter reading services by MAS, and air monitoring services by AirLogics as SJI RCBSs. SJG has in the past consistently objected to the inclusion of Millennium and AirLogics as RCBSs, as SJG believes the definition of RCBS in the EDECA Standards does not apply to these two entities. Furthermore, SJG argues that Marina neither sells retail services nor falls under the EDECA definition of a competitive product/service. SJG believes so strongly that Marina is not an RCBS that they had officers that served both the utility and

[98] Ibid.
[99] Response to Discovery, OC-146 SJG Audit Completion Reports – ED section.
[100] Overland's most recent visit to the website was on 4/12/13.

Marina.[101] If Marina were considered to be an RCBS, this would be in violation of the EDECA Standard 14:4-3.5(q) which prohibits sharing of officers between regulated affiliates and those affiliates considered RCBSs. Overland believes that Marina does provide some retail services to its customers. The largest Marina project to-date is the power it provides to the Borgata Hotel-Casino in Atlantic City. The hotel-casino is not reselling the power provided by Marina and therefore Marina's power supply to the hotel must be considered "retail" in nature. The NJBPU should not exempt SJI from the EDECA Standard 14:4-3.5(q) as it pertains to sharing of officers between the utility and Marina because Marina falls into the definition set forth in the EDECA Standards of a RCBS. Currently, no SJI or SJG officers are shared with Marina.[102]

  - ED-2 recommended that SJG stop determining that retail activities are permissible because the BPU has not specifically declared them to be "competitive". SJG believes that certain operations and activities are outside of the scope of Affiliate Standards. The BPU should hold SJG to the standards, and specifically the definitions of "competitive services" and "retail services", set forth in the EDECA Standards.

- <u>Prior audit recommendations - Management and Operations Audit Recommendations.</u> There were 50 recommendations concerning management and operations. The recommendations in this section covered a wide range of topics including: the Board of Directors, strategic planning, finance, information systems, accounting, customer service, and gas operations. SJG agreed to implement all of the recommendations, except one. The recommendation SJG respectfully disagreed with is described below.
  - ➢ MO-7 recommended that SJG adopt a lower threshold for the level of business dealings that may be permitted with enterprises that Board members are associated with, on the one hand, and SJI entities, on the other hand. SJG believes that the independence standards set by the NYSE are appropriate for establishing thresholds regarding transactions between directors and the Company.[103]

  The Company also suggested nine clarifications and/or exceptions to these recommendations. Those that remain relevant during this audit period are briefly summarized below.
  - MO-2 – SJG agrees, in principle, that the Governance Committee should not be required to take counsel from inside directors in recommending committee chairs to the full Board. However, SJG believes that the Chairman and CEO should be a part of the selection process of committee chairs.
  - MO-12 – SJG agrees with the recommendation to have formal contingency planning, but believes that a 12 to 18 month rolling-forward forecasts is an unnecessary administrative burden.
  - MO-37 - SJG agreed that addressing backlogs deserve attention; however, the Company did not believe simply increasing the workforce was the best solution. The Company

[101] Response to Discovery, OC-146 Audit AX04040277 Response – 1 08-02-2005 pdf.
[102] Overland reviewed the SJI officer duties in the response to OC-49 and the SJE management webpage.
[103] Ibid.

also disagreed that there were any difficulties complying with federal and state regulations during the prior audit period.

- MO-38 – SJG agreed that developing leak repair timeframes to promptly repair "B" leaks is important. However, the Company believes the leaks should be repaired within the timeframe allowed by the System Operations risk management tools and analysis of the "B" leak backlog.
- MO-43 – SJG agreed that SJG customers should not receive a lower level of customer service than SJESP. SJG noted that SJESP customers have a longer wait time than SJG customers. The Company was working to improve overall response times for both SJESP and SJG customers.
- MO-44 – SJG agreed that the Company should continue to research customer [complaints] to better understand customer expectations and perceptions. However, SJG pointed out that it had reduced customer complaints during 2004 and 2005.
- MO-45 – SJG agreed that the AVP of HR should have a role in the administration of executive compensation; however, the Company believes the administration of executive compensation should remain at the executive level.

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3. South Jersey Industries Cost Distributions

This Chapter covers SJI's parent company organization, its costs and cost distributions to subsidiaries, and in particular, distributions to SJG. It covers the following subjects:

- Parent company organizational structure;
- Services provided to SJG and other subsidiaries;
- Functional Analysis of costs incurred by the parent company organization;
- SJI total charges to SJG; and
- SJI's Management Services Fee (MSF) and its allocation among subsidiaries.

Summary of Findings

1. SJI, through its parent organization, effectively acts as a second service company, providing primarily corporate-type services to SJG and other subsidiaries. Among the functions performed during the 2009-2011 review period were strategic and financial planning, shareholder services, treasury and cash management, internal auditing, legal and executive management, corporate accounting and risk management, investor relations, insurance and environmental affairs. During this time the parent also had cost responsibility for corporate directors' fees and expenses, corporate bank interest, corporate-level consulting and audit fees, certain employee benefit costs, corporate charitable contributions and certain public and media relations costs incurred from external service providers.
2. The parent organization grew by more than 50% between the end of 2008 and the middle of 2012, from 31 employees to 47 employees. The Environmental Affairs function was moved to the parent in 2010, the Insurance function[1] was moved in 2011 and the tax function was moved to the parent in 2012. The number of employees in most of the parent company's other functions also increased between 2008 and 2012.
3. The parent organization's incurred costs (the functional costs for which it has budget responsibility) grew from $11.6 million in 2009 to $13.4 million in 2010 and to $20.5 million in 2011. Although some of the increase was due to growth in the employee organization, a fairly significant portion of the increase between 2010 and 2011 reflected an increase in net intercompany and bank interest expense.
4. In addition to the costs incurred by the parent organization, SJI makes payments of various costs incurred by its subsidiaries on their behalf. It then bills subsidiaries for reimbursement of these payments. For example, in 2009, SJI billed SJG for an $8.2 million pension contribution payment that SJI made on behalf of SJG. SJI also makes payments on behalf of subsidiaries and obtains reimbursement through affiliate billings for affiliate bank fees, insurance, contributions to employee 401K accounts and various other subsidiary costs.

[1] Organizationally, Insurance is part of the Risk Management department.

5. SJI does not have a reporting process that can effectively summarize the costs it incurs and distributes to its subsidiaries by function (cost center or department), cost type and cost distribution methodology.
6. According to SJI's Cost Allocation Manual, nearly all costs incurred by the parent company organization are either directly charged to subsidiaries or allocated to subsidiaries through the Management Service Fee, which distributes costs through a size-based three-factor formula. One exception appears to be bank fees, which the CAM indicates are distributed "based on bank accounts." Parent company cost distribution methodologies differ from those used by SJI Services, SJI's other service company. For example, SJIS does not use a three-factor formula to distribute its costs.
7. A significant percentage of the costs incurred by the parent company organization are classified as part of the Management Service Fee (MSF) and are distributed using an "unattributable" three factor formula. The formula is based on three arbitrarily selected measures of corporate size: assets, "margin" and payroll.[2] During the years 2009-2011, roughly 75% of costs distributed through the MSF were allocated to SJG. Calculating the three-factor formula involves a number of steps and assumptions.
8. The three-factor formula is based on relative measures of subsidiary size taken from the accounting system and financial reports. During the review period over three-fourths of MSF costs distributed using the three-factor formula were allocated to SJG. SJI makes various assumptions and adjustments in calculating the formula that affect the percentages distributed between SJG and its non-regulated affiliates. It is not obvious that all of these are theoretically justified. For example, in calculating the "margin" component of the formula, adjustments were made to GAAP revenues for certain non-regulated affiliates. The adjustments and various assumptions on which the three-factor formula is based are not described or explained in the Company's Cost Allocation Manual.
9. Review of the spreadsheets supporting the calculation of the three factor formula used to distribute MSF costs revealed two calculation problems. 1) In calculating the "margin" component of the three factor allocator, in 2009 the company lowered the revenue figures included in the calculation for non-regulated affiliates SJE and SJRG by reflecting them on an "after tax" basis (presumably, by subtracting taxes from the revenues). SJG's revenues input into the same 2009 calculation were reflected on a higher, and more commonly used "pre-tax" basis.[3] We do not have sufficient data to calculate the impact of this on SJG's 2009 share of margin, but it appears that increasing SJRG's revenue to a "pre-tax" amount would have increased its margin and reduced SJG's share of the margin component of the allocator by at least five percent, meaning it would have reduced SJG's 2009 MSF allocation by $100,000 or more. 2) In calculating the payroll component of the three factor formula during the review period (2009 through 2011), the Company began with payroll from the entities that wrote employee paychecks. It then reflected intercompany payroll charges and allocations, so that the payroll was weighted according to the entities to which it was charged, rather than the entities from which it was paid. In so doing, the company redistributed the majority

[2] SJI's MSF formula is a variation on the "Massachusetts Formula," an allocator approved by the FERC to allocate costs among subsidiaries based on gross plant, gross revenue and "labor."

[3] Response to Discovery, OC-490-B. In 2010, and continuing in 2011, the company changed the margin calculation to consistently reflect revenues for all affiliates, including SJE and SJRG, on the more commonly used "pre-tax" basis.

of an amount of payroll from non-regulated holding company South Jersey Energy Services (SJES) to SJG's factor percentage. The calculation should have worked such that the percentage initially charged to SJES (representing payroll for employees in the non-regulated affiliates owned by SJES) was redistributed only to the operating companies under the SJES umbrella. None of it, and certainly not a majority, should have been redistributed to the gas utility's percentage share of the payroll component. The result of this error was an overstatement of SJG's share of the three-factor formula's payroll component of approximately three percent for each of the three audit period years. Since the payroll component is weighted at one-third of the allocator, SJG's three factor formula percentage was overstated by approximately one percent (one-third of three percent). Holding all other calculation steps constant, this resulted in an overstatement of SJG's MSF allocation averaging approximately $100,000 annually for the three year review period.

10. Among the costs distributed through the MSF are corporate donations to civic and charitable organizations. Approximately 75% of these costs were distributed to SJG, which yields a corporate contributions distribution to SJG of approximately $1.1 million during the years 2009 through 2011. SJG recorded the costs "above the line" in account 923 – Outside Services Expense. Corporate contributions are normally not funded by regulated utility customers, and are properly recorded on the utility's books "below-the-line" in FERC USOA Account 426.1 – Donations Expense.

Recommendations

1. SJI should immediately develop the reporting capability to show how costs incurred in the parent organization are incurred, by function (department) and cost type, how functional costs are directly charged and to what subsidiaries, which of the functional costs are pooled for allocation and how allocable costs by function are distributed to each subsidiary. The current reporting process does not provide an audit trail from costs incurred by function to the ultimate affiliates to which such costs are directly charged or allocated. Parent company cost allocation reporting should permit the identification, for each SJI function and major cost type (e.g. loaded payroll, outside services, etc.), of the costs that are directly charged to each subsidiary, and the costs that are allocated to subsidiaries through the MSF allocator. The applicable MSF allocation percentages and amounts allocated to each subsidiary should also be identified.
2. SJI should update and improve its Cost Allocation Manual to provide a complete description of the various steps involved in calculating the three-factor formula which is used to distribute a majority of the costs it incurs. A majority of the costs SJI incurs within the parent organization are allocated to subsidiaries through the Management Service Fee (MSF) using the three-factor formula. During the years 2009 through 2011, the three factor allocator distributed an average of more than $10 million annually, more than three-fourths of which was allocated to SJG. Calculating the individual components of the formula requires multiple steps and involves assumptions, none of which are explained or justified in the CAM. SJI's CAM should be enhanced to include a full description of the steps and assumptions used to calculate the three-factor formula, including the basis for changing the amounts for assets, revenues, cost of service or payroll data as found in consolidating financial data or the books of individual subsidiaries. Any changes in the calculation, such as the change that occurred between the 2009 and 2010 allocation years in the way SJRG's and SJE's revenues were

treated (pre-tax vs. after tax), should be separately highlighted in a section entitled “changes in calculation methods or assumptions from the prior year.”

3. SJI should correct the template used to calculate the payroll component of the three-factor formula to prevent assigning payroll from unregulated holding company South Jersey Energy Services to the payroll component factor used to distribute costs to SJG. As explained in findings above, in calculating the payroll component of the three-factor formula, the calculation works such that a majority of payroll percentage from SJES that remains unassigned after amounts are “allocated out” is added to SJG’s share of the formula’s payroll component factor. SJES’ payroll is not attributable to SJG, and therefore should not serve to increase SJG’s share of the three-factor allocator’s payroll component. SJI should correct this error in its three-factor formula worksheet template.

SJI’s Parent Company Organization

Although SJI has a service company, many of the costs common to SJG and its affiliates are incurred by and charged from SJI, the parent company. Currently, SJI is approximately equivalent to SJIS in terms of employees and activity levels. Most of the departments maintained in SJI perform corporate functions typically found either in a utility’s parent company or its service company.

Table 3-1 – South Jersey Industries Parent Organization - Employees By Department

South Jersey Industries Employees By Department					
Department	**Dec-08**	**Dec-09**	**Dec-10**	**Dec-11**	**Aug-12**
ACCOUNTING - SJE SOLUTIONS	2	2	1	1	
CASH MANAGEMENT	3	3	4	5	5
ENVIROMENTAL AFFAIRS			2	3	3
EXECUTIVE / LEGAL	9	8	10	12	12
FINANCIAL PLANNING	8	8	6	9	9
INTERNAL AUDITING	5	5	6	6	7
RISK MANAGEMENT	2	1	6	8	7
SHAREHOLDER RECORDS	2	2	1	1	1
TAX DEPARTMENT					3
Total	**31**	**29**	**36**	**45**	**47**
Source: OC-5					

Services Provided to SJG

Functions maintained in SJI include Cash Management, Environmental Affairs, Corporate Executive, Financial and Strategic Planning, Internal Audit, Legal, Risk Management, Corporate Accounting and Shareholder Services. SJI added the Tax function in 2012. Generally, SJI separates its functional costs into separate cost centers. In addition to functional costs, SJI maintains a General and Corporate center which houses many of the non-departmental costs associated with the corporation as a whole. The following discussion describes SJI's functions and the costs they incurred during the 2009-2011 review period.[4]

The table below summarizes, by function, the portion of costs incurred in SJI cost centers distributed through the Management Service Fee's (MSF's) three-factor allocator. For the General and Corporate cost center only, it also includes amounts distributed to SJES' non-regulated subsidiaries through the "SJES Management Service Fee."[5] It does not include SJI costs that were directly charged to specific subsidiaries.[6]

Table 3-2 - Parent Company Costs Allocable to Subsidiaries Through the Management Service Fee

South Jersey Industries Parent Organization Costs Allocated to Subsidiaries Through the SJI Management Service Fee / Three-Factor Formula				
Cost Center		2009	2010	2011
30-3001	General and Corporate	3,495,100	3,503,300	2,753,500
30-3003	Strategic Planning	742,700	749,100	794,000
30-3004	Shareholder Records	247,600	352,600	323,000
30-3005	Treasury	260,600	304,400	424,900
30-3006	Internal Audit	481,000	486,800	687,900
30-3007	Risk Mgt.& Accounting	308,800	391,600	493,300
30-3008	Diversity	114,500	3,000	1,300
30-3009	Officers	2,984,700	3,536,900	4,028,000
30-3010	Public Relations	185,800	161,000	230,100
30-3011	Govt Relations	448,000	488,000	512,600
30-3012	Investor Relations	153,100	135,500	172,400
30-3013	Legal	-	393,800	698,600
30-3014	Insurance	-	-	271,300
30-3016	Environmental	-	-	288,400
Totals		9,421,900	10,506,000	11,679,300
Source: OC-341				

[4] Response to Discovery, OC-341, which requested, in part: For the years 2009, 2010 and 2011, please provide, in electronic (MS Excel) format, the accounting data which contains total (pre-billed, pre-allocated) SJI parent company costs, by type. . . and by SJI function / cost center. . ."

[5] General and Corporate amounts charged only to the unregulated SJES companies include net intercompany interest expense, bank interest expense and bank fees. According to data provided in response to discovery OC-754-A, these costs totaled $815,300, $800,200 and $1,437,900 in 2009, 2010 and 2011, respectively.

[6] Overland made several attempts through discovery to obtain a complete set of costs incurred by function (i.e. department or cost center) and by cost type, along with information showing how such costs were categorized for distribution (amounts directly charged vs. amounts allocated), and how much was distributed to each subsidiary using each method. The data we were ultimately able to obtain at the functional level was limited to costs distributed through the MSF's three-factor formula. Data showing all parent company costs (directly charged and allocated) on a functional (departmental) basis were not available. Subsequent to reviewing our draft report, SJI provided a flowchart demonstrating, for the example year 2011, how directly charged parent company labor and benefit costs tie in with costs allocated through the MSF and how directly charged amounts charged to SJG (shown in Table 3-18) tie in with total directly charged labor and benefits costs (shown in Table 3-3 below as Salaries, Payroll Taxes and Benefits "Allocated Out"). We do not have significant concerns about the integrity of parent company cost flows to subsidiaries in total; however, as discussed elsewhere in this chapter, the process through which such cost flows are reported can and should be improved to permit a proper evaluation of the costs directly charged and allocated to subsidiaries by SJI's individual parent company functions.

Functional Analysis of SJI Management Service Fee Costs

The following discussion describes the key responsibilities and activities conducted in the parent organization by each SJI function (department). The costs shown in the tables that accompany the discussion are limited to costs distributed through the SJI Management Service Fee (for all cost centers) or costs distributed to non-regulated affiliates through the SJES Management Service Fee (for the General and Corporate cost center only). Overland was not able to obtain functional (cost center) data for the parent organization that also included the costs directly charged to subsidiaries, and so, directly charged costs are not included in these tables.

General and Corporate

Costs in SJI's General and Corporate cost center accounted for more than half of the costs recorded by the parent entity during the review period. General and Corporate costs, which are not directly aligned with specific parent company departments, consist primarily of the following:

- Intercompany interest income earned by SJI on borrowings from affiliates, associated primarily with Marina Energy.[7]
- Interest paid to banks by SJI on short-term and long-term debt, associated with non-regulated holding company SJES and its subsidiaries.[8]
- Allocations of cost, primarily loaded labor expenses, to SJI from other affiliates, including the utility, the service company and South Jersey Energy Solutions.[9]
- Bank fees on long and short-term debt and revolving credit agreements (associated primarily with non-regulated affiliates),[10]
- Employee Benefits costs,
- Directors fees and expenses,
- Professional services "not broken out as separate accounts" (not identified with departments), including "recruiting fees, licensing fees, software fees, PCAOB/SEC fees and other miscellaneous administrative expenses."[11]
- Income Taxes.

The table below summarizes SJI's General and Corporate costs during the review period. The line "Salaries and Payroll Taxes Allocated Out" appears to reflect amounts applied to labor and charged out by SJI employees from various SJI functions in cost centers 3002 through 3016, discussed below. To show total costs incurred prior to any distribution to affiliates, we have added them back to obtain the pre-allocated total for cost center 3001. General and Corporate Costs increased substantially in 2011, due primarily to an increase in intercompany and bank interest expense.

[7] Response to discovery, OC-754-E.
[8] Response to discovery, OC-754-F.
[9] Response to discovery, OC-754-D.
[10] Response to discovery, OC-754-C.
[11] Response to discovery, OC-754-B.

Table 3-3 - Cost Center 3001 – General and Corporate Costs

South Jersey Industries Cost Center 3001 - General and Corporate Costs Amounts Distributed Through SJES and SJI Management Service Fees			
Description	2009	2010	2011
Employee Benefits	1,405,500	1,408,500	1,717,500
Employee Benefits Allocated Out	(497,000)	(493,300)	(833,200)
Directors Fees and Expenses	620,400	740,800	830,600
Payroll Charged to SJI from Affiliates (SJG, SJES & SJIS)	1,257,800	1,620,300	1,931,100
Salaries and Payroll Tax Expenses	119,200	31,500	17,900
Salaries & Payroll Taxes Allocated Out	(1,436,100)	(1,362,000)	(1,960,100)
Insurance Expenses	95,300	106,900	117,900
Interest Income Assoc. Co.	(353,600)	(694,400)	(2,148,400)
Interest Expense - Assoc Co	158,800	290,600	1,020,200
Interest Expense - Banks	640,200	934,400	1,621,300
Bank Fees	436,300	440,200	958,300
Consulting Fees	333,700	85,100	84,300
Audit Expense	144,800	100,300	140,600
Other Professional Services	193,000	271,500	456,600
Legal Expense	212,200	100	1,800
Depreciation Expense	135,500	143,400	160,000
Other Interest Deductions	(23,200)	(131,900)	6,300
Taxes (FIT & CBT)	42,000	43,000	(3,800)
Other Income and Expense, Net	512,700	803,500	72,300
Total	4,311,300	4,303,400	4,191,400
Subtract Amounts Assigned to SJES	815,300	800,100	1,437,900
Amts Distributed Thru SJI's Mgt. Service Fee	3,496,000	3,503,300	2,753,500
MSF Cost Distribution per OC-754			
South Jersey Gas	2,700,300	2,643,600	2,050,300
SJ Energy Services Plus	229,300	225,600	168,000
South Jersey Energy	109,400	111,400	87,300
South Jersey Resources Group	215,700	286,600	282,500
Marina Energy	241,200	236,100	165,500
Totals	3,495,900	3,503,300	2,753,600
Sources: Response to Discovery, OC-341 & OC-754			

Strategic and Financial Planning

The Strategic Planning cost center is aligned with SJI's Financial Planning department. The Financial Planning department is headed by a Director, Strategic and Financial Planning, who reports to the Vice President, Research and Corporate Development. During the review period the department had an average of 9 employees, including, in addition to the Director, a Manager, Financial Planning, several Financial / Budget Analysts and a Business Consultant.

As reflected in the job description of the department's employees, the Financial Planning department has the following key responsibilities:

- Translating corporate strategy into financial and operational objectives through the balanced scorecard process, and developing and maintaining internal performance metrics and benchmarks;

- Coordinating the annual planning process and preparing reports for senior executives and the board of directors;
- Developing and maintaining the status of new revenue generating initiatives;
- Monitoring industry trends and analyzing strategic market opportunities;
- Economic analysis and due diligence for potential acquisitions;
- Corporate budgeting and financial analysis; and
- Financial forecasting and capital allocation analysis.

The Strategic Planning cost center consists primarily of the salaries and salary-related costs of Financial Planning department employees. The costs shown below are limited to costs distributed through the Management Service Fee using the three-factor formula. Directly charged Strategic Planning costs are not included.

Table 3-4 - Dept. 30-3003 – Strategic Planning

South Jersey Industries Cost Center-3003 - Strategic Planning Mgt. Service Fee / Three-Factor Formula Cost Distributions			
Description	2009	2010	2011
Other Professional Services	3,200	19,200	27,300
Employee Benefits	1,300	-	7,200
Employee Training & Seminars	18,300	7,700	13,200
Employee Exp - Operations	1,400	400	2,500
Expenses of Officers	5,000	4,700	3,300
Meals & Entertainment - 50% Dr	1,800	900	900
Office Supplies & Expense	7,100	10,000	5,200
Salaries Expense	650,600	640,800	667,000
Travel Expense	7,000	12,400	4,200
Payroll Tax Expense	47,000	53,000	63,200
Total Management Service Fee	742,700	749,100	794,000
MSF Cost Distribution per OC-751			
South Jersey Gas	573,700	565,300	591,200
SJ Energy Services Plus	48,700	48,200	48,400
South Jersey Energy	23,200	23,800	25,200
South Jersey Resources Group	45,800	61,300	81,500
Marina Energy	51,200	50,500	47,700
Totals	742,600	749,100	794,000
Source: OC-341 & OC-751			

Shareholder Records

The Shareholder Records function includes a Records Specialist and a Clerk. The Records Specialist reports to the Treasurer. The function is responsible for maintaining shareholder records, which include daily maintenance of shareholder master files and updating accounts for funds adjustments and dividend reinvestment withdrawals and terminations.[12] It is also responsible for performing research, responding to shareholder inquiries, proxy tabulations and assistance with dividend checks. As shown in the table below, costs consist of the salaries of the function's two employees, and "other professional

[12] Response to Discovery, OC-71, SJI and SJIS Job Descriptions, Position Description – Shareholder Records Specialist.

services," which SJI described as "administrative expenses . . . includ[ing] shareholder services charges to (sic) banks and transfer agents and other miscellaneous administrative fees."[13] The costs shown below are limited to costs distributed through the Management Service Fee using the three-factor formula. Directly charged Shareholder Records costs are not included.

Table 3-5 - Cost Center 3004 – Shareholder Records

South Jersey Industries Cost Center 3004 - Shareholder Records Mgt. Service Fee / Three-Factor Formula Cost Distributions			
Description	2009	2010	2011
Other Professional Services	76,500	173,200	139,300
Meals & Entertainment - 50% Dr	-	-	-
Office Supplies & Expense	48,900	58,000	64,900
Salaries Expense	113,000	111,900	109,100
Payroll Tax Expense	9,200	9,500	9,700
Total Management Service Fee	247,600	352,600	323,000
MSF Cost Distribution per OC-750			
South Jersey Gas	191,200	266,100	240,500
SJ Energy Services Plus	16,200	22,700	19,700
South Jersey Energy	7,700	11,200	10,200
South Jersey Resources Group	15,300	28,800	33,100
Marina Energy	17,100	23,800	19,400
Totals	247,500	352,600	322,900
Source: OC-341 & OC-750			

Treasury (Cash Management)

The Treasury cost center includes the salaries and salary-related expenses of SJI's Cash Management department. At the end of 2009 the department consisted of a General Manager, Finance and Investor Relations, and Investor Relations and Finance Specialist and a Financial / Regulatory Assistant. During the review period the department increased from three to five employees. By the end of 2011 Cash Management included a Director, Finance and Investor Relations (a promotion from General Manager), a Cash Manager, a Financial Specialist, Cash Management, a Manager, Finance and a Financial / Regulatory Assistant. The Director reports to the Treasurer, whose compensation costs are included in the Officers cost center, discussed above. The costs shown below are limited to costs distributed through the Management Service Fee using the three-factor formula. Directly charged Treasury costs are not included.

[13] Response to discovery, OC-750-B.

Table 3-6 - Cost Center 2005 - Treasury

South Jersey Industries Cost Center 3005 - Treasury Mgt. Service Fee / Three-Factor Formula Cost Distributions			
Description	2009	2010	2011
Other Professional Services	-	7,700	8,100
Employee Training & Seminars	-	-	1,700
Office Supplies & Expense	400	800	1,300
Salaries Expense	242,300	276,700	390,900
Payroll Tax Expense	17,900	19,200	22,900
Total Management Service Fee	260,600	304,400	424,900
MSF Cost Distribution per OC-753			
South Jersey Gas	201,300	229,700	316,400
SJ Energy Services Plus	17,100	19,600	25,900
South Jersey Energy	8,200	9,700	13,500
South Jersey Resources Group	16,100	24,900	43,600
Marina Energy	18,000	20,500	25,500
Totals	260,700	304,400	424,900
Source: OC-341 & OC-753			

Based on job descriptions, the department's key responsibilities include the cash management function, capital raising activities and financial compliance.[14] The primary activities include:

- Cash forecasting;
- Daily banking activities, including communication with banks, managing incoming and outgoing electronic payments and wire transfers, reconciliation of monthly bank information and analysis of bank lines of credit;
- Debt covenant compliance reporting;
- Earnings release, investor and ratings agency presentations and support; and
- Evaluation of long term capital requirements.

Internal Audit

At the beginning of the review period the Internal Audit function had five employees (two Internal Auditors, a Senior Internal Auditor and a Director). As of August 2012 SJI's Internal Audit function had seven employees. In 2009 and 2010 the Director was promoted to the new position of AVP and in 2010 the Director position was filled, for a total of six employees. In 2012 SJI added an IT Auditor position, for a total of seven employees. Costs in the Internal Audit cost center consist primarily of salaries and salary-related expenses of the department's employees.

Some, if not most, Internal Audit labor costs are directly assigned "based on the entity (i.e. SJI, SJG, SJES, etc.) they [employees] worked on, tracked by the hour."[15] The costs shown below are limited to costs distributed through the Management Service Fee using the three-factor formula, which appear to be costs charged to SJI. Amounts charged to entities other than SJI are not included.

[14] Response to Discovery, OC-71, SJI and SJIS Job Descriptions, Position Descriptions, – Director, Finance & Investor Relations, Cash Manager & Financial Specialist, Cash Management.

[15] Response to discovery, OC-745-A.

Table 3-7 - Cost Center – 3006 – Internal Audit

South Jersey Industries Cost Center 3006 - Internal Audit Mgt. Service Fee / Three-Factor Formula Cost Distributions			
Description	2009	2010	2011
Other Professional Services	2,700	1,000	17,600
Employee Benefits	4,300	5,500	14,100
Consulting Fees	-	6,100	-
Employee Training & Seminars	6,900	6,500	7,400
Meals & Entertainment - 50% Dr	1,300	900	1,900
Office Supplies & Expense	3,000	6,000	33,400
Salaries Expense	426,100	418,800	558,500
Travel Expense	4,800	7,800	10,700
Payroll Tax Expense	31,900	34,200	44,300
Total Management Service Fee	481,000	486,800	687,900
MSF Cost Distribution per OC-745			
South Jersey Gas	371,500	367,300	512,200
SJ Energy Services Plus	31,600	31,300	42,000
South Jersey Energy	15,100	15,500	21,800
South Jersey Resources Group	29,700	39,800	70,600
Marina Energy	33,200	32,800	41,300
Totals	481,100	486,700	687,900
Source: OC-341 & OC-745			

Risk Management & Accounting

SJI cost center 3007 consists of salaries and outside services incurred by the Risk Management and Corporate Accounting functions. During the review period the department consisted of a Manager, Financial Reporting, a Manager, Risk Management and a Risk Analyst. It also included several employees responsible for the Insurance function, whose costs are discussed in connection with Insurance 3014 below. A review of job descriptions shows that this function is responsible for identifying and assessing business risks, and "ensuring that the sum is a risk profile consistent with the company's risk strategy."[16] Specific activities include:

- Financial modeling to quantify and monitor SJI's market risk, credit risk, earnings risk and cash flow risk exposure;
- Setting and maintaining credit limits for the wholesale and retail businesses;
- Maintaining margin account cash requirements by funding accounts as necessary;
- Measuring, monitoring and reporting risk metrics and trading limits;
- Ensuring forward physical transactions are confirmed with counterparties and validate forward transaction market prices;
- Performing risk assessment reviews of gas and other contracts;
- Developing and managing ISDA agreements, master credit list, credit approval requirements, a rating database for trading counterparties and listing of corporate guarantees.

[16] Response to Discovery, OC-71, SJI and SJIS Job Descriptions, Position Descriptions – Manager, Risk Management and Risk Analyst.

The “Accounting” component of “Risk Management and Accounting” includes the corporate accounting function, which includes the consolidation of SJI and subsidiary financial statements, and the preparation of SEC financial data and annual financial reports to shareholders.[17] Specific activities include:

- Managing preparation of forms 10Q, 10K and the Annual Report to Shareholders;
- Quarterly and annual consolidation of financial data for SJI and its subsidiaries;
- Technical accounting research on GAAP and SEC reporting requirements;
- Preparation, review and verification of reporting to senior management and the board of directors; and,
- Supervising the general accounting (general ledger activities) of the parent, and subsidiaries SJESP, EMI, R&T and SJF.

The costs shown below are limited to Risk Management & Accounting department costs distributed through the Management Service Fee using the three-factor formula. Directly charged costs are not included.

Table 3-8 - Dept. 30-3007 – Risk Management & Accounting

South Jersey Industries Cost Center 3007 - Risk Management & Accounting Mgt. Service Fee / Three-Factor Formula Cost Distributions			
Description	2009	2010	2011
Other Professional Services	3,900	64,200	136,100
Employee Benefits	-	-	2,700
Consulting Fees	-	7,200	-
Employee Training & Seminars	4,700	7,400	5,000
Meals & Entertainment - 50% Dr	200	700	900
Office Supplies & Expense	700	500	2,800
Salaries Expense	275,800	281,600	315,300
Travel Expense	1,200	6,300	3,600
Payroll Tax Expense	22,300	23,700	26,900
Total Management Service Fee	308,800	391,600	493,300
MSF Cost Distribution per OC-749			
South Jersey Gas	238,500	295,500	367,300
SJ Energy Services Plus	20,300	25,200	30,100
South Jersey Energy	9,700	12,500	15,600
South Jersey Resources Group	19,100	32,000	50,600
Marina Energy	21,300	26,400	29,600
Totals	308,900	391,600	493,200
Source: OC-341 & OC-749			

Officers (Executive)

The Officers cost center includes salaries, cash and equity incentive compensation and payroll taxes for SJI’s senior corporate management, including the following positions:[18]

[17] Response to Discovery, OC-71, SJI and SJIS Job Descriptions, Position Description – Manager, Financial Reporting.
[18] Response to discovery, OC-748-A.

- Chairman, President and CEO (Edward Graham);
- Vice President / Chief Financial Officer (David Kindlick);
- Treasurer (Steven Clark);
- AVP, Financial Reporting & Risk Management (Kenneth Lynch);
- VP, Research & Corporate Development (Kevin Patrick); and
- General Counsel & Corporate Secretary (Gina Merritt-Epps).

As of August, 2012, the Officers cost center also included a Director of Legal Affairs, an Office Generalist – Corporate Counsel, a Staff Attorney and a Legal Assistant who worked in the SJI Legal function and two Administrative Assistants.[19]

The table below shows Officers cost center expenses distributed through the Management Service Fee using the three-factor formula. Directly charged costs are not included.

Table 3-9 - Cost Center 3009 - Officers

South Jersey Industries Cost Center 3009 - Officers Mgt. Service Fee / Three-Factor Formula Cost Distributions			
Description	2009	2010	2011
Expenses of Officers	-	-	400
Meals & Entertainment - 50% Dr	600	-	-
Officers Salary Expense	2,870,300	3,417,100	3,641,500
Transportation Expense	1,000		-
Travel Expense	3,300	3,400	-
Payroll Tax Expense	109,500	116,400	386,100
Total Management Service Fee	2,984,700	3,536,900	4,028,000
MSF Cost Distribution per OC-748			
South Jersey Gas	2,305,400	2,668,900	2,999,200
SJ Energy Services Plus	195,800	227,800	245,700
South Jersey Energy	93,400	112,500	127,700
South Jersey Resources Group	184,200	289,300	413,300
Marina Energy	205,900	238,400	242,100
Totals	2,984,700	3,536,900	4,028,000
Source: OC-341 & OC-748			

Public and Government Relations

The Public Relations and Government Relations cost centers are not aligned with an SJI department. Parent company public Relations costs consist primarily of outside services expenses, including advertising, media relations and professional services. Below are Public Relations costs allocated as part of the Management Service Fee using the three-factor formula. Directly charged expenses are not included.

[19] Response to discovery, OC-5.

Table 3-10 - Cost Center 3010 – Public Relations

South Jersey Industries Cost Center 3010 - Public Relations Mgt. Service Fee / Three-Factor Formula Cost Distributions			
Description	2009	2010	2011
Advertising Expense	16,300	8,800	12,400
Other Professional Services	101,100	79,400	86,700
Media Relations Expense	58,100	57,600	121,300
Office Supplies & Expense	10,300	15,200	9,700
Total Management Service Fee	185,800	161,000	230,100
MSF Cost Distribution per OC-752			
South Jersey Gas	143,500	121,500	171,300
SJ Energy Services Plus	12,200	10,400	14,000
South Jersey Energy	5,800	5,100	7,300
South Jersey Resources Group	11,500	13,200	23,600
Marina Energy	12,800	10,900	13,800
Totals	185,800	161,100	230,000
Source: OC-341 & OC-752			

The Government Relations function, which includes oversight of corporate charitable activities, is housed in SJI Services. However, SJI's larger charitable contributions are funded by the parent, as shown below.[20] The table includes charitable contributions allocated as part of the Management Service Fee using the three-factor formula. Directly charged contributions, if any, are not included.

Table 3-11 - Cost Center 3011 – Government Relations

South Jersey Industries Cost Center 3011 - Government Relations Mgt. Service Fee / Three-Factor Formula Cost Distributions			
Description	2009	2010	2011
Contributions	448,000	488,000	512,600
Total Management Service Fee	448,000	488,000	512,600
MSF Cost Distribution per OC-743			
South Jersey Gas	333,600	363,400	381,700
SJ Energy Services Plus	27,300	29,800	31,300
South Jersey Energy	14,200	15,500	16,200
South Jersey Resources Group	46,000	50,100	52,600
Marina Energy	26,900	29,300	30,800
Totals	448,000	488,100	512,600
Sources: OC-341 & OC-743			

Investor Relations

The Investor Relations cost center does not include the employee costs. During the review period it consisted primarily of outside services and travel expenses. The employees who oversee the Investor Relations cost center belong to the Cash Management and Shareholder Records departments, discussed separately. The table includes costs allocated as part of the Management Service Fee using the three-factor formula. Directly charged Investor Relations expenses are not included.

[20] Response to Discovery, OC-599.

Table 3-12 - Cost Center 3012 – Investor Relations

South Jersey Industries Cost Center 3012 - Investor Relations Mgt. Service Fee / Three-Factor Formula Cost Distributions			
Description	2009	2010	2011
Advertising	700	4,500	-
Other Professional Services	69,900	72,300	84,900
Employee Benefits	5,200	3,100	1,700
Employee Training & Seminars	-	700	5,400
Expenses of Officers	300	2,100	4,000
Meals & Entertainment - 50% Dr	7,100	10,600	16,000
Office Supplies & Expense	3,700	5,800	11,500
Salaries Expense	-	-	12,000
Travel Expense	66,200	36,400	36,900
Total Management Service Fee	153,100	135,500	172,400
MSF Cost Distribution per OC-746			
South Jersey Gas	118,300	102,200	128,400
SJ Energy Services Plus	10,000	8,700	10,500
South Jersey Energy	4,800	4,300	5,500
South Jersey Resources Group	9,400	11,100	17,700
Marina Energy	10,600	9,100	10,400
Totals	153,100	135,400	172,500
Source: OC-341 & OC-746			

Legal

The Legal function is consolidated organizationally into SJI's Executive department. It is headed by Gina Merritt-Epps, General Counsel and Corporate Secretary, whose costs are included along with other senior managers in SJI's "Officers" cost center.[21] In 2009 Legal also included a Director, Legal Affairs and a Legal Assistant. During 2010 and 2011, the Legal function added an Administrative Assistant, a Staff Attorney and an Office Generalist, Corporate Counsel.

Legal function costs in the following table are those allocated from SJI as part of the Management Service Fee using the three-factor formula. They consist primarily of 1) salaries and salary-related expenses of the Legal function's Director, Administrative Assistant and Staff Attorney, and 2) external legal expenses assigned to SJI.[22] Directly charged Legal costs are not included.

[21] However, Ms. Epps payroll costs are included in the Officers cost center, discussed below, rather than the Legal cost center.

[22] In 2009 external legal expenses assigned to SJI were recorded in cost center 3001 – General and Corporate Costs.

Table 3-13 - Cost Center 3013 - Legal

South Jersey Industries Cost Center 3013 - Legal Mgt. Service Fee / Three-Factor Formula Cost Distributions			
Description	2009	2010	2011
Other Professional Services	-	19,300	11,600
Employee Training & Seminars	-	12,500	10,600
Employee Exp - Operations	-	1,700	2,600
Expenses of Officers	-	13,900	12,700
Legal Expense	-	122,700	284,700
Meals & Entertainment - 50% Dr	-	5,700	2,900
Office Supplies & Expense	-	7,000	17,800
Salaries Expense	-	176,200	312,600
Travel Expense	-	21,200	23,800
Payroll Tax Expense	-	13,600	19,300
Total Management Service Fee	-	393,800	698,600
MSF Cost Distribution per OC-747	-		
South Jersey Gas	-	297,200	520,200
SJ Energy Services Plus	-	25,400	42,600
South Jersey Energy	-	12,500	22,100
South Jersey Resources Group	-	32,200	71,700
Marina Energy	-	26,500	42,000
Totals	-	393,800	698,600
Source: OC-341 & OC-747			

Below is a subject-matter breakout of external legal expenses assigned to the parent.[23]

Table 3-14 - Parent Company External Legal Expenses

South Jersey Industries Parent Company External Legal Expenses			
Subject	2009	2010	2011
FERC Compliance	74,623	27,471	40,744
Auditor Letters	15,242	8,391	11,843
ERISA Matters	51,880	17,683	113,366
Exec Comp Disclosure Advice			8,046
General Corporate			13,280
General Legal Matters			9,816
Securities Matters	57,500	26,092	47,609
Employee Benefits	1,871	30,540	17,863
FICA Tax Issues			11,724
General Legal Matters	20,374	13,768	
Other Matters	12,863	3,633	3,593
Total	234,353	127,579	277,882
Source: OC-435			

The Cost Allocation Manual states that legal services are directly assigned to the entity responsible for the service provided. In fact, as shown below, SJI's legal costs consist primarily of external legal

[23] These amounts were derived from legal case management data provided in OC-435. As such, they do not tie precisely to the cost center data from the accounting system provided in OC-341, but they are close. The costs from 2009 were recorded in cost center 3001 – General and Corporate Costs. 2010 and 2011 costs were recorded in cost center 3013 – Legal.

expenses assigned directly to various affiliates. The CAM also states that costs assigned to SJI are part of the Management Service Fee and are distributed using the three-factor general allocator.[24] As shown below, legal expenses assigned to the parent, which are allocated using the general allocator, comprise a small portion of the approximately $3 million in external legal costs incurred annually by SJI and its subsidiaries.

Table 3-15 - External Legal Expenses By Affiliate

South Jersey Industries External Legal Expenses By Affiliate			
Affiliate	2009	2010	2011
Energy & Minerals, Inc.	155,023	122,138	75,223
LVE Energy Partners, LLC	217,579	241,347	328,112
Marina Energy, LLC	79,011	200,361	1,364,660
R & T Group			11,066
SJE/OFE	66,186		
South Jersey Energy Company	121,512	28,373	29,025
South Jersey Energy Service Plus	77,183	94,958	109,260
South Jersey Exploration, LLC			183
South Jersey Fuel, Inc.	18,936	30,865	17,719
South Jersey Gas Company	2,012,390	1,728,651	1,181,639
South Jersey Industries	234,353	127,579	277,882
South Jersey Resources Group	3,339	39,534	145,731
WC Landfill Energy, LLC	8,890	1,172	
Total	2,994,402	2,614,980	3,540,499
Source: OC-435			

The Legal function is one of the functions covered in Chapter 17, Support Services, and the Support Services chapter contains additional detail on the function.

Insurance

In 2011, SJI moved the employees in Insurance function from SJI Services to the Risk Management department in SJI. Insurance employees are responsible for managing third-party claims against the company, evaluating and obtaining adequate external coverage for risks the company chooses not to self-insure and managing the performance of all insurance policies and programs.[25] As of August 2012, Insurance consisted of a Manager, Thomas Hewitt; a Property Claims Specialist and an Office Administration Generalist. An additional position, Insurance Specialist, was vacant at the time but has since been filled. Mr. Hewitt reports to Kenneth Lynch, AVP, Financial Reporting and Risk Management.

The costs shown below are the costs of running the Insurance function (payroll and payroll-related costs) and do not include the costs of policies purchased from external insurers or any other directly charged Insurance department costs. Costs in the table are also limited to the period since the Insurance function moved to SJI for budget purposes at the beginning of 2011. A more complete discussion of insurance is included in Chapter 17.

[24] Response to Discovery, OC-134, Cost Allocation Manual, Dec. 31, 2011, p.8.
[25] Response to Discovery, OC-71, SJI and SJIS Job Descriptions, Position Description – Manager, Insurance.

Table 3-16 - Cost Center 3014 - Insurance

South Jersey Industries Cost Center 3014 - Insurance Mgt. Service Fee / Three-Factor Formula Cost Distributions			
Description	2009	2010	2011
Other Professional Services	-	-	1,000
Employee Training & Seminars	-	-	6,300
Meals & Entertainment - 50% Dr	-	-	900
Office Supplies & Expense	-	-	5,100
Salaries Expense	-	-	232,800
Travel Expense	-	-	5,100
Payroll Tax Expense	-	-	20,100
Total Management Service Fee	-	-	271,300
MSF Cost Distribution per OC-744			
South Jersey Gas	-	-	202,000
SJ Energy Services Plus	-	-	16,500
South Jersey Energy	-	-	8,600
South Jersey Resources Group	-	-	27,800
Marina Energy	-	-	16,300
Totals	-	-	271,200
Sources: OC-341 & OC-744			

Environmental Affairs

The Environmental Affairs function was moved from SJG into the parent company in 2010. In 2011 it consisted of two Project Managers and a Secretary. The Project Managers report to the Vice President of South Jersey Energy Solutions. Environmental Affairs' primary responsibilities include managing compliance programs and administering remediation of former manufactured gas plant facilities. Costs consist of the salaries and salary-related expenses of the department's employees allocated as part of the Management Service Fee using the three-factor allocation formula. Environmental Affairs costs directly charged to subsidiaries are not included.

Table 3-17 - Cost Center 3016 – Environmental Affairs Expense

South Jersey Industries Cost Center 3016 - Environmental Affairs Expense Mgt. Service Fee / Three-Factor Formula Cost Distributions			
Description	2009	2010	2011
Employee Benefits - Tuition Reimb.	-	-	3,400
Employee Training & Seminars	-	-	2,100
Office Supplies & Expense	-	-	400
SJIS Time Allocation	-	-	7,100
Salaries Expense	-	-	211,800
Transportation Expense	-	-	41,700
Travel Expense	-	-	3,700
Payroll Tax Expense	-	-	18,100
Total Management Service Fee	-	-	288,300
MSF Cost Distribution per OC-742			
South Jersey Gas			214,700
SJ Energy Services Plus			17,600
South Jersey Energy			9,100
South Jersey Resources Group			29,600
Marina Energy			17,300
Totals	-	-	288,300
Sources: OC-341 & OC-742			

SJI's Billings to SJG

SJG provided charges from affiliates to SJG in response to data request OC-57. In OC-344, we asked the Company to classify charges from the parent company to SJG into meaningful categories of cost. Following is a summary of what was provided.

Table 3-18 - Summary of Charges to South Jersey Gas

South Jersey Industries Billings to South Jersey Gas Co. Summary of Charges to South Jersey Gas 2009-2011			
	2009	2010	2011
Employee Time & Related Costs			
Management Service Fee	7,278,116	7,927,891	8,696,157
Management Cost Allocation	1,259,355	1,181,409	1,864,966
Stock:			
Officer	230,130	264,194	312,056
Non-Officer	-		52,713
Directors Fees & Expenses:			
Directors Fees & Expenses	91,287	111,774	143,465
Directors Stock	75,804	59,232	91,692
Directors Pension	7,150	6,600	3,850
Employee Expenses			
SJI - PAC	2,906	2,570	2,646
UBS	26,440	39,016	45,443
Century Payroll - FSA	71,260	70,421	75,862
Incentive/Bonus Awards	(12,852)	245,961	350,033
Insurance:			
Willis of PA	1,129,493	302,580	1,267,120
LINA - Officers	1,404	-	-
McCart	230,498	8,912	196,696
NJ Manufacturers			10,814
Other Items			
ESOP	67,668	71,634	34,709
Audit (Deloitte & Touche)	474,942	491,963	497,349
Legal Costs	6,288	3,333	32,247
401K (Merrill Lynch)	3,254,983	3,433,149	3,941,765
Actuarial Fees (Watson & Wyatt)	118,246	158,119	162,989
Pension	8,244,000		
Bank Syndicate / Analysis Fees	237,986	217,040	201,995
JP Morgan - P-card		45,317	123,096
Tax Payments	1,909,573	5,613,239	(2,830,403)
Subtotal "Recurring" Journals	24,704,676	20,254,356	15,277,259
Add: "Non-Recurring" Journals	54,796	135,831	10,608
Total	24,759,471	20,390,187	15,287,867
Source: OC-344			

What is significant about the amounts shown in Table 3-18 is the fact that the total amounts charged to SJG far exceed the combined costs of SJI's cost centers as shown in Table 3-2. There are two reasons for this. First, the amounts in Table 3-2 are limited to amounts distributed through SJI's Management Service Fee using the three-factor allocator. Directly charged costs are not included because data showing directly charged amounts associated with individual parent company departments (functions) were not available.[26] Second, many of the items billed to SJG, as shown in the table directly above, appear not to be costs of running SJI or the corporation as whole; rather, they appear to be costs for which SJG has budget responsibility, but which are paid by SJI on behalf of SJG.

[26] Total directly charged payroll and benefits costs for all parent company functions combined is reflected in amounts (Salaries and Payroll Taxes Allocated Out and Employee Benefits Allocated Out) shown as credits in cost center 3001 – General and Corporate, in Table 3-3.

SJI Costs Billed to SJG

As noted at the beginning of this Chapter, SJI effectively operates as a service company, providing various services, primarily of a corporate nature, to SJG and its affiliates. Of the items discussed above that SJI billed to SJG in the years 2009 through 2011, only the top two items (Management Service Fee and Management Cost Allocation) appear to be costs incurred by SJI in providing services to subsidiaries, for which SJI, and not the affiliate, has budget responsibility for the incurred cost. The table below, taken from SJI's 2011 Cost Allocation Manual, summarizes the methods used to distribute various SJI costs to SJG. Note that these categories do not directly represent SJI's departments; rather, they reflect a set of cost types.

Table 3-19 - Summary of Cost Charging Procedures as of December 31, 2011

South Jersey Industries	
Summary of Cost Charging Procedures as of December 31, 2011	
Service Provided	**Cost Charging Methodology**
Executive Management	
Corporate Accounting Support	Mgmt. Service Fee / 3-Factor Allocator
Office Supplies Relating to Corporate Support Services	
Officer Expenses Relating to Corporate Support Services	
Insurance Services	
Rent Relating to Corporate Support Services	
Earnings on Invested Excess Funds	
Legal and Other Professional Services	Directly assigned to operating affiliates. Mgmt Service Fee / 3-Factor Allocator if attributable to SJI
Board of Directors Services - Affiliates	Directly assigned to the affiliate
Board of Directors Services - SJI	Mgmt. Service Fee / 3-Factor Allocator
Corporate Secretary	Mgmt. Service Fee / 3-Factor Allocator unless directly attributable to an
Shareholder Records	Mgmt. Service Fee / 3-Factor Allocator
Investor Relations	Mgmt. Service Fee / 3-Factor Allocator
Financial Planning / Consulting	Hourly labor & benefits charged based on time reporting
Internal Audit	
ESOP Administration	
401(k) Coordination	
Management Consulting	
Insurance Payment / Processing	
Risk Management	
Cash Management	
Insurance Policy Placement / Claims Admin	
SEC Compliance & Filing	
Environmental Consulting	
Bank Fee Payment and Processing	Allocated based on bank accounts
Source: OC-134 (SJI CAM, December 31, 2011)	

Management Service Fee

SJI uses two cost pools with the title "Management Service Fee." Costs for all centers (departments) except the "General and Corporate" cost center are distributed through a pool referenced as the SJI Management Service Fee. Certain costs incurred in the General and Corporate cost center are assigned to SJES companies through what is referenced as the SJES Management Service Fee.

Allocation of MSF Costs - The following table summarizes the costs accumulated and distributed through the SJI and SJES Management Service Fee cost pools during the years 2009-2011.

Table 3-20 - Accumulation and Distribution of MSF Expenses

South Jersey Industries Accumulation and Distribution of MSF Expenses 2009-2011			
Item	**2009**	**2010**	**2011**
MSF - SJG/ SJE/ SJRG/ ME:			
Expense			
Other Professional Services	469,254	710,634	970,449
Contributions	448,011	488,224	512,601
Directors Fees and Expense	620,416	740,777	830,619
Net Employee Benefits	919,484	923,522	913,367
Insurance Exp.	95,312	107,051	117,863
Legal Services	212,213	122,861	286,516
Other Office Supplies	240,746	273,657	324,531
Net Salaries	4,592,685	5,613,229	6,447,213
Depreciation	135,467	143,368	160,019
Payroll Tax Expense	258,386	269,442	610,646
Other Income - CSV Officers	353,603	404,724	(521,215)
Other Accounts	1,077,153	708,595	1,026,355
Total Expense	9,422,729	10,506,085	11,678,965
MSF Allocation			
SJG	7,278,116	7,927,891	8,696,157
SJG Percentages	*77.2%*	*75.5%*	*74.5%*
SJESP	621,092	676,592	712,417
SJE	296,344	334,093	370,223
SJRG	573,894	859,398	1,198,262
Marina Energy	653,283	708,110	701,906
Total Allocation Out	9,422,729	10,506,085	11,678,965
MSF - SJES			
Expense			
Bank Syndicate Fees	394,949	401,417	938,458
Interest Income	(354,469)	(694,430)	(2,148,456)
Interest Expense	774,867	1,093,053	2,647,737
Total Chg to SJES	815,347	800,039	1,437,740
Source: OC-341, "DR#341 - Management Service Fee 2009.xls", "MSF 2010.xls" & "MSF 2011.xls"			

Costs assigned to the SJI MSF are allocated among SJI subsidiaries using a three-factor formula composed of SJI-calculated assets, "margin" and payroll. SJI's three-factor allocator is somewhat similar to the "Massachusetts formula" approved by the FERC for use in allocating costs among gas distribution operating companies.[27] The table below summarizes the components and percentages derived for the MSF during the review period.[28] As shown, SJG's share of the MSF factor dropped from 77.2% in 2009 to 74.5% in 2011. The budgeted MSF for 2012 shows SJG's percentage dropping to 69%.

[27] The Massachusetts formula is a three-factor formula based on gross plant (instead of assets), gross revenues (instead of margin) and labor.

[28] It should be noted that it takes additional detail, not included in this table, to be able to reproduce the percentages reflected for each year. In 2009, for example, the percentage of assets attributed to SJG is 77.2%. However, SJG's actual share of assets is 76.4% ($1,059,101 / $1,386,959). In this case, 77.2% is derived by subtracting assets from the service company and the parent company, included among $15,233 in assets attributed to "Others," from the denominator before making the calculation.

Table 3-21 - Management Service Fee Allocation Factor Calculation

South Jersey Industries Summary of MSF Three-Factor Formula Percentages 2009-2011								
Year / Cost Obj.	Assets		Payroll		Margin		Weighted	Factor
	Amt. (000s)	Pct.	Amt. (000s)	Pct.	Amt. (000s)	Pct.		
2009								
SJG-Utility	1,059,101	77.17%	33,834	77.16%	181,340	77.14%	77.16%	77.24%
SJES	2,363	0.00%	2,002	0.00%	-			
SJESP	9,741	0.71%	6,855	15.63%	7,828	3.33%	6.56%	6.56%
SJE	31,446	2.29%	1,382	3.15%	9,247	3.93%	3.13%	3.13%
SJRG	143,081	10.42%	885	2.02%	14,201	6.04%	6.16%	6.17%
Marina Energy	125,994	9.18%	856	1.95%	22,458	9.55%	6.90%	6.90%
Others	15,233	0.23%	5,933	0.09%	-		0.10%	
Totals	1,386,959	100.00%	51,747	100.00%	235,075	100.00%	100.00%	100.00%
2010								
SJG-Utility	1,100,451	78.77%	34,540	75.59%	188,413	71.36%	75.24%	75.46%
SJES	3,657	0.00%	2,248	0.00%	-		0.00%	
SJESP	15,659	1.12%	7,036	15.40%	7,348	2.78%	6.43%	6.44%
SJE	34,390	2.46%	1,697	3.71%	8,798	3.33%	3.17%	3.16%
SJRG	112,445	8.05%	1,346	2.95%	35,694	13.52%	8.17%	8.18%
Marina Energy	124,618	8.92%	1,039	2.27%	23,785	9.01%	6.73%	6.74%
Others	38,789	0.68%	7,421	0.07%	-		0.25%	
Totals	1,430,010	100.00%	55,327	100.00%	264,039	100.00%	100.00%	100.00%
2011								
SJG-Utility	1,183,719	77.31%	36,214	75.86%	195,703	69.92%	74.37%	74.46%
SJES	4,831	0.00%	2,540	0.00%	-		0.00%	
SJESP	15,950	1.04%	6,996	14.65%	7,187	2.57%	6.09%	6.10%
SJE	33,670	2.20%	1,786	3.74%	9,971	3.56%	3.17%	3.17%
SJRG	158,057	10.32%	1,637	3.43%	47,593	17.00%	10.25%	10.26%
Marina Energy	134,960	8.81%	1,076	2.25%	19,423	6.94%	6.00%	6.01%
Others	56,968	0.31%	6,489	0.06%	-		0.12%	
Totals	1,588,154	100.00%	56,739	100.00%	279,877	100.00%	100.00%	100.00%
Source: OC-137 / 346								

Calculation of Three-Factor Allocator Components

SJI's MSF allocator is based on a simple average of relative percentages for three arbitrarily selected measures of financial size: assets, payroll and "margin," defined loosely as revenues minus the "cost of service." The measurement periods for each allocation year in the table above are: 1) for assets, the balances as of June 30 of the prior calendar year, and 2) for payroll and "margin," the 12 months ending June 30 of the prior calendar year. During the review period, SJG's relative share of all three allocation formula components was around 75%. In general, component totals associated with holding companies and service companies are removed in the factor calculation process, as holding and service company entities are not final cost objectives.

Asset Component - The "Assets" worksheet in the MSF allocation factor work file shows that the asset factor calculation for a given year begins with "Total Assets per Consolidation" as of June 30 of the prior calendar year. Prior to calculating relative percentages, various adjustments are made to eliminate holding company investments in subsidiaries, inter-company notes and net intercompany receivables, deferred and prepaid taxes, derivative assets, and various accrued utility assets which have corresponding accrued liabilities. Although a theoretical case may be made for these adjustments, they all represent arbitrary deviations from the "assets" totals upon which one-third of the allocator is based. None of these adjustments are shown, explained or theoretically justified in the Cost Allocation Manual.

Payroll Component – Payroll cannot be directly traced to consolidating financial information. The allocation factor support contains a worksheet that begins with a column titled "Gross Payroll for period 7/01/X0-6/30/X1 Originally Charged to Each Co. per Lawson." These totals are adjusted for intercompany payroll allocations, the intent of which appears to be to obtain final payroll distributions to each subsidiary. However, for whatever reason, various amounts of holding company and "SERP" payroll remain after holding company "allocations out" are distributed.[29]

For purposes of calculating each subsidiary's share of the payroll component during the review period, holding company and SERP payroll percentages remaining after "allocations out" were reassigned to the operating subsidiaries, which are the ultimate cost objectives for all allocated costs. Because SJG is the largest operating subsidiary, accounting for more than two-thirds of the payroll factor before adjustment, it received the lion's share of the redistribution. Although proportional redistribution of undistributed payroll from SJI's parent organization and SERP to SJG and the other operating company cost objectives makes some sense, the same is not true of undistributed SJES payroll because almost none of the payroll incurred by SJES is attributable to SJG.[30] However, because the Company's redistribution equation bundled the undistributed amounts from SJI, SERP and SJES all together, a majority of amounts remaining to be distributed from SJES were assigned to SJG. This caused SJG's share of payroll in the final operating company distribution to be overstated by about three percent. Correspondingly, since the payroll component contributes one-third to the weight of the three-factor formula, SJG's share of the three-factor formula was overstated by approximately one percent, resulting in an over-allocation of the MSF to SJG of approximately $100,000 annually over the three-year review period.

Margin Component – The "margin" component of the three-factor formula is a function of revenue (the definition of which varies by entity) and "cost of service." The calculation of margin used in the allocator is summarized below.

[29] Overland believes SERP refers to Supplemental Employee Retirement Plan executive pension expenses. For some reason, this "payroll" is given its own line item, and is not a component of subsidiary payroll shown elsewhere on the payroll component's worksheet.

[30] For example, of $2.4 million "allocated out" from SJES to SJG in the factor calculation used in 2009, none was distributed to SJG. None of the $3.3 million in SJES payroll "allocated out" in 2010 was distributed to SJG, and only $6,180 of the $3.7 million "allocated out" from SJES in 2011 was distributed to SJG.

Table 3-22 - Calculation of "Margin" Component of the Three-Factor Formula Used to MSF Costs

South Jersey Industries Parent Organization Calculation of "Margin" Component of the Three-Factor Formula Used to Distribute MSF Costs All Amounts $000s									
Subsidiary	Revenues (12 mos. End June Prior Yr.)			"Cost of Service" (12 Mos End June, Prior Yr.)			Margin (12 Mos. End June Prior Yr.)		
	2009	2010	2011	2009	2010	2011	2009	2010	2011
SJI	0	0	0	0	0	0	0	0	0
SJG	588,162	544,519	434,489	406,823	356,105	238,786	181,339	188,414	195,703
SJESP	18,738	19,206	18,961	10,909	11,858	11,774	7,829	7,348	7,187
SJE	235,421	209,786	279,243	226,174	200,988	269,273	9,247	8,798	9,970
SJRG	63,280	116,319	92,888	49,079	80,625	45,295	14,201	35,694	47,593
Marina	43,871	42,711	36,862	21,412	18,926	17,438	22,459	23,785	19,424
SJES	0	0	0	0	0	0	0	0	0
Total	949,472	932,541	862,443	714,397	668,502	582,566	235,075	264,039	279,877
SJG Pct.	61.95%	58.39%	50.38%	56.95%	53.27%	40.99%	77.14%	71.36%	69.92%
Source: OC-137 / OC-346									

Margin is akin to the revenue component of the FERC-approved Massachusetts formula. "Cost of service" is roughly equivalent to cost of sales. While SJG's share of total corporate revenue ranged from approximately 50% to 62% during the review period, its share of margin, as calculated for allocation purposes, was much higher, ranging from 70% to 77% between 2009 and 2011. The disparity between SJG's revenue and margin percentages is due primarily to the fact that SJG's share of total calculated "cost of service" is lower than its calculated share of revenue.[31] Had the Massachusetts formula's revenue component been used as a measure of financial size instead of margin, SJG's overall share of MSF costs distributed using the three-factor formula would have been between four and six percent lower, depending on the year.[32] A five percent reduction in SJG's share of the three-factor formula would have reduced SJG's allocation of SJI's MSF costs by approximately $500,000 annually.

Analysis of the details of the calculation of the margin factor showed that its revenue component is based on GAAP for some affiliates (SJG and SJESP), while for other affiliates (SJE and SJRG) it is based on what the Company calls "economic earnings."[33] Economic earnings are defined as GAAP revenues adjusted for "unrealized gains," "the change in unrealized losses on . . . commodity derivative transactions" and "the ineffective portion of interest rate derivative transactions that [the Company is] marking to market." The GAAP revenues from some affiliates are blended with adjusted GAAP revenues (economic earnings) from other affiliates in the margin calculation. Although GAAP revenues are adjusted for SJE and SJRG, "cost of sales" figures, the second component of the margin calculation, are not adjusted.

[31] In allocation year 2009, it is also partly due to the use of "after tax" revenue numbers for SJE and SJRG, as explained below.

[32] Calculated as one third (the margin's component's share of the weight in the three-factor formula) of the difference between SJG's share of calculated margin (which ranged from 70 to 77%) and its share of revenue (which ranged from 50 to 62%).

[33] Response to discovery, OC-490-B

In comparing the margin calculations used to calculate the 2009 and 2010 three-factor formula allocators, we noticed a difference in the total combined subsidiary revenue for the six months ended June 30, 2009.[34] We asked the Company to explain the disparity, and in response they stated as follows:

> In the 2008 analysis [used for the 2009 factor calculation] we took out the unrealized gains/losses after-tax, whereas in the 2009 analysis [used for the 2010 factor calculation] we took them out pre-tax, which is causing our difference.[35]

Further, the Company explained,

> In the 2008 analysis we used the after-tax number; however in the 2009 analysis (and the 2010 analysis also), we determined that pre-tax was a better measure, since revenues are shown pre-tax on the income statement.[36] The impact of using pre-tax versus after-tax on the overall weighted average percentages used for the Management Service Fee was not material.

Although it may not have had a material impact on SJG's overall three-factor formula percentage, the change from after-tax to pre-tax gains and losses did have a significant effect on the formula's margin component percentage for SJRG, which increased from 6.1% in 2009 to 13.5% in 2010. Correspondingly, SJG's share of the margin component of the formula decreased from 77.1% in 2009 to 71.4% in 2010.

Neither the change from "after tax" to "pre-tax," nor any of the machinations involved in adjusting GAAP revenue for selected affiliates are explained anywhere in SJI's Cost Allocation Manual. It should be noted that the differences in factor outcomes created by component selections, such as margin instead of revenue, and by selective adjustments to amounts obtained from supporting documentation, highlight the arbitrariness of size-based allocation formulas and demonstrate that the factors that result from them may be influenced or even tailored by choices made in the calculation process.

[34] Specifically, total revenues for all subsidiaries for the 6 months ending June 30, 2008 were $189.7 million in the margin calculation used to develop the 2009 allocator. In the margin calculation used to develop the 2010 allocator, revenues for the same period had grown to $224.1 million.

[35] Response to Discovery, OC-490-B.

[36] Id.

4. SJI Services and Cost Distributions to SJG

This chapter covers the organization, costs and cost distributions of SJI Services, which provides administrative services that benefit SJG and its affiliates. It covers the following topics:

- SJIS' organization structure
- Services provided to affiliates
- Functional analysis of costs incurred and distributed
- Analysis of allocated costs and allocation methods

Summary of Findings

1. SJIS provides administrative services to SJG and its affiliates in the areas of information technology, human resources, facilities management, procurement, materials management and communications. SJIS is one of two entities within SJI providing shared services. The other is the parent organization, which provides various corporate and executive services.
2. There were changes in the functions provided by SJIS during our review period. Prior to 2011, the government and regulatory relations functions and the insurance function were also part of SJIS. Beginning in 2012, the government and regulatory functions were moved to SJG. The insurance function was moved to the parent organization at the end of 2010.
3. SJIS grew from 40 employees at the end of 2008 to 49 employees in August, 2012. As of 2012, almost half of SJIS' total employees worked in the information technology function. Slightly less than one-third worked in the human resources function.[1] The remaining employees were split among the communications, facilities management, procurement and materials management functions.
4. Costs incurred by SJIS during our 2009-2011 review period consisted primarily of labor and labor-related costs incurred by employees providing shared services in the functions noted above. In addition to labor, some SJIS functions incurred costs for outside services. SJIS also had an "overheads" cost center through which costs including depreciation, general office expenses such as telecommunications, pension costs, certain outside services and charges from other affiliates were collected for distribution based on a rate applied to functional costs.
5. As a shared services entity, SJIS costs are fully charged out to affiliates and affiliate billings are produced on a monthly basis. A majority of SJIS costs (approximately 70% during the review period) appear to have been directly charged. SJIS costs not directly charged during the review period were allocated to affiliates using factors that include measures of relative operational size, including metrics such as the number of personal computer and number of employees.
6. During the review period SJIS incurred costs averaging approximately $7.5 million annually. Approximately 80% of the costs incurred and charged during the years 2009 through 2011

[1] Human resources employees included a Vice President and Chief H.R. Officer listed in the Executive department. There were no other SJIS employees in the Executive department. Prior to 2012 this employee's title within SJIS was Chief Operating Officer.

period were ultimately charged to SJG. According to SJIS Billing Summaries produced from data in the Lawson accounting system, SJG averaged 71.2% of total SJIS costs billed during the years 2009 through 2011. However, SJI's parent organization was also a cost objective of SJIS and the costs charged to SJI were reallocated. These reallocations were distributed primarily to SJG. After accounting for the reallocation of amounts charged to the parent, SJG's ultimate share of SJIS' costs was approximately 80%, or $6 million, out of an average $7.5 million incurred annually. This is somewhat, albeit not a great deal, higher than SJG's relative share of SJI's total size as measured by the size-related factors used in the parent company's three-factor allocator, which distributed between 74.5% and 77.2% to SJG during these years.

7. Unlike most utilities, SJIS does not have the ability to summarize the costs it incurs and distributes to affiliates by function, cost type, cost distribution methodology and affiliate cost objective. Most shared services operations are able to produce reports showing the end-to-end flow of costs, beginning with costs incurred by service company function and general ledger account, costs distributed by method (direct and allocated), and costs distributed by cost objective (affiliate) to which they are charged. SJIS was unable to do this. The inability to summarize the cost collection and distribution process appears to be a result of the present process, in which disconnected systems are used to gather and price incurred costs and to bill affiliates. According to the company, this is due to the inflexibility of the Lawson accounting system and its inability to handle the entire shared services transfer price and cost distribution process.
8. The SJIS cost collection and distribution process is a "black box" that is not auditable in any practical sense. Although significant billing errors appear unlikely, it is not apparent that affiliates receiving cost distributions from SJIS can have confidence that their individual bills are correct. Attempts to review SJIS cost collection and distribution processes presented several problems. Cost distributions from SJIS are the product of a multi-step process involving two disconnected systems (the Lawson accounting system and a separately maintained "timecard" application) as well as various manual accounting steps and adjustments. The process is managed by two SJI employees – an accountant and an information technology analyst - neither of whom fully understands the entire process end-to-end. The separate "timecard" system is used because the Lawson accounting system apparently does not have the ability in its current state to price out labor on a fully distributed cost basis, or to handle the complete process of calculating allocable costs as well as storing and applying allocation factors. While the timecard system was able to produce output for audit testing in electronic format, the output provided from the Lawson accounting system consisted primarily of hardcopy reports (provided in Adobe format), as opposed to electronic data. Because of the number of manual steps and adjustments required to bill affiliates each month, we limited our attempt to tie out amounts billed to SJG to a single month – December 2011. As described in additional findings below, we were unable to tie amounts directly charged to SJG between the timecard and Lawson system journal entries even for one month, and we found support for allocation factors and allocated amounts shown on Lawson system output during the review period was inadequate.

9. We were unable to tie labor costs directly charged to SJG from SJIS' "timecard" system (used to obtain labor cost data to bill affiliate) to the journal entry used to enter timecard system data into the Lawson accounting system. Loaded labor costs directly billable by SJIS to affiliates are calculated outside the Lawson accounting system in a separate "timecard" application run by an employee in the Information Technology function. Because the processes involve manual steps and various minor monthly adjustments, we limited an attempted tie-out to a single month. For the month of December, 2011, we attempted, unsuccessfully, to tie the amount billable to SJG from the timecard system to the monthly journal entry used to enter timecard data into the Lawson accounting system. Although differences between the timecard and accounting systems became smaller over the course of the company supplementing its response to our initial request for data, some of the differences between the timecard system and journal entries remained unexplained even after the company responded to a detailed follow-up request to explain and reconcile the differences.
10. We were unable to tie 2011 SJIS' costs allocable to affiliates from SJIS' "timecard" system to amounts allocated according to monthly "Billable to Multiple Clients" reports from the Lawson accounting system. Like directly charged amounts, SJIS labor costs allocable to affiliates are calculated outside the Lawson accounting system in a separate "timecard" application. Amounts shown to have been allocated from SJIS according to "Billable to Multiple Clients" reports for the month of December, 2011, and for the year 2011 as a whole, did not comport with allocable amounts from the timecard system. As noted above, the timecard system is a system maintained by an employee from SJIS' Information Technology function separate from the Lawson accounting system. Follow-up requests for information did not result in explanation or reconciliation of these differences.
11. Support for the calculation of factors used to distribute allocable SJIS costs in the year we tested (2011) was inadequate. – We found several problems with support for SJIS' allocation factors:
    - Data provided in response to our request for allocation factor support excluded the input data used to calculate several of the factors. In these cases it was not possible to see the support underlying the factor percentages.
    - For 9 of the 10 cost centers for which factor support include affiliate allocation percentages, there were differences between the percentage attributed to SJG in the factor support and SJG's percentage calculated using affiliate cost distributions shown in "Billable to Multiple Clients Reports." We were unable to reconcile these differences.
    - There was a significant difference between SJG's percentage of allocable Government Relations costs indicated by factor support (42% SJG) and by relative amounts billed according to "Billable to Multiple Clients" reports (75.5%). Overland's follow-up request for an explanation did not produce support for either of the two Government Relations percentages.

Recommendations

1. Overland strongly recommends that SJIS develop (or be required to develop) reporting that shows the following on a monthly and an annual basis: 1) SJIS costs incurred by function and

account, 2) how functional costs are classified for distribution by cost distribution method (i.e. the amounts, by function, directly charged or allocated using each allocation method), and 3) how these SJIS functional costs are distributed and billed to each affiliate (i.e., show the amounts for each method allocated to each affiliate). It should go without saying; however, it is important to emphasize that the totals for each function in items 1, 2 and 3 above should tie with one-another, both on a monthly as well as an annual basis. That means either SJIS will have to incorporate the full cost collection and distribution process into one system, or perform the monthly analysis necessary to identify functional amounts as incurred, as pooled for distribution by method, and as distributed to each affiliate, such that the total amounts reported for each SJIS function at each stage of the process *equal* one-another for a given timeframe.

2. SJIS should improve support for allocation factors to include 1) support for current year (as opposed to previous years') factors for all allocators and 2) the input data used to calculate each affiliates share of all allocators.
3. SJI should improve Cost Allocation Manual documentation of the SJIS allocation process. Specifically, documentation in the CAM should be expanded to include the following:
   - A description of the functions performed by SJIS at least equivalent to the descriptions contained in this report. Currently, the descriptions of "Services Provided by SJI Services, LCC, to SJG," spanning parts of pages 9 and 10 of the CAM dated at year-end 2011, consists of a very limited amount of information. The CAM should list, by function, the responsibilities of each function equivalent to those listed in this Chapter, to provide a reasonable understanding of what services are actually provided to affiliates.
   - An end-to-end description of the process by which SJIS incurs costs, identifies them for direct charging or pools them for distribution, and distributes and bills them to affiliates, including the basis for various allocators used to distribute "billable to multiple clients" costs. To the extent current procedures remain in place (notwithstanding other recommendations discussed above), the CAM should describe how timecard data is collected and input into the Lawson system, and the other recurring journal entries required to produce an SJIS affiliate billing, and the purpose of each. In the current CAM, descriptions of various SJIS processes and items are scattered throughout the CAM and various exhibits and attachments. This scattered approach inhibits an understanding of the process as a whole.[2]

SJIS Organization

SJI Services (SJIS) includes approximately 50 employees who provide administrative services, consisting primarily of human resources and information technology, to other SJI affiliates. The functions maintained in SJIS, combined with the functions maintained in SJI, are among those in a typical utility service company.

[2] For example, CAM table 9-1 (spanning pp. 11-14 of the December, 2011 CAM), includes descriptions of the allocation methods for various non-labor costs. Some of these costs originate in SJIS, while others originate in the parent organization. There is no identification of the affiliates that incur and distribute the individual categories of cost.

Table 4-1 - SJI Services, LLC, Employees by Department

SJI Services, LLC Employees By Department					
Function or Department	**Dec-08**	**Dec-09**	**Dec-10**	**Dec-11**	**Aug-12**
COMMUNICATIONS	4	4	4	5	5
EXECUTIVE	2	1	1	1	1
FACILITIES / BUILDING SERVICES	1	1	1	1	1
GOVERNMENT AND REG. AFFAIRS	3	3	4		
HUMAN RESOURCES	6	7	11	13	14
INFO SYSTEMS & TECHNOLOGY	17	21	21	22	23
INSURANCE	3	3			
MATERIALS MANAGEMENT	4	4	4	4	5
Total	**40**	**44**	**46**	**46**	**49**
Source: OC-5					

The combined force level of SJI and SJIS increased 35%, from 71 to 96 employees, between December 2008 and August 2012.

Services Provided to SJG

SJI Services provides services in the following functions:

- Human Resources
- Information Systems & Technology (Computer Operations, Management Systems and Network Services)
- Facilities and Building Services
- Procurement, Materials and Fleet Management
- Government & Regulatory Affairs
- Communications

The table below summarizes the services provided by SJIS to affiliates and the methods used to distribute the costs of each service.

Table 4-2 - SJI Services, Summary of Cost Charging Procedures as of December 31, 2011

SJI Services Summary of Cost Charging Procedures as of December 31, 2011	
Service Provided	**Cost Charging Methodology**
Human Resources - Labor & Benefits	Time Reporting
Fleet Management Labor & Benefits	Time Reporting
Graphics & Design Labor & Benefits	Time Reporting
Personal Computer Supply Services	Time Reporting
Personal Computer Materials & Supplies	Directly Assigned
Information Systems Labor & Benefits	Time Reporting
Lawson Information System Costs	Allocated Based on Employees and "Special Studies"
Telephone & Web Services Labor & Benefits	Time Reporting
Telephone Service	Directly Assigned
Data Processing Services Labor & Benefits	Time Reporting
Data Processing Network Services	Allocated Based on PCs
Data Processing Hardware Use & Maint.	Allocated Based on CPU Cycles
PC User Support	Allocated Based on Timecard System
Mailroom Services Labor & Benefits	Time Reporting
Facilities Management Labor & Benefits	Allocated Based on Occupied Space
Facilities Office Space	Allocated Based on Occupied Space
External Relations & Communications	Time Reporting
Procurement Services Labor & Benefits	Time Reporting
Source: OC-134 (SJI CAM, December 31, 2011)	

SJIS Billings to Affiliates by Function

This section describes our functional analysis of SJIS activities and cost distributions among affiliates. SJG's charges from SJIS averaged 71.2% of total SJIS costs billed during the years 2009 through 2011, before accounting for the impact of amounts initially allocated to parent entity SJI that were reallocated to SJG and its affiliates. SJG's share of SJIS' costs, after accounting for reallocation of amounts initially allocated to SJI, was approximately 80% during the years 2009-2011.[3] The following table summarizes the distribution of SJIS's costs to affiliates during the audit period by function. Attachment 4-1 provides a breakout of these amounts for each year by function (cost center) and financial statement category (O&M and capital).

[3] 11.6 percent of SJIS costs during the years 2009-2011 was allocated to SJI, before being reallocated to subsidiaries. SJG's ultimate allocation of SJIS' costs, approximately 80 percent, is calculated as follows: 71.2 percent + (75 percent x 11.6 percent) = 79.9 percent.

Table 4-3 - SJIS Billings to Affiliates, All Cost Centers

SJIS Billings to Affiliates All Cost Centers					
Cost Objectives	**2009**	**2010**	**2011**	**Total**	**Pct. Dist.**
Energy and Minerals (Morie)	27,653	17,142	423	45,219	0.2%
Marina - Marina Energy	109,518	129,043	67,875	306,437	1.4%
MAS - Millennium Account Services	39,188	24,600	8,088	71,876	0.3%
Open Flow	26,704	30,844	32,581	90,129	0.4%
RandT Group	1,438	1,023	423	2,884	0.0%
SJE - South Jersey Energy	83,282	70,132	242,543	395,956	1.8%
SJES - South Jersey Energy Solutions	131,814	226,296	303,039	661,150	3.0%
SJESP - South Jersey Energy Service Plus	764,141	625,619	651,918	2,041,678	9.1%
SJF - South Jersey Fuel Company	956	745	152	1,853	0.0%
SJG - South Jersey Gas	**5,130,371**	**5,541,546**	**5,280,054**	**15,951,971**	**71.2%**
SJI - South Jersey Industries	687,693	856,387	1,046,512	2,590,593	11.6%
SJRG - South Jersey Resources Group	76,956	71,472	87,839	236,268	1.1%
Totals	7,079,716	7,594,850	7,721,449	22,396,015	100.0%
Source: OC-340, 3rd Supplement, Billing Summaries					

Insurance (Cost Center 761)

In 2009 and 2010 SJIS housed an Insurance department consisting of a Manager, Insurance, an Insurance Specialist and a Property Claims Specialist. In 2011 the Insurance department was moved out of SJIS and became part of the Risk Management department of SJI. As described in the Insurance manager's job description, responsibilities include company insurance programs, claims management, enterprise risk management, contractor damages and vendor insurance. Specific responsibilities of the department include:

- Evaluate and obtain coverage for risks the company chooses to insure externally.
- Manage the company's self-insurance program.
- Review and analyze the performance of insurance policies and programs.
- Evaluate insurance claims against the company.
- Process claims [on behalf of and against the company] with outside adjusters and attorneys.
- Review contracts for risk and insurance-related issues and make appropriate recommendations to avoid or mitigate risk.
- Identify and quantify risk exposures.
- Develop and enforce workers compensation loss prevention measures.
- Develop a contractor damage program.
- Determine that vendors have proper insurance certificates with required endorsements.

The table below summarizes audit period charges to affiliates from the SJIS Insurance cost center. The costs consist almost entirely of the salaries and benefits of employees in the Insurance department.

Table 4-4 - SJIS Billings to Affiliates, Insurance Cost Center 761

SJIS Billings to Affiliates Insurance Cost Center 761					
Cost Objectives	**2009**	**2010**	**2011**	**Total**	**Pct. Dist.**
Energy and Minerals (Morie)	17,014	11,757	-	28,770	3.7%
Marina - Marina Energy	33,954	54,402	-	88,356	11.4%
MAS - Millennium Account Services	976	657	-	1,633	0.2%
Open Flow	5,079	1,832	-	6,911	0.9%
RandT Group	1,014	733	-	1,748	0.2%
SJE - South Jersey Energy	16,552	7,130	-	23,683	3.1%
SJES - South Jersey Energy Solutions	4,434	5,184	-	9,618	1.2%
SJESP - South Jersey Energy Service Plus	28,539	24,326	-	52,864	6.8%
SJF - South Jersey Fuel Company	825	605	-	1,430	0.2%
SJG - South Jersey Gas	**302,820**	**239,853**	**-**	**542,673**	**69.9%**
SJI - South Jersey Industries	6,363	2,101	-	8,464	1.1%
SJRG - South Jersey Resources Group	7,528	2,576	-	10,105	1.3%
Totals	425,098	351,156	-	776,255	100.0%
Source: OC-340, 3rd Supplement, Billing Summaries					

Executive (Cost Center 821)

The SJIS Executive cost center includes the compensation (salary, stock awards and cash awards) and benefits cost of Sharon Pennington, Chief Operating Officer. In 2012 Ms. Pennington's title was changed to Vice President and Chief Human Resources Officer. In 2009 this cost center also included the compensation and benefits of the Vice President of Information Systems, who left the company in 2009. Job descriptions provided in response to OC-71 did not include a description for Ms. Pennington's position. The positions reporting to Ms. Pennington at the beginning of the audit period included the Director, Corporate Communications, the Manager, Insurance, the Manager, Administrative Services and the Directors of Human Resources and Organizational Development. Organizational data shows that no positions reported to Ms. Pennington at the end of 2011; however, as of August, 2012, several managers in the Human Resources function reported to her.

The following table summarizes charges from the SJIS Executive cost center during the audit period. During this period, the share of costs charged to SJG decreased from 66% in 2009 to 29% in 2011.

Table 4-5 - SJIS Billings to Affiliates, Executive Cost Center 821

SJIS Billings to Affiliates Executive Cost Center 821					
Cost Objectives	**2009**	**2010**	**2011**	**Total**	**Pct. Dist.**
Energy and Minerals (Morie)	6,177	1,146	-	7,323	0.5%
Marina - Marina Energy	18,696	11,269	11,006	40,971	2.6%
MAS - Millennium Account Services	3,577	370	259	4,206	0.3%
Open Flow	202	(104)	194	292	0.0%
RandT Group	-	(716)	-	(716)	0.0%
SJE - South Jersey Energy	8,493	4,881	3,787	17,161	1.1%
SJES - South Jersey Energy Solutions	11,570	19,830	40,477	71,877	4.6%
SJESP - South Jersey Energy Service Plus	62,193	33,179	37,522	132,894	8.6%
SJF - South Jersey Fuel Company	-	-	-	-	0.0%
SJG - South Jersey Gas	**395,171**	**192,202**	**149,889**	**737,262**	**47.6%**
SJI - South Jersey Industries	71,257	162,876	260,734	494,867	32.0%
SJRG - South Jersey Resources Group	18,728	12,694	10,230	41,651	2.7%
Totals	596,063	437,626	514,098	1,547,787	100.0%
Source: OC-340, 3rd Supplement, Billing Summaries					

Corporate Overheads (Cost Center 822)

This SJIS cost center is not a functioning department; rather, it is a repository for costs to be spread over all service company activities. Audit period corporate overhead costs are summarized in the following table:

Table 4-6 - SJIS Services Billing Summary, Cost Components of Corporate Overheads Cost Center 822

SJIS Services Billing Summary Cost Components of Corporate Overheads Cost Center 822				
	2009	**2010**	**2011**	**Total**
SJG Services Employed-Mgmt Cost Alloca	104,861	119,504	93,306	317,671
SJI Services Employed-Assoc. Co. Salaries	151,022	174,495	262,903	588,420
Depreciation Expense	71,598	73,337	94,490	239,425
Gen'l Office Exp. (primarily wireless phone)	31,596	63,854	77,545	172,995
Information Technology License Fees	22,972	19,655	71,941	114,568
Outside Services (primarily audit expense)	48,699	47,551	33,200	129,450
Intercompany Telephone Charges	2,419	5,114	66,567	74,100
Employee-related Insurance Exp.	24,662	23,145	34,013	81,820
Bank Fees	6,557	7,238	7,804	21,599
Pensions - SERP	-	-	50,036	50,036
FICA Tax	-	-	43,056	43,056
Interest Income from SJI	(6,886)	(5,689)	(12,326)	(24,901)
Other - Net	5,378	(1,253)	(1,669)	904,604
Totals	462,878	526,951	820,866	1,810,695
Source: OC-340, 3rd Supplement, Billing Summaries				

Budgeted overheads from cost center 822 are billed to affiliates during the year based on relative SJIS billings from other categories. In other words, they are billed on a pro-rata basis to each affiliate based on its share of billings from SJIS management functions, which include all of the other cost centers discussed in this section. Since a rate is used to bill these charges, a year-end true-up entry is also necessary to eliminate the under- or over-cleared amounts.

Purchasing and Materials Management (Cost Center 850)

The Purchasing and Materials Management department is headed by a Manager, Administrative Services, who reports to the Director of Corporate Development, a position within SJI's parent company organization. In 2012 the department consisted of seven employees. Five of these, including the Manager, Administrative Services, a Supervisor, Purchasing and Fleet, a Supervisor, Business Continuity a Contract Administrator and an Administrative Services Assistant worked for SJIS. Two other employees, including a Materials Management Clerk and a Materials Management Analyst, worked for SJG. Except for the Supervisor, Business Continuity, a position that was added in 2012, the department was similar to the 2009-2011 review period. Department responsibilities include:

- Oversee policies and procedures relating to the purchase and control of materials, supplies and services.
- Oversee tools, systems, processes and staff relating to storerooms and inventories.
- Evaluate alternative suppliers and alternative approaches to obtaining products and services.
- Oversee evaluation of vendor performance.
- Oversee the Minority Purchasing Program.

The table below summarizes affiliate billings from Purchasing and Materials Management for the years 2009 through 2011. The share of billings charged to SJG remained constant throughout the audit period at approximately 86%.

Table 4-7 - SJIS Billings to Affiliates, Purchasing & Materials Mgt. Cost Center 850

SJIS Billings to Affiliates Purchasing & Materials Mgt. Cost Center 850					
Cost Objectives	**2009**	**2010**	**2011**	**Total**	**Pct. Dist.**
Energy and Minerals (Morie)	-	-	-	-	0.0%
Marina - Marina Energy	2,281	744	881	3,906	0.2%
MAS - Millennium Account Services	31	-	-	31	0.0%
Open Flow	452	405	1,654	2,510	0.1%
RandT Group	-	-	-	-	0.0%
SJE - South Jersey Energy	2,032	752	1,280	4,065	0.2%
SJES - South Jersey Energy Solutions	12,368	18,161	26,664	57,194	3.2%
SJESP - South Jersey Energy Service Plus	42,218	33,435	26,733	102,386	5.7%
SJF - South Jersey Fuel Company	-	-	-	-	0.0%
SJG - South Jersey Gas	**512,150**	**551,696**	**480,053**	**1,543,898**	**86.4%**
SJI - South Jersey Industries	18,554	28,276	22,924	69,754	3.9%
SJRG - South Jersey Resources Group	465	848	2,502	3,815	0.2%
Totals	590,552	634,316	562,692	1,787,560	100.0%
Source: OC-340, 3rd Supplement, Billing Summaries					

Facilities and Building Services (Cost Center 859)

This Facilities department consists of two employees: a Manager, Facilities who currently reports to the Director of Corporate Development, and a Senior Maintenance Mechanic who reports to the manager. Essential functions include:

- Promote, formulate policy and procedures relating to safety, security and property protection.
- Coordinate and direct the design, planning, construction and maintenance of buildings, machinery and equipment.
- Manage space allocation, layout and communication services.
- Supervise maintenance workers.
- Develop the program and monitor preventative maintenance of facilities.
- Negotiate leases of facilities.
- Oversee preparation and execution of a five-year capital facilities plan.
- Promote security and property protection.
- Serve as liaison to buyers, developers and realtors interested in SJI properties.

Building services consists largely of maintenance associated with the Folsom building that serves as SJI's headquarters. The following table summarizes charges from SJIS Facilities and Building Services during the audit period. The costs consist primarily of the compensation and benefits associated with the two employees housed in the cost center.

Table 4-8 - SJIS Billings to Affiliates, Facilities & Building Services Cost Center 859

SJIS Billings to Affiliates Facilities & Building Services Cost Center 859					
Cost Objectives	**2009**	**2010**	**2011**	**Total**	**Pct. Dist.**
Energy and Minerals (Morie)	-	171	333	504	0.1%
Marina - Marina Energy	93	186	77	357	0.0%
MAS - Millennium Account Services	-	-	-	-	0.0%
Open Flow	114	83	7	204	0.0%
RandT Group	85	53	-	138	0.0%
SJE - South Jersey Energy	76	96	89	261	0.0%
SJES - South Jersey Energy Solutions	6,357	13,444	3,498	23,298	2.7%
SJESP - South Jersey Energy Service Plus	16,132	9,355	4,253	29,740	3.5%
SJF - South Jersey Fuel Company	-	-	-	-	0.0%
SJG - South Jersey Gas	**269,217**	**261,439**	**260,242**	**790,898**	**92.3%**
SJI - South Jersey Industries	3,393	4,849	3,106	11,349	1.3%
SJRG - South Jersey Resources Group	241	152	84	476	0.1%
Totals	295,707	289,828	271,690	857,225	100.0%
Source: OC-340, 3rd Supplement, Billing Summaries					

Corporate Communications (Cost Center 861)

In 2012 this consisted of five employees (a Director, two Media & Community Relations Specialists, a Supervisor, Creative Services and a Secretary), an increase of one employee since 2008. Among the responsibilities listed in the Director's job description are the following:

- Develop and implement strategies to influence public opinion about activities, projects or events in which SJI and its companies are involved and educate consumers about mandated programs.
- Provide strategic public relations counsel and support to SJI and subsidiaries on emerging issues to optimize opportunities, redirect threats and minimize negative media coverage.
- Ensure communications used to promote SJI products and services are consistent with the SJI brand.
- Oversee communication of key messages to targeted media to build awareness and influence opinions about the company, and position executives as subject experts on energy topics.
- Oversee production of the company's financial reports (Annual Report to Shareholders, Proxy and financial news releases).
- Oversee implementation of change management programs.

The following table summarizes charges from SJIS Corporate Communications to affiliates during the years 2009 through 2011. Costs consist primarily of the compensation and benefits for the employees of the Corporate Communications department.

Table 4-9 - SJIS Billings to Affiliates, Corporate Communications Cost Center 861

SJIS Billings to Affiliates Corporate Communications Cost Center 861					
Cost Objectives	**2009**	**2010**	**2011**	**Total**	**Pct. Dist.**
Energy and Minerals (Morie)	-	-	-	-	0.0%
Marina - Marina Energy	14,309	10,596	5,905	30,810	2.1%
MAS - Millennium Account Services	158	169	29	357	0.0%
Open Flow	-	-	1,329	1,329	0.1%
RandT Group	-	-	-	-	0.0%
SJE - South Jersey Energy	8,253	3,041	4,726	16,019	1.1%
SJES - South Jersey Energy Solutions	9,848	30,831	28,966	69,645	4.8%
SJESP - South Jersey Energy Service Plus	30,617	23,336	19,665	73,618	5.1%
SJF - South Jersey Fuel Company	-	-	-	-	0.0%
SJG - South Jersey Gas	**244,314**	**225,996**	**243,578**	**713,889**	**49.1%**
SJI - South Jersey Industries	186,877	195,698	149,359	531,933	36.6%
SJRG - South Jersey Resources Group	13,639	636	1,123	15,397	1.1%
Totals	508,015	490,302	454,680	1,452,998	100.0%
Source: OC-340, 3rd Supplement, Billing Summaries					

Government Relations (Cost Center 863)

During most of the audit period SJIS had a small Government and Regulatory Affairs function consisting of a General Manager, a Government Relations Specialist and a Media and Community Relations Specialist. Sometime in 2011 the employees were moved from SJIS to SJG and the company hired a Director, Government and Regulatory Affairs to manage the function. The General Manager's position, when the function was housed in SJIS, included the following responsibilities:

- Maintain strategic direction for government and community relations.
- Oversee internal and external legislative and lobbying-related communications.
- Manage corporate philanthropic and social investment activities.
- Prepare the operating budget and social investment budget and control and administer related expenditures.

The Director of Government and Regulatory Affairs, a gas company position, lists approximately the same government affairs duties shown above that were the responsibility of the General Manager prior to 2011. It also lists the following additional functions:

- Develop a proactive regulatory affairs corporate strategy before the NJBPU and strengthen the company's image with the NJBPU and the Ratepayer Advocate.
- Develop corporate strategies for potential revisions for New Jersey regulatory practices.
- Provide a proactive approach to changes in state and federal regulatory policy.
- Oversee strategic direction for government and regulatory affairs.

The following table summarizes SJIS Government Relations billings to affiliates during the audit period. The costs consist primarily of compensation and benefits for the employees working in the function.

Table 4-10 - SJIS Billings to Affiliates, Government Relations Cost Center 863

SJIS Billings to Affiliates Government Relations Cost Center 863					
Cost Objectives	**2009**	**2010**	**2011**	**Total**	**Pct. Dist.**
Energy and Minerals (Morie)	-	-	-	-	0.0%
Marina - Marina Energy	18,955	14,230	4,076	37,261	4.3%
MAS - Millennium Account Services	-	-	-	-	0.0%
Open Flow	-	-	-	-	0.0%
RandT Group	-	-	-	-	0.0%
SJE - South Jersey Energy	9,617	5,809	4,808	20,235	2.3%
SJES - South Jersey Energy Solutions	3,253	2,951	24,916	31,120	3.6%
SJESP - South Jersey Energy Service Plus	9,225	8,540	9,557	27,322	3.1%
SJF - South Jersey Fuel Company	-	-	-	-	0.0%
SJG - South Jersey Gas	**101,635**	**92,624**	**137,853**	**332,113**	**37.9%**
SJI - South Jersey Industries	154,075	150,527	123,108	427,709	48.8%
SJRG - South Jersey Resources Group	-	-	84	84	0.0%
Totals	296,761	274,681	304,403	875,845	100.0%
Source: OC-340, 3rd Supplement, Billing Summaries					

Information Technology

Information Technology (IT) is the largest service company function in terms of employees. In the 2009-2011 review period it consisted of approximately two-dozen employees in three cost centers: Network Services (Cost Center 870), Management Systems (Cost Center 871) and Computer Operations (Cost Center 873). During this time IT was headed by a Director of Information Technology, who had the following key responsibilities:

- Develop and maintain the IT strategic plan and prepare agendas for the board's IT steering committee.
- Administer the procedure for acquiring new technology.
- Assist in ensuring proper technology implementation.
- Establish and maintain benchmarks to ensure the adequacy of IT support and services.
- Oversee network security and disaster recovery services.
- Oversee management of the help desk, application development and system implementation functions.
- Approve IT software and hardware purchases.

During our review period the Management Systems and Computer Operations departments were managed by a General Manager, IT who reported to the Director. Managers of IT Application Services and IT Infrastructure and Network Services reported to the General Manager, who was responsible for the following:

- Assisting business leaders in researching and evaluating future business processes and technology requirements and coordinating the overall design and implementation of technology-based solutions to support business lines.
- Acting as a liaison between IT and business lines in the analysis, selection and implementation of technology.
- Internal controls that assure the privacy, integrity and reliability of mainframe systems and databases.
- Recommendations for the acquisition of computer software and hardware.
- Development of company IT policy and procedures.
- Performance of the Computer Operations department to meet company requirements.

The table below shows the charges from SJIS Information Technology cost centers to affiliates. Although a majority of the costs consisted of the compensation and benefits of approximately two dozen employees, about 15% of the cost incurred during the audit period (ranging from 9% in 2011 to 19% in 2010) consisted of a combination of outside services and software or hardware license fees.[4]

Table 4-11 - SJIS Billings to Affiliates, Information Technology Cost Centers 870, 871 and 873

SJIS Billings to Affiliates Information Technology Cost Centers 870, 871 & 873					
Cost Objectives	**2009**	**2010**	**2011**	**Total**	**Pct. Dist.**
Energy and Minerals (Morie)	-	-	-	-	0.0%
Marina - Marina Energy	6,186	12,669	12,280	31,135	0.4%
MAS - Millennium Account Services	12,505	11,183	1,049	24,737	0.3%
Open Flow	11,440	10,838	14,416	36,695	0.4%
RandT Group	-	-	-	-	0.0%
SJE - South Jersey Energy	17,967	24,197	54,757	96,921	1.1%
SJES - South Jersey Energy Solutions	52,278	70,476	63,531	186,285	2.1%
SJESP - South Jersey Energy Service Plus	391,313	221,562	236,037	848,911	9.7%
SJF - South Jersey Fuel Company	-	-	-	-	0.0%
SJG - South Jersey Gas	**2,290,486**	**2,524,316**	**2,215,742**	**7,030,544**	**80.6%**
SJI - South Jersey Industries	133,937	117,498	142,307	393,742	4.5%
SJRG - South Jersey Resources Group	17,660	24,011	30,993	72,663	0.8%
Totals	2,933,773	3,016,750	2,771,111	8,721,634	100.0%
Source: OC-340, 3rd Supplement, Billing Summaries					

Human Resources (HR)

SJIS three HR departments grew from six employees at the beginning of the audit period to 13 employees at the end of the period. Three of the 13 employees at the end of 2011 were listed as part of the Organizational Development department and were actually trainees for South Jersey Energy’s power management business. As of 2012, HR included a Director, a General Manager, Compensation and Benefits, two General Managers – HR Business Partner, Managers of Diversity and Employee Labor Relations, Recruiters, an Analyst, Compensation and Benefits, an Information Systems Administrator and

[4] Responses to Discovery, OC-590 & 591.

a Talent Management Specialist. Key responsibilities of the HR function, as listed in the Director's job description, include:

- Prepare compensation recommendations for senior management approval.
- Ensure compliance with applicable laws, including healthcare reform.
- Direct the benefits administration process and manage relationships with healthcare insurance carriers and vendors.
- Develop human resources policies that comply with established law.
- Oversee employee assistance, service award, drug and alcohol and "gas light" programs.
- Manage the performance review policy.
- Develop and maintain company-wide job descriptions and an HR manual.
- Administer community volunteer activities.
- Oversee and manage the grievance process.
- Conduct employee counseling, disciplinary actions and terminations.
- Administer disability management and leave programs.
- Monitor the unemployment and workers compensation claims handling process and assist with appeals.

The following table summarizes costs charged by the SJIS Human Resources cost centers to affiliates during the years 2009 through 2011. Like most other SJIS cost centers, the costs consist primarily of compensation and benefits for Human Resources employees.

Table 4-12 - SJIS Billings to Affiliates, Human Resources Cost Centers 921, 922, 923 & 924

SJIS Billings to Affiliates					
Human Resources Cost Centers 921, 922, 923 & 924					
Cost Objectives	**2009**	**2010**	**2011**	**Total**	**Pct. Dist.**
Energy and Minerals (Morie)	1,647	1,464	-	3,111	0.1%
Marina - Marina Energy	3,995	7,158	19,657	30,810	1.0%
MAS - Millennium Account Services	17,732	8,744	5,186	31,661	1.0%
Open Flow	6,512	13,430	8,283	28,225	0.9%
RandT Group	166	-	333	500	0.0%
SJE - South Jersey Energy	11,803	14,410	123,264	149,477	4.9%
SJES - South Jersey Energy Solutions	17,331	35,472	53,301	106,103	3.5%
SJESP - South Jersey Energy Service Plus	118,130	186,034	187,084	491,248	16.2%
SJF - South Jersey Fuel Company	25	42	-	67	0.0%
SJG - South Jersey Gas	**490,255**	**678,562**	**709,758**	**1,878,575**	**62.0%**
SJI - South Jersey Industries	41,941	75,161	133,658	250,761	8.3%
SJRG - South Jersey Resources Group	10,841	21,383	24,848	57,073	1.9%
Totals	720,378	1,041,860	1,265,374	3,027,612	100.0%
Source: OC-340, 3rd Supplement, Billing Summaries					

Analysis of SJIS Billings to SJG

We reviewed costs directly charged and allocated to SJG from SJIS. There are four monthly and one annual recurring intercompany journal entries (RJIs) that go into producing affiliate bills. These entries include:[5]

- RJI-216 – SJI's Lawson accounting system is apparently unable to efficiently handle the process of collecting and charging amounts chargeable to affiliate for SJIS employees. For the purpose of determining loaded labor amounts chargeable to SJG and other affiliates, SJIS uses a separate "timecard" model operated by Shawn Denz, an employee in SJIS' Information Technology department. On a monthly basis, Mr. Denz provides a file to Accounting containing the direct and allocated loaded payroll charges for employees billing time to affiliates through SJIS. This file is uploaded into the Lawson system.
- RJI-307 – The Accounting department runs a series of reports to reclassify certain SJIS billings to capital, mainly for the purpose of identifying items that should be charged to the utility's balance sheet. There are several capital inputs to RJI-307, including RJ-223, which calculates a capital allocation for the Folsom headquarters building cost center 859; RJ-224, which reclassifies a portion of labor charges from Purchasing cost center 850 to capital; RJ-225 which 2011 reclassified approximately half of the amounts in Benefits cost center 921 to capital; and RJ-226 which reclassifies amounts from SJIS Executive cost center 821 to capital.
- RJI-302 – Service company costs from Information Technology cost centers 870 (Network Services) and 873 (Computer Operations) do not flow through the off-line "timecard" system. These costs originate in the Payroll and Accounts Payable systems, and must be manually input into the affiliate billing process through RJI-302 on a monthly basis.
- RJI-301 – Costs incurred in "Overheads" cost center 822, consisting primarily of labor charged to SJIS from parent company SJI, depreciation, telephone, outside services and software licensing fees, are cleared to affiliate bills by charging them at a rate determined at the beginning of each year. For 2011 this rate was 25% of all other costs billed. Thus, if an affiliate's monthly bill for all SJIS costs other than cost center 822 was $10,000, its allocation of overheads for that month would be $2,500.
- RJI-300 – The overheads clearing rate determined at the beginning of each year is a best guess of the rate needed to completely clear overheads. The residual under- or over-cleared amount remaining at the end of the year, is cleared annually through RJI-300.

The process of collecting and processing amounts billed by SJIS to affiliates is complex and involves a number of manual steps and journal entries performed on a monthly basis. Essentially, the components of the process are a "black box." We selected the month of December 2011 to test the audit trail between source data, including that from the "timecard" model, and amounts billed to SJG (as shown in the December, 2011 SJIS Billing Summary to SJG). Through discussion with Michael Palogruto, the accountant responsible for the journal entries that feed the affiliate billing process, we were able to obtain and tie supporting journal entry data to the affiliate bills for the recurring entries discussed

[5] Discussion with Michael Palogrutto, Nov. 26, 2012.

above. Although there were small differences between the bill and the journal entry detail, they were generally explainable. However, we were unable to tie amounts from the largest entry, RJI-216, back to monthly payroll charges from the "timecard" model run by Mr. Denz.

The table below summarizes differences between the affiliate bill and incoming "timecard" data for the month of December 2011 for those SJIS cost centers in which the billing to SJG is based on loaded payroll charges from timecard system data. Most of the amounts in the differences column at the right are differences between the data provided for the "timecard" system and the journal entry that provides timecard amounts to the affiliate billing process, RJ-216, although there are also smaller amounts that represent a difference between the amounts in the journal entry and the affiliate bill.

Table 4-13 - SJIS Charges to SJG, Comparison of December 2011 SJIS Billings to SJG with "Timecard" Model Data

SJIS Charges to SJG
Comparison of December 2011 SJIS Billing to SJG with "Timecard" Model Data

Cost Center		Amts Directly Charged & Allocated to SJG per "Timecard" Model (1)					SJIS to SJG Bill Summary Amts (2)			Timecard Model / Afiliate Bill Differences
		Allocated Expense	Direct Expense	Total Expense	Direct Capital	Total Timecard Amounts	Expense	Capital	Total Bill Amounts	
821	SJIS OH	-	3,886	3,886		3,886	7,577	2,459	10,036	(6,150)
850	Purch & Facilities	1,560	29,126	30,686		30,686	14,023	17,086	31,109	(423)
859	Purch & Facilities	173	16,764	16,938	383	17,320	12,707	4,618	17,325	(5)
861	Communications	6,170	10,530	16,700		16,700	16,700		16,700	(0)
863	Govt Relations Svcs	3,652	5,283	8,935		8,935	8,935		8,935	-
871	IT Services	28,621	17,504	46,126	47,524	93,650	52,280	41,182	93,462	188
921	HR Services	11,936	7,511	19,446	5,016	24,463	9,893	19,538	29,431	(4,968)
922	HR Services	1,693	10,075	11,769		11,769	11,760		11,760	9
923	HR Services	3,691	7,034	10,725		10,725	10,635		10,635	90
924	HR Services	4,724		4,724		4,724	4,700		4,700	23
Total		62,221	107,714	169,935	52,923	222,858	149,210	84,883	234,093	(11,235)

Sources:
(1) OC-340, 3rd Supplement
(2) SJIS to SJG December 2011 Billing Summary (provided by M. Palogrutto, Nov. 19, 2012)

Documentation of the Flow of Costs from Incurrence to Distribution

Unlike many utilities we have audited, SJIS does not have the ability to summarize the costs it incurs and distributes to affiliates by function, cost type and cost distribution methodology. As such, we attempted to construct an analytical framework to understand and follow the flow of costs for each SJIS function from incurrence to its distribution to SJG, including the cost amounts and methods by which they were distributed.

In OC-340 we asked for accounting detail including pre-billed, pre-allocated SJIS costs, by cost type and SJIS function or cost center, and the distribution of these costs to each affiliate billed by SJIS. The company's initial response consisted of a set of "cost center activity reports" in Adobe, showing, for each SJIS cost center, the amounts of cost incurred by cost category (payroll, payroll taxes, materials & supplies) and the total cost billed to each affiliate. The "in between" (how the costs were assembled, pooled into direct assignment and allocable cost categories, and how the allocable costs were distributed) was missing.

A supplemental response included data from the "timecard" system, a system that prices out employee time on a loaded labor rate basis and identifies amounts directly charged and allocable from each SJIS function to affiliates. We initially tried to analyze the timecard system data and tie it out with annual amounts billed to affiliates for the period 2009 through 2011. In the third supplemental response to data request OC-340 the company provided data in a usable format, including separate files showing allocation factors, and in which the differences between amounts from the "timecard" system and affiliate bills were small enough to deal with at the cost center level.

In OC-601 we requested explanations for differences between data from the timecard system and amounts in the journal entry into which the timecard loaded payroll is fed for input into the December 2011 affiliate bill. In general, the company's response did not serve to explain the differences such that we could clear them. Based on the work we performed, we have concluded the SJIS cost collection and distribution process is a "black box." At best, it appears that a couple of people at SJI (Messrs. Palogruto and Denz) understand the process in enough detail to produce SJIS' monthly billing to affiliates, and neither one of them appears to understand the other's portion of the process in detail. In addition to containing various manual and detailed steps, as evidenced by the significant amount of time we spent trying to understand and tie out (without success) a single month's data, the process does not appear to be auditable in any practical sense. This means that apart from high-level tests of reasonableness, such as monthly or annual comparisons for fluctuations, it is difficult for "clients," including the various SJG business units that are billed by SJIS, to have confidence that their bills are correct, even if they are correct.[6]

Testing of SJIS Direct Charges

We examined amounts directly charged by individual employees in 2011 to determine whether the charges appeared correct given the functions performed by the cost centers to which the employees were assigned, the job titles and descriptions of the employees charging time, and the projects to which employee time was charged. Below are specific findings from this review:

1. <u>Some SJIS employees charged time through cost centers other than the one to which they were assigned</u> - The Company stated that the timecard application is intended for people assigned to a SJIS cost center to charge that cost center. However, we found several individuals who charged amounts through SJIS cost centers other than the ones to which they were assigned. SJI stated that "there have been several individuals who [had identities] in more than one cost center." In other cases employees billed through a cost center other than their own "because that [was] where [the] task [they were working on] was housed."[7]

[6] To put this into perspective, for the month we attempted to tie out (December, 2011), the unexplained portion of differences between the timecard system and the journal entry that feeds timecard costs into the general ledger, as shown in the table above, amounted to slightly less than 5 percent of the amount billed to SJG.

[7] Responses to Discovery, OC-599.

2. SJG charged "above-the-line" accounts for SJIS Government Relations charges to projects whose descriptions suggest lobbying and other forms activity required by the FERC USOA to be recorded below-the-line. SJG also charged activities associated with corporate charitable activities above-the-line. The FERC USOA requires "donations for charitable, social or community welfare purposes" and "expenditures for the purpose of influencing public opinion with respect to . . . public officials, referenda, legislation or ordinances" to be recorded "below-the-line" in account 426 in the Other Income and Deductions account category. Loaded labor costs charged by SJIS Government Relations employees to the following projects were billed to SJG and recorded by SJG in "above-the-line" regulated expense accounts, rather than "below-the-line" in account 426. The project descriptions represent information provided in response to Overland's request for information about the activities charged to each project. [8]
   - *GCR – Electric compliance, reporting, lobbying activity* – Time spent completing compliance documents required by the Election Law Enforcement Commission.
   - *GCR – Interface Government Official* – Time spent with elected officials for the purpose of furthering business objectives.
   - *GCR – Legislative review, research, update* – Time spent monitoring, reviewing, analyzing and assessing the impacts of legislation.
   - *GCR – Social Investment* – time spent on corporate charitable activities of South Jersey Industries, and in some cases, its affiliates.

   In explaining why charges to these projects were not recorded below-the-line, the company stated that "since the activities described [for these projects] represent employee time spent on the day to day operations of our department in supporting SJG objectives, none of those costs were billed below the line."[9] Arguably, at least some of the Government Relations costs charged to these projects should have been charged below-the-line in accordance with FERC Uniform System of Account (USOA) descriptions. In addition, although activities associated with charitable contributions are not specifically addressed in the USOA, if the BPU's intent is that customers not fund SJG's donations to charities, the BPU should consider requiring SJG to charge the cost of administering charitable contributions below-the-line, in account 426.

SJIS Cost Allocations

A relatively small portion of the total amount billed to SJG by SJIS during the review period was allocated between SJG and affiliates (as opposed to directly charged to affiliates). Costs allocable to SJG are distributed among the individual business units within SJG.

In attempting to tie the various elements of the SJIS billing process together, we reviewed the procedures used to allocate the service company's costs to affiliates. The table below shows the amounts allocated by each SJIS cost center to each affiliate cost objective (including individual business

[8] Responses to Discovery, OC-598-A. It is interesting to observe that although the title of the first project refers directly to lobbying activities, the description of activities performed provided by the Company makes no reference to lobbying.
[9] Responses to Discovery, OC-598-C.

units within SJG) for the year 2011, as reflected in monthly "Billable to Multiple Clients Summary Report[s]" provided to Overland in Adobe. As discussed in more detail below, "timecard" data provided in electronic format shows different amounts. For example, timecard data from OC-340, 3rd Supplement, shows $1.46 million in total allocable costs in 2011, compared with the $1.24 million shown in Billable to Multiple Clients Summary Reports. We have been unable to get an explanation for or reconciliation of the differences.[10]

Table 4-14 - SJI Services, Amounts Allocated to Affiliates in 2011 and Percentages Allocated to SJG

SJI Services Amounts Allocated to Affiliates in 2011 and Percentages Allocated to SJG												
Affiliate Cost Objectives	SJIS Cost Centers and Amounts Allocated											
	821 Executive	822 Corporat	850 Purchasi	859 Folsom	861 Corp Comm	863 Govt Rel	871 IT Mgt Sys	921 HR Benefits	922 HR Labor	923 HR	924 HR Org	Total All Cost Ctrs
Energy and Minerals (Morie)	-	-	-	-	-	-	-	-	-	-	-	-
Marina - Marina Energy	-	-	476	6	-	-	4,510	2,245	468	1,360	2,430	11,495
MAS - Millennium Acct Svcs.	-	-	-	-	-	-	-	-	-	-	-	-
Open Flow	-	-	542	7	-	-	3,863	2,567	533	1,551	2,767	11,831
RandT Group	-	-	-	-	-	-	-	-	-	-	-	-
SJE - South Jersey Energy	-	-	542	89	-	-	7,085	2,567	533	1,551	2,767	15,134
SJES - S J.Energy Solutions	21	3	2,036	290	21,507	17,725	18,033	9,621	2,003	5,823	10,394	87,455
SJESP - S.J. Energy Svcs Plus	8	1	6,316	863	7,605	6,268	60,548	29,822	6,211	18,057	32,239	167,937
SJF - S.J. Fuel Company	-	-	-	-	1	-	-	-	-	-	-	1
SJG - Acct/Tax/Budget	***-***	***-***	***1,155***	***171***	***-***	***-***	***12,236***	***5,439***	***1,136***	***1,981***	***5,894***	***28,012***
SJG - CCC	***-***	***-***	***5,161***	***708***	***-***	***-***	***43,803***	***24,310***	***5,076***	***8,855***	***26,345***	***114,257***
SJG - Corporate Support	***89***	***11***	***66***	***25***	***89,712***	***73,936***	***32,208***	***31,988***	***65***	***113***	***337***	***228,552***
SJG - Eng./Construction	***-***	***-***	***2,649***	***371***	***-***	***-***	***9,019***	***12,475***	***2,605***	***4,545***	***13,521***	***45,185***
SJG - Enviornmental	***-***	***-***	***137***	***35***	***-***	***-***	***1,934***	***639***	***134***	***234***	***697***	***3,810***
SJG - Gas Supply/OSS	***-***	***-***	***542***	***89***	***-***	***-***	***12,882***	***2,560***	***533***	***930***	***2,767***	***20,304***
SJG - Operations	***-***	***-***	***15,417***	***2,082***	***-***	***-***	***159,097***	***72,613***	***15,162***	***26,452***	***78,696***	***369,519***
SJG - Rates	***-***	***-***	***476***	***744***	***-***	***-***	***6,443***	***2,240***	***468***	***817***	***2,430***	***13,617***
SJG - Sales	***-***	***-***	***1,900***	***271***	***-***	***-***	***16,104***	***8,956***	***1,868***	***3,259***	***9,696***	***42,054***
SJI - South Jersey Industries	-	-	2,512	353	-	-	27,052	11,866	2,471	7,182	12,824	64,260
SJRG - S.J.Resources Group	-	-	881	12	-	-	7,731	4,169	867	2,522	4,500	20,682
Totals	118	15	40,807	6,116	118,825	97,929	422,549	224,075	40,133	85,233	208,305	1,244,105
Pct. of Total Allocated to SJG	75 51%	75.47%	67.39%	73 51%	75 50%	75.50%	69.51%	71.95%	67 39%	55.36%	67.39%	69 55%
Source: DR #340 2011 Allocated Time Reports folder, 12 monthly adobe documents titled "2011-xx Timecard-Billable to All Total" (DR 340, second supplement)												

In the third supplement to OC-340, we received allocable cost data in electronic format from the timecard system. However, the data provided did not show how allocable costs were pooled or distributed.[11] We compiled the amounts in the table above into a spreadsheet from Adobe images of

[10] As discussed in further detail below, we requested an explanation and reconciliation of differences in the amount of allocable cost from different sources in OC-602. The response did not provide the requested explanation.

[11] OC-340, 2nd Supplement, "DR340 2011 SJIS TimeCard Chgs.xls." Near the end of the project, from data provided in responses to requests OC-603 and 604, we learned that SJIS could produce timecard system data showing the percentages of "billable to all" cost distributed to each subsidiary. However, this level of data was never produced earlier in the project, either in response to the initial request or any of **three requests for supplement** to data request OC-340. OC-340 requested "the accounting data which contains total (pre-billed, pre-allocated) SJI Services (SJIS) costs, by type and by SJIS function / cost center . . . and showing the distribution of such costs to each affiliate billed by SJIS, [including] all relevant accounting and

monthly "Billable to Multiple Clients" reports provided in the second supplement to OC-340. While these reports show the *results* of the allocation process, they do not show the process itself. For example, they do not show how costs are put into allocation pools or show the factors applied to distribute amounts to each affiliate. In addition, as shown in the table below, the allocable cost amounts in the Billable to Multiple Clients reports do not equal the allocable cost amounts in the timecard database.

Table 4-15 - SJI Services, Comparison of 2011 Allocable Costs – SJIS Timecard System vs. Billable to Multiple Clients Data

SJI Services Comparison of 2011 Allocable Costs - SJIS Timecard System vs. Billable to Multiple Clients Data							
Cost Center		Timecard data		Billable to Multiple Clients Report		Differences	
		Dec. 2011	2011 Total	Dec. 2011	2011 Total	Dec. 2011	2011 Total
821 & 822	SJIS OH / Executive	7,966	120,216		133	7,966	120,083
850	Purch & Facilities	2,501	44,511	2,315	40,807	185	3,704
859	Purch & Facilities	232	5,922	243	6,116	(11)	(194)
861	Corp Communications	8,172	118,804	8,172	118,825	(0)	(21)
863	Govt Relations Svcs	4,838	97,928	4,838	97,929	(0)	(1)
870	IT Services	-	2,655			-	2,655
871	IT Services	45,630	468,463	41,174	422,549	4,456	45,914
873	IT Services	-	118			-	118
921	HR Services	17,714	239,029	16,578	224,075	1,136	14,954
922	HR Services	2,714	43,345	2,513	40,133	201	3,212
923	HR Services	7,459	95,136	6,703	85,233	756	9,903
924	HR Services	7,570	225,028	7,009	208,305	561	16,723
Grand Total		104,795	1,461,155	89,544	1,244,105	15,250	217,050
Sources: OC-340, 3rd Supplement, "2012-11-15 DR Query 2011.xls," "Allocated Time" sheet; OC-340, 2nd Supplement, 2011 Allocated Time Reports.							

In discovery request OC-602 we asked that the Company explain and reconcile the differences for December 2011, which are summarized in the table above along with differences for the year 2011 as a whole. The response consisted of a series of spreadsheets, one of which was actually entitled "Explanation." However, the response neither reconciled nor explained the differences for the month of December 2011 as shown in the table above.[12] At the writing of this report, we do not know why the timecard system contains one set of allocable cost amounts, while the "Billable to Multiple Clients" report contains a different set of amounts, nor do we know which set of amounts, if either, is correct.

allocation fields in the data, allocation method (code and description), amounts charged / allocated to each affiliate and any other fields and field descriptive information necessary to completely understand the cost loading, pooling and allocation processes."

[12] The response to OC-602 did not include any narrative explanation of the differences.

Allocation Factor Support

In the second supplement to data response OC-340 we obtained spreadsheets showing the factors used to distribute common (allocable) service company costs. These are summarized in the table below.[13] The full allocation support provided by the company is shown in Attachment 4-2.

Table 4-16 - SJI Services, Comparison of SJG Allocation Factor Percentages and Percentages of Cost Allocated in 2011

SJI Services Comparison of SJG Allocation Factor Percentages and Percentages of Cost Allocated in 2011						
Cost Center		Allocator Name	Allocation Factor Calcs. per Supporting Wksheets Provided by the Company		Amounts Allocated to SJG per "Billable to Multiple Clients" Report	
			Factor Inputs Provided?	SJG Alloc. Factor Pct.	SJG Alloc. Percentage	SJG Allocation Amount
821	SJIS - Exec	Officers	No	77.20%	75.51%	89
822	Corporate OH	Unknown	No	Unknown	75.47%	11
850	Purchasing	Empl. Head Count 1	Yes	62.40%	67.39%	27,502
859	Facilities Folsom	Empl.Head Count 2	Yes	65.18%	73.51%	4,496
861	Corp Comm	Comm. & Officers	No	75.50%	75.50%	89,712
863	Govt Relations	Govt. Relations	No	42.00%	75.50%	73,936
871	IT Services	PC Count	Yes	62.73%	69.51%	293,727
921	HR Services	Benefits Head Count	Yes	67.38%	71.95%	161,220
922	HR Services	Empl.Head Count 1 & 3	Yes	62.40%; 0.00%	67.39%	27,047
923	HR Services	Empl.Head Count 1 & 3	Yes	62.40%; 0.00%	55.36%	47,187
924	HR Services	Empl.Head Count 1 & 3	Yes	62.40%; 0.00%	69.55%	140,385
Total Allocated to SJG per "Billable to Multiple Clients" Summary Report						865,312
Source: OC-340, 2nd Supplement, "DR340 2011 Alloc Timecards.xls" (Factor Calc. Support) & DR #340 Allocated Time Reports (Billable to Multiple Clients Reports).						

As shown in the table, for some of the allocators "support" did not include the inputs used to calculate the allocators. The factors used by SJIS to distribute costs during the review period included the following:

- ***Officers*** – The Officer's allocation was used for cost center 821 and possibly cost center 822. As shown in the table above, the service company cost amounts distributed using this allocation method were trivial. The factor inputs supporting the Officer's allocation were not provided, so it is not possible to determine how or from what inputs it was calculated.
- ***Employee Headcount*** – According to the allocation factor support provided in Attachment 4-2, SJIS used three employee headcount allocators to distribute the costs of human resources cost centers 922, 923 and924, purchasing cost center 850 and Folsom facilities cost center 859. Allocators 1 and 2 are based on calculations that include all (allocator #1) or nearly all (allocator #2) SJI employees. The only difference between them is the exclusion of employees from a few small affiliates (Marina, Open Flow and South Jersey Resources Group) from allocator #2, which

[13] Spreadsheet "DR340 AllocTimeCards.xls" contains allocation factors for each type of allocator and affiliate. Support for some of the allocation methods includes the inputs used to calculate the factors (e.g. employees, personal computer counts, etc.), while support for other methods does not.

was used in 2011 to distribute costs from the Folsom headquarters building. A third employee headcount allocator excludes employees of SJG. This allocator appears to be used for a small portion of the costs distributed from Human Resources cost centers 922, 923 and 924; however, as noted above, it was not possible to identify the precise amounts distributed with any allocation factor because cost allocation pools and the application of factors to the pools was not included in the timecard system detail provided by the company. As shown in Attachment 4-2, the supporting data provided for the employee headcount allocators included the factor inputs, which, in this case were employee counts described as being current as of January 19, 2011. We compared these counts to December 2010 employee counts in organizational data provided elsewhere and found them to be closely comparable.[14]

- ***Communications / Officers*** - Allocation factor support indicates that the Communications / Officers factor was used to distribute allocable costs from SJIS cost center 861. Even though the column that should include the factor input data is labeled "Employee Count," SJG's share of the allocator is somewhat higher than its share of employees. Factor inputs for the Communications and Officers Allocation were omitted from the support so it is not possible to determine how or from what source the stated factors were derived. Approximately 76% of the total cost is distributed to SJG's Corporate Support business unit. The remainder is split between South Jersey Energy Services Plus (the appliance affiliate) and South Jersey Energy Solutions.
- ***Government Relations*** – This allocator was used to distribute the allocable costs of SJIS' Government Relations cost center 863. As shown in Attachment 4-2, allocation factor support for the Government Relations allocator shows that it was not updated between 2009 and 2011. Like the Communications / Officers allocator, the company did not provide the factor input data used to calculate the allocator, so it was not possible to determine how or from what the allocation factors were derived. SJG's share of the allocator was 42% in 2011, distributed primarily to SJG's Corporate Support business unit. However, as discussed in more detail below, SJG was distributed a significantly higher percentage (approximately 76%) of allocable Government Relations costs than the factor support shown in Attachment 4-2 would indicate is appropriate.
- ***PC Count*** – The PC Count allocator was used to distribute allocable costs from SJIS cost center 871 – IT Network Services. As the title suggests, it is based on relative affiliate levels of personal computers. SJG's 2011 share of the allocator was approximately 63%, slightly less than its share of total employees.

Differences Between Allocation Factor Support and Percentages of Cost Allocated

As the table above shows, there are differences between the percentages indicated by the allocation factor calculation support and the percentages derived from amounts shown to have been allocated to SJG in "Billable to Multiple Clients Reports." In fact, for the year 2011 there were differences for 9 of the 10 SJIS cost centers for which factor support was provided. In most cases, the differences were relatively small. However, factor support for the Government Relations cost center shows an SJG

[14] Organizational data with employee counts at various points in time were provided in response to OC-5.

allocation percentage significantly different from "Billable" reports.[15] In addition, as noted in the table above, the factor support provided for Government Relations did not include the input data used to calculate the allocator, and the chart provided indicated that the allocator was current as of July 20, 2009. We asked the company to explain the basis for the allocation percentages used to distribute Government Relations cost to SJG and to provide a copy of the data used to develop the percentages used to distribute costs in 2011. The company's response stated that "the prior year's actual billable hours" were the basis for the allocation. However, the "billable hours" data used to calculate the allocator that was "current as of July 20, 2009" was not provided. The response also stated that documentation supporting the 2010 and 2011 Government Relations allocators (including the 76% SJG distribution in 2011) was not available.

[15] Factor support provided in the 2nd supplement to OC-340, which shows a 42 percent Government Relations factor for SJG, while amounts distributed according to "Billable to Multiple Clients" reports reflect a 76 percent distribution to SJG.

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SJIS Services Billing Summary
2009 O&M Billings

Cost Objectives	Insurance 761	Executive 821	Corp OH 822	Purchasing 850	Folsom 859	Corp Comm 861	Govt Rel 863	IT Network Services 870	IT Mgt Systems 871	IT Computer Ops 873	HR Benefits 921	HR Labor Rel 922	HR Recruiting 923	HR Org Dev 924	Total
Energy and Minerals (Morie)	17,014	6,177	2,816	-	-	-	-	-	-	-	1,647	-	-	-	27,653
Marina - Marina Energy	23,491	18,696	10,211	2,281	93	14,309	18,955	3,992	2,195	-	1,765	688	1,530	12	98,218
MAS - Millennium Account Services	976	3,577	4,210	31	-	158	-	-	12,505	-	3,295	11,877	2,560	-	39,188
Open Flow	5,079	202	2,906	452	114	-	-	5,987	5,453	-	1,579	3,204	1,717	12	26,704
RandT Group	1,014	-	172	-	85	-	-	-	-	-	166	-	-	-	1,438
SJE - South Jersey Energy	16,552	8,493	8,487	2,032	76	8,253	9,617	10,940	7,027	-	2,067	1,283	8,441	12	83,282
SJES - South Jersey Energy Solutions	4,434	11,570	13,720	12,368	6,357	9,848	3,253	14,858	37,270	-	6,866	4,994	5,430	40	131,008
SJESP - South Jersey Energy Service Plus	28,539	47,321	63,711	42,218	16,132	30,617	9,225	78,354	94,759	89,547	29,941	68,168	19,821	199	618,553
SJF - South Jersey Fuel Company	825	-	106	-	-	-	-	-	-	-	25	-	-	-	956
SJG - South Jersey Gas	240,152	250,726	416,581	290,632	195,464	244,314	101,635	352,223	754,198	504,827	69,827	268,509	75,725	777	3,765,591
SJI - South Jersey Industries	6,363	71,257	71,206	18,554	3,393	186,877	154,075	57,603	75,266	-	14,731	12,703	14,445	62	686,535
SJRG - South Jersey Resources Group	7,528	18,728	7,861	465	241	13,639	-	7,909	9,460	-	2,974	2,191	3,209	2,468	76,672
Totals	351,967	436,747	601,987	369,034	221,954	508,015	296,761	531,865	998,133	594,373	134,884	373,618	132,877	3,583	5,555,799

SJIS Services Billing Summary
2009 Capital Billings

Cost Objectives	Insurance 761	Executive 821	Corp OH 822	Purchasing 850	Folsom 859	Corp Comm 861	Govt Rel 863	IT Network Services 870	IT Mgt Systems 871	IT Computer Ops 873	HR Benefits 921	HR Labor Rel 922	HR Recruiting 923	HR Org Dev 924	Total
Energy and Minerals (Morie)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Marina - Marina Energy	10,463	-	837	-	-	-	-	-	-	-	-	-	-	-	11,300
MAS - Millennium Account Services	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Open Flow	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
RandT Group	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
SJE - South Jersey Energy	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
SJES - South Jersey Energy Solutions	-	-	657	-	-	-	-	-	150	-	-	-	-	-	807
SJESP - South Jersey Energy Service Plus	-	14,872	2,063	-	-	-	-	-	128,653	-	-	-	-	-	145,588
SJF - South Jersey Fuel Company	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
SJG - South Jersey Gas	62,668	144,444	107,742	221,518	73,753	-	-	170,351	438,974	69,914	75,416	-	-	-	1,364,780
SJI - South Jersey Industries	-	-	90	-	-	-	-	-	1,069	-	-	-	-	-	1,158
SJRG - South Jersey Resources Group	-	-	(6)	-	-	-	-	-	290	-	-	-	-	-	284
-	73,131	159,316	111,381	221,518	73,753	-	-	170,351	569,136	69,914	75,416	-	-	-	1,523,917

SJIS Services Billing Summary
2009 Total Billings

Cost Objectives	Insurance 761	Executive 821	Corp OH 822	Purchasing 850	Folsom 859	Corp Comm 861	Govt Rel 863	IT Network Services 870	IT Mgt Systems 871	IT Computer Ops 873	HR Benefits 921	HR Labor Rel 922	HR Recruiting 923	HR Org Dev 924	Total
Energy and Minerals (Morie)	17,014	6,177	2,816	-	-	-	-	-	-	-	1,647	-	-	-	27,653
Marina - Marina Energy	33,954	18,696	11,048	2,281	93	14,309	18,955	3,992	2,195	-	1,765	688	1,530	12	109,518
MAS - Millennium Account Services	976	3,577	4,210	31	-	158	-	-	12,505	-	3,295	11,877	2,560	-	39,188
Open Flow	5,079	202	2,906	452	114	-	-	5,987	5,453	-	1,579	3,204	1,717	12	26,704
RandT Group	1,014	-	172	-	85	-	-	-	-	-	166	-	-	-	1,438
SJE - South Jersey Energy	16,552	8,493	8,487	2,032	76	8,253	9,617	10,940	7,027	-	2,067	1,283	8,441	12	83,282
SJES - South Jersey Energy Solutions	4,434	11,570	14,377	12,368	6,357	9,848	3,253	14,858	37,420	-	6,866	4,994	5,430	40	131,814
SJESP - South Jersey Energy Service Plus	28,539	62,193	65,774	42,218	16,132	30,617	9,225	78,354	223,412	89,547	29,941	68,168	19,821	199	764,141
SJF - South Jersey Fuel Company	825	-	106	-	-	-	-	-	-	-	25	-	-	-	956
SJG - South Jersey Gas	302,820	395,171	524,323	512,150	269,217	244,314	101,635	522,574	1,193,172	574,741	145,243	268,509	75,725	777	5,130,371
SJI - South Jersey Industries	6,363	71,257	71,296	18,554	3,393	186,877	154,075	57,603	76,334	-	14,731	12,703	14,445	62	687,693
SJRG - South Jersey Resources Group	7,528	18,728	7,855	465	241	13,639	-	7,909	9,750	-	2,974	2,191	3,209	2,468	76,956
Totals	425,098	596,063	713,369	590,552	295,707	508,015	296,761	702,216	1,567,269	664,287	210,300	373,618	132,877	3,583	7,079,716

Source: OC-340, 3rd Supplement, Billing Summaries

REDACTED

SJIS Services Billing Summary
2010 O&M Billings

Cost Objectives	Insurance 761	Executive 821	Corp OH 822	Purchasing 850	Folsom 859	Corp Comm 861	Govt Rel 863	IT Network Services 870	IT Mgt Systems 871	IT Computer Ops 873	HR Benefits 921	HR Labor Rel 922	HR Recruiting 923	HR Org Dev 924	Total
Energy and Minerals (Morie)	11,757	1,146	2,605	-	171	-	-	-	-	-	1,464	-	-	-	17,142
Marina - Marina Energy	42,558	11,269	15,608	744	186	10,596	14,230	8,463	4,206	-	1,591	566	2,315	2,686	115,018
MAS - Millennium Account Services	657	370	3,477	-	-	169	-	-	11,183	-	2,981	2,655	3,107	-	24,600
Open Flow	1,832	(104)	4,360	405	83	-	-	7,317	3,521	-	1,930	1,231	7,583	2,686	30,844
RandT Group	733	(716)	952	-	53	-	-	-	-	-	-	-	-	-	1,023
SJE - South Jersey Energy	7,130	4,881	9,808	752	96	3,041	5,809	13,311	10,830	-	2,706	701	7,335	3,669	70,070
SJES - South Jersey Energy Solutions	5,184	19,830	29,693	18,161	13,444	30,831	2,951	33,940	34,653	-	6,985	2,277	13,557	12,654	224,158
SJESP - South Jersey Energy Service Plus	24,326	33,179	85,554	33,435	9,355	23,336	8,540	113,984	89,311	15,842	33,508	52,934	57,549	42,043	622,895
SJF - South Jersey Fuel Company	605	-	98	-	-	-	-	-	-	-	42	-	-	-	745
SJG - South Jersey Gas	180,378	115,849	531,132	328,498	186,575	225,996	92,624	392,307	636,695	549,180	87,061	213,090	116,735	178,031	3,834,151
SJI - South Jersey Industries	2,101	162,876	118,438	28,276	4,849	195,698	150,527	50,879	61,615	-	19,025	7,515	35,510	13,111	850,419
SJRG - South Jersey Resources Group	2,576	12,694	9,024	848	152	636	-	14,546	8,309	-	3,132	1,193	12,193	4,866	70,167
Totals		361,273	810,749	411,118	214,964	490,302	274,681	634,747	860,324	565,022	160,422	282,162	255,882	259,747	5,861,232

SJIS Services Billing Summary
2010 Capital Billings

Cost Objectives	Insurance 761	Executive 821	Corp OH 822	Purchasing 850	Folsom 859	Corp Comm 861	Govt Rel 863	IT Network Services 870	IT Mgt Systems 871	IT Computer Ops 873	HR Benefits 921	HR Labor Rel 922	HR Recruiting 923	HR Org Dev 924	Total
Energy and Minerals (Morie)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Marina - Marina Energy	11,844	-	2,181	-	-	-	-	-	-	-	-	-	-	-	14,025
MAS - Millennium Account Services	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Open Flow	-	-	-	-		-	-	-	-	-	-	-	-	-	-
RandT Group	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
SJE - South Jersey Energy	-	-	7	-	-	-	-	-	55	-	-	-	-	-	62
SJES - South Jersey Energy Solutions	-	-	255	-	-	-	-	-	1,883	-	-	-	-	-	2,138
SJESP - South Jersey Energy Service Plus	-	-	300	-	-	-	-	-	2,424	-	-	-	-	-	2,724
SJF - South Jersey Fuel Company	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
SJG - South Jersey Gas	59,475	76,353	243,725	223,198	74,864	-	-	335,914	538,124	72,096	83,646	-	-	-	1,707,395
SJI - South Jersey Industries	-	-	965	-	-	-	-	-	5,004	-	-	-	-	-	5,969
SJRG - South Jersey Resources Group	-	-	149	-	-	-	-	135	1,021	-	-	-	-	-	1,305
-		76,353	247,581	223,198	74,864	-	-	336,049	548,511	72,096	83,646	-	-	-	1,733,618

SJIS Services Billing Summary
2010 Total Billings

Cost Objectives	Insurance 761	Executive 821	Corp OH 822	Purchasing 850	Folsom 859	Corp Comm 861	Govt Rel 863	IT Network Services 870	IT Mgt Systems 871	IT Computer Ops 873	HR Benefits 921	HR Labor Rel 922	HR Recruiting 923	HR Org Dev 924	Total
Energy and Minerals (Morie)	11,757	1,146	2,605	-	171	-	-	-	-	-	1,464	-	-	-	17,142
Marina - Marina Energy	54,402	11,269	17,789	744	186	10,596	14,230	8,463	4,206	-	1,591	566	2,315	2,686	129,043
MAS - Millennium Account Services	657	370	3,477	-	-	169	-	-	11,183	-	2,981	2,655	3,107	-	24,600
Open Flow	1,832	(104)	4,360	405	83	-	-	7,317	3,521	-	1,930	1,231	7,583	2,686	30,844
RandT Group	733	(716)	952	-	53	-	-	-	-	-	-	-	-	-	1,023
SJE - South Jersey Energy	7,130	4,881	9,815	752	96	3,041	5,809	13,311	10,886	-	2,706	701	7,335	3,669	70,132
SJES - South Jersey Energy Solutions	5,184	19,830	29,948	18,161	13,444	30,831	2,951	33,940	36,536	-	6,985	2,277	13,557	12,654	226,296
SJESP - South Jersey Energy Service Plus	24,326	33,179	85,853	33,435	9,355	23,336	8,540	113,984	91,735	15,842	33,508	52,934	57,549	42,043	625,619
SJF - South Jersey Fuel Company	605	-	98	-	-	-	-	-	-	-	42	-	-	-	745
SJG - South Jersey Gas	239,853	192,202	774,857	551,696	261,439	225,996	92,624	728,220	1,174,819	621,276	170,707	213,090	116,735	178,031	5,541,546
SJI - South Jersey Industries	2,101	162,876	119,402	28,276	4,849	195,698	150,527	50,879	66,619	-	19,025	7,515	35,510	13,111	856,387
SJRG - South Jersey Resources Group	2,576	12,694	9,173	848	152	636	-	14,681	9,330	-	3,132	1,193	12,193	4,866	71,472
Totals	351,156	437,626	1,058,330	634,316	289,828	490,302	274,681	970,796	1,408,836	637,119	244,069	282,162	255,882	259,747	7,594,850

Source: OC-340, 3rd Supplement, Billing Summaries

REDACTED

SJIS Services Billing Summary
2011 O&M Billings

Cost Objectives	Executive 821	Corp OH 822	Purchasing 850	Folsom 859	Corp Comm 861	Govt Rel 863	IT Network Services 870	IT Mgt Systems 871	IT Computer Ops 873	HR Benefits 921	HR Labor Rel 922	HR Recruiting 923	HR Org Dev 924	Total
Energy and Minerals (Morie)	-	90	-	333	-	-	-	-	-	-	-	-	-	423
Marina - Marina Energy	11,006	13,994	881	77	5,905	4,076	7,499	4,780	-	3,087	3,361	7,300	5,910	67,875
MAS - Millennium Account Services	259	1,565	-	-	29	-	-	1,049		3,294	185	1,706	-	8,088
Open Flow	194	6,697	1,654	7	1,329	-	10,111	4,320	-	2,707	532	2,277	2,767	(14)
RandT Group	-	90	-	-	-	-	-	-	-	333	-	-	-	423
SJE - South Jersey Energy	3,787	49,793	1,280	89	4,726	4,808	24,991	29,631	-	4,292	1,013	9,270	108,689	242,369
SJES - South Jersey Energy Solutions	40,477	61,076	26,664	3,498	28,966	24,916	32,543	28,756		20,699	2,703	12,057	17,842	300,198
SJESP - South Jersey Energy Service Plus	37,522	129,117	26,733	4,253	19,665	9,557	80,826	138,028	9,539	45,197	46,105	53,164	42,617	642,324
SJF - South Jersey Fuel Company	-	152	-	-	-	-	-	-	-	-	-	-	-	152
SJG - South Jersey Gas	117,326	765,074	258,428	187,861	243,578	137,853	338,425	717,745	449,697	126,709	200,537	92,418	141,518	3,777,170
SJI - South Jersey Industries	260,734	199,316	22,924	3,106	149,359	123,108	38,402	57,818	-	25,815	7,134	40,928	59,781	988,426
SJRG - South Jersey Resources Group	10,230	17,509	2,502	84	1,123	84	18,763	10,268	-	6,256	907	12,392	5,293	85,411
Totals	481,534	1,244,475	341,067	199,309	454,680	304,403	551,559	992,394	459,236	238,389	262,478	231,514	384,418	6,112,846

SJIS Services Billing Summary
2011 Capital Billings

Cost Objectives	Executive 821	Corp OH 822	Purchasing 850	Folsom 859	Corp Comm 861	Govt Rel 863	IT Network Services 870	IT Mgt Systems 871	IT Computer Ops 873	HR Benefits 921	HR Labor Rel 922	HR Recruiting 923	HR Org Dev 924	Total
Energy and Minerals (Morie)	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Marina - Marina Energy	-	-	-	-	-	-	-	-	-	-	-	-	-	-
MAS - Millennium Account Services	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Open Flow	-	-	-	-	-	-	(14)	-	-	-	-	-	-	(14)
RandT Group	-	-	-	-	-	-	-	-	-	-	-	-	-	-
SJE - South Jersey Energy	-	38	-	-	-	-	135	-	-	-	-	-	-	174
SJES - South Jersey Energy Solutions	-	610	-	-	-	-	1,996	237	-	-	-	-	-	2,842
SJESP - South Jersey Energy Service Plus	-	1,950	-	-	-	-	304	7,340	-	-	-	-	-	9,594
SJF - South Jersey Fuel Company	-	-	-	-	-	-	-	-	-	-	-	-	-	-
SJG - South Jersey Gas	32,564	317,864	221,625	72,381	-	-	228,223	421,324	60,328	148,151	425	-	-	1,502,884
SJI - South Jersey Industries	-	12,000	-	-	-	-	17,775	28,312	-	-	-	-	-	58,087
SJRG - South Jersey Resources Group	-	466	-	-	-	-	1,962	-	-	-	-	-	-	2,428
Totals	32,564	332,927	221,625	72,381	-	-	250,381	457,213	60,328	148,151	425	-	-	1,575,994

SJIS Services Billing Summary
2011 Total Billings

Cost Objectives	Executive 821	Corp OH 822	Purchasing 850	Folsom 859	Corp Comm 861	Govt Rel 863	IT Network Services 870	IT Mgt Systems 871	IT Computer Ops 873	HR Benefits 921	HR Labor Rel 922	HR Recruiting 923	HR Org Dev 924	Total
Energy and Minerals (Morie)	-	90	-	333	-	-	-	-	-	-	-	-	-	423
Marina - Marina Energy	11,006	13,994	881	77	5,905	4,076	7,499	4,780	-	3,087	3,361	7,300	5,910	67,875
MAS - Millennium Account Services	259	1,565	-	-	29	-	-	1,049	-	3,294	185	1,706	-	8,088
Open Flow	194	6,697	1,654	7	1,329	-	10,096	4,320	-	2,707	532	2,277	2,767	32,581
RandT Group	-	90	-	-	-	-	-	-	-	333	-	-	-	423
SJE - South Jersey Energy	3,787	49,832	1,280	89	4,726	4,808	25,126	29,631	-	4,292	1,013	9,270	108,689	242,543
SJES - South Jersey Energy Solutions	40,477	61,686	26,664	3,498	28,966	24,916	34,539	28,993	-	20,699	2,703	12,057	17,842	303,039
SJESP - South Jersey Energy Service Plus	37,522	131,066	26,733	4,253	19,665	9,557	81,130	145,368	9,539	45,197	46,105	53,164	42,617	651,918
SJF - South Jersey Fuel Company	-	152	-	-	-	-	-	-	-	-	-	-	-	152
SJG - South Jersey Gas	149,889	1,082,938	480,053	260,242	243,578	137,853	566,648	1,139,069	510,025	274,860	200,963	92,418	141,518	5,280,054
SJI - South Jersey Industries	260,734	211,316	22,924	3,106	149,359	123,108	56,177	86,129	-	25,815	7,134	40,928	59,781	1,046,512
SJRG - South Jersey Resources Group	10,230	17,975	2,502	84	1,123	84	20,725	10,268	-	6,256	907	12,392	5,293	87,839
Totals	514,098	1,577,402	562,692	271,690	454,680	304,403	801,941	1,449,607	519,564	386,539	262,904	231,514	384,418	7,721,449

Source: OC-340, 3rd Supplement, Billing Summaries

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Allocation Factor Calculations

Benefits Head Count (Includes Retirees in Corp Support)

Current As of 1/1/11

Utilized by 921

Client	Employee Count	Percentage of Total
SJG-Acct/Tax/Budget (021)	17	2.2730%
SJG-CCC (022)	76	10.1600%
SJG-Engineering/Construction (023)	39	5.2140%
SJG-Corporate Support (024)	100	13.3690%
SJG-Rates (025)	7	0.9360%
SJG-Environmental (026)	2	0.2670%
SJG-Distributed Operations (027)	227	30.3480%
SJG-Sales (028)	28	3.7430%
SJG-Gas Supply/OSS (029)	8	1.0700%
SJESP	93	12.4330%
SJE	8	1.0700%
SJI	37	4.9470%
SJIS	48	6.4170%
SJRG	13	1.7380%
MAS		0.0000%
Marina	7	0.9360%
OpenFlow	8	1.0700%
SJES	30	4.0110%
	748	**100.00%**

Employee Head Count Totals

Current As of 1/19/11

Utilized by 850, 922, 923, 924

Client	Employee Count	Percentage of Total
SJG-Acct/Tax/Budget (021)	17	2.6200%
SJG-CCC (022)	76	11.7100%
SJG-Engineering/Construction (023)	39	6.0100%
SJG-Corporate Support (024)	1	0.1500%
SJG-Rates (025)	7	1.0800%
SJG-Environmental (026)	2	0.3100%
SJG-Distributed Operations (027)	227	34.9800%
SJG-Sales (028)	28	4.3100%
SJG-Gas Supply/OSS (029)	8	1.2300%
SJESP	93	14.3300%
SJE	8	1.2300%
SJI	37	5.7000%
SJIS	48	7.4000%
SJRG	13	2.0000%
MAS		0.0000%
Marina	7	1.0800%
OpenFlow	8	1.2300%
SJES	30	4.6200%
	649	**99.9900%**

Allocation Factor Calculations

Employee Head Count Totals Current As of 1/19/11 Utilized by 859		
Client	**Employee Count**	**Percentage of Total**
SJG-Acct/Tax/Budget (021)	17	0.0293
SJG-CCC (022)	76	0.1202
SJG-Engineering/Construction (023)	39	0.0632
SJG-Corporate Support (024)	1	0.0046
SJG-Rates (025)	7	0.0139
SJG-Environmental (026)	2	0.0062
SJG-Distributed Operations (027)	227	0.3529
SJG-Sales (028)	28	0.0462
SJG-Gas Supply/OSS (029)	8	0.0154
SJESP	93	0.1464
SJE	8	0.0154
SJI	37	0.0601
SJIS	48	0.0771
SJRG	-	0.0000
MAS	-	0.0000
Marina	-	0.0000
OpenFlow	-	0.0000
SJES	30	0.0493
	621	**100.00%**

Employee Head Count Totals for SJES Only SJE, SJESP, SJES, Marina, SJRG, OF Current As of 1/1/11 Utilized by 921, 922, 923		
Client	**Employee Count**	**Percentage of Total**
SJG	-	
SJESP	93	38.1150%
SJE	8	3.2790%
SJI	37	15.1600%
SJIS	48	19.6700%
SJRG	13	5.3280%
MAS	-	0.0000%
Marina	7	2.8690%
OpenFlow	8	3.2790%
SJES	30	12.2950%
	244	**99.9950%**

Allocation Factor Calculations

Communications, Officers Allocation Current As of 1/1/11 Utilized by 861		
Client	**Employee Count**	**Percentage of Total**
SJG-Acct/Tax/Budget (021)		0.0000%
SJG-CCC (022)		0.0000%
SJG-Engineering/Construction (023)		0.0000%
SJG-Corporate Support (024)		75.5000%
SJG-Rates (025)		0.0000%
SJG-Environmental (026)		0.0000%
SJG-Distributed Operations (027)		0.0000%
SJG-Sales (028)		0.0000%
SJG-Gas Supply/OSS (029)		0.0000%
SJESP		6.4000%
SJE		0.0000%
SJI		0.0000%
SJIS		0.0000%
SJRG		0.0000%
MAS		0.0000%
Marina		0.0000%
R&T		0.0000%
Morie		0.0000%
OpenFlow		0.0000%
SJES		18.1000%
		100.0000%

Govt Relations Current As of 7/20/09 Utilized by 863		
Client	**Employee Count**	**Percentage of Total**
SJG-Acct/Tax/Budget (021)		0.0000%
SJG-CCC (022)		0.0000%
SJG-Engineering/Construction (023)		2.0000%
SJG-Corporate Support (024)		38.0000%
SJG-Rates (025)		0.0000%
SJG-Environmental (026)		0.0000%
SJG-Distributed Operations (027)		2.0000%
SJG-Sales (028)		0.0000%
SJG-Gas Supply/OSS (029)		0.0000%
SJESP		5.0000%
SJE		5.0000%
SJI		40.0000%
SJIS		0.0000%
SJRG		0.0000%
MAS		0.0000%
Marina		8.0000%
R&T		0.0000%
Morie		0.0000%
OpenFlow		0.0000%
SJES		0.0000%
		100.0000%

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Allocation Factor Calculations

PC Count Totals Current As of 1/1/10 Utilized by 870, 871, 873		
Client	**PC Count**	**Percentage of Total**
SJG-Acct/Tax/Budget (021)	19	2.6130%
SJG-CCC (022)	68	9.3540%
SJG-Engineering/Construction (023)	14	1.9260%
SJG-Corporate Support (024)	50	6.8780%
SJG-Rates (025)	10	1.3760%
SJG-Environmental (026)	3	0.4130%
SJG-Distributed Operations (027)	247	33.9750%
SJG-Sales (028)	25	3.4390%
SJG-Gas Supply/OSS (029)	20	2.7510%
SJESP	94	12.9300%
SJE	11	1.5130%
SJI	42	5.7770%
SJIS	71	9.7660%
SJRG	12	1.6510%
MAS	-	0.0000%
Marina	**7**	0.9630%
OpenFlow	6	0.8250%
SJES	28	3.8510%
	727	**100.0010%**

Officers Allocation Current As of 1/1/11 Utilized by 821		
Client	**Employee Count**	**Percentage of Total**
SJG-Acct/Tax/Budget (021)		0.0000%
SJG-CCC (022)		0.0000%
SJG-Engineering/Construction (023)		0.0000%
SJG-Corporate Support (024)		77.2000%
SJG-Rates (025)		0.0000%
SJG-Environmental (026)		0.0000%
SJG-Distributed Operations (027)		0.0000%
SJG-Sales (028)		0.0000%
SJG-Gas Supply/OSS (029)		0.0000%
SJESP		6.6000%
SJE		3.1000%
SJI		0.0000%
SJIS		0.0000%
SJRG		6.2000%
MAS		0.0000%
Marina		6.9000%
R&T		0.0000%
Morie		0.0000%
OpenFlow		0.0000%
SJES		0.0000%
		100.0000%

5. Organizational Structure

This chapter provides an overview of the SJI corporate organization. It describes the legal and management organizations in place at SJI and it also provides a brief historical perspective of the events that shaped SJI into its current form.

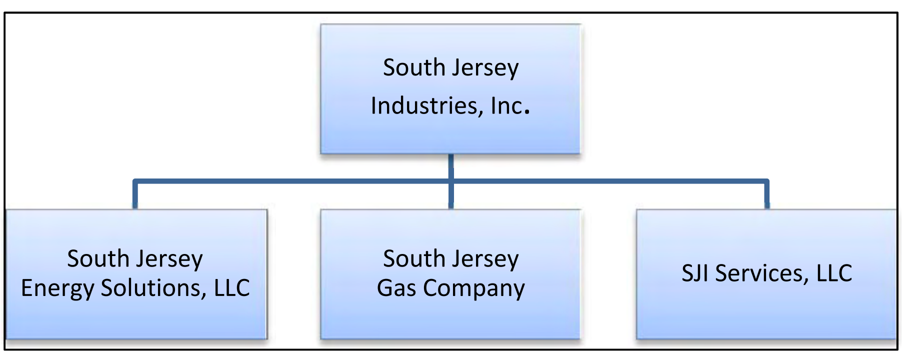
Corporate History of SJI

SJI's corporate history dates back to 1910 when the Atlantic City Gas and Water Company merged with Atlantic City Gas Company. This began a series of acquisitions that eventually led to the creation of South Jersey Gas Company in 1948. During the 1950s and 1960s, SJG continued to acquire smaller New Jersey gas companies in the surrounding regions. In 1969 the SJG board of directors decided to pursue non-regulated activities, and establish South Jersey Industries, Inc. (SJI) as a holding company in the state of New Jersey. SJI's current corporate organization structure is described below.

SJI's Legal Organization Structure

SJI is a utility holding company that provides a variety of energy-related products and services through its wholly owned subsidiaries. SJI's utility and nonutility operations are primarily performed through two wholly owned subsidiaries, South Jersey Gas Company (SJG) and South Jersey Energy Solutions, LLC (SJES). SJG is a New Jersey natural gas utility regulated by the NJ BPU and is the primary focus of this management audit. SJES was created for the purpose of holding SJI's interest in nonutility companies. SJI is also the direct parent of SJI Services, LLC (SJI Services) that provides support functions to all SJI affiliates. The corporate relationship of these companies is illustrated in the chart below.

Table 5-1 – SJI Direct Subsidiaries

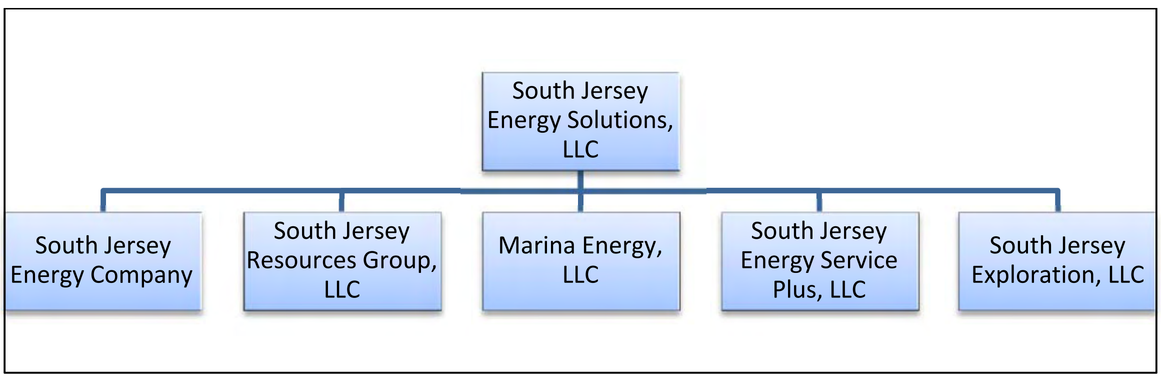


The non-utility activities of the Company are primarily through the following five subsidiaries:

- South Jersey Energy Company (SJE)– SJE provides services related to the acquisition and transportation of natural gas and electricity for retail end users. It also markets total energy management services, primarily to customers within southern New Jersey, northwestern Pennsylvania and New England.

- Marina Energy LLC (Marina) – Marina develops and operates energy-related projects, including providing the cooling, heating and emergency power to the Borgata Casino located in Atlantic City, NJ.
- South Jersey Resources Group, LLC (SJRG) – SJRG markets wholesale natural gas storage, commodity and transportation in various states around the mid-Atlantic, Appalachian and southern regions of the United States.
- South Jersey Energy Services Plus, LLC (SJESP) – SJESP installs residential and small commercial HVAC systems, and provides plumbing services and services appliances under warranty via a subcontractor arrangement.
- South Jersey Exploration (SJEX) - owns oil, gas and mineral rights in the Marcellus Shale region of Pennsylvania.[1]

Table 5-2 –SJI Non-Utility Subsidiaries



As illustrated in the table below, the net income related to SJI's non-utility subsidiaries has increased during each year of our audit period. Consequently, the proportion of earnings derived from the Gas Company as a percentage of total SJI earnings has decreased from 67.5% in 2009 to 59.2% in 2011, a decline of roughly 8.3%.

[1] SJEX was a wholly owned subsidiary of SJRG until November 2011, when it became a wholly owned subsidiary of SJES.

Table 5-3 – SJI Consolidated Net Income – By Contributing Entity[2]

South Jersey Gas SJI Consolidated Net Income - By Contributing Entity			
SJI Corporate Entity	% of 2011 Net Income	% of 2010 Net Income	% of 2009 Net Income
South Jersey Gas Company	59.2%	65.9%	67.5%
South Jersey Energy (A)	2.1%	13.3%	-7.4%
South Jersey Resources Group	11.2%	6.7%	30.7%
Marina	24.2%	14.1%	7.8%
Other	3.3%	0.0%	1.4%
Grand Total	100%	100%	100%

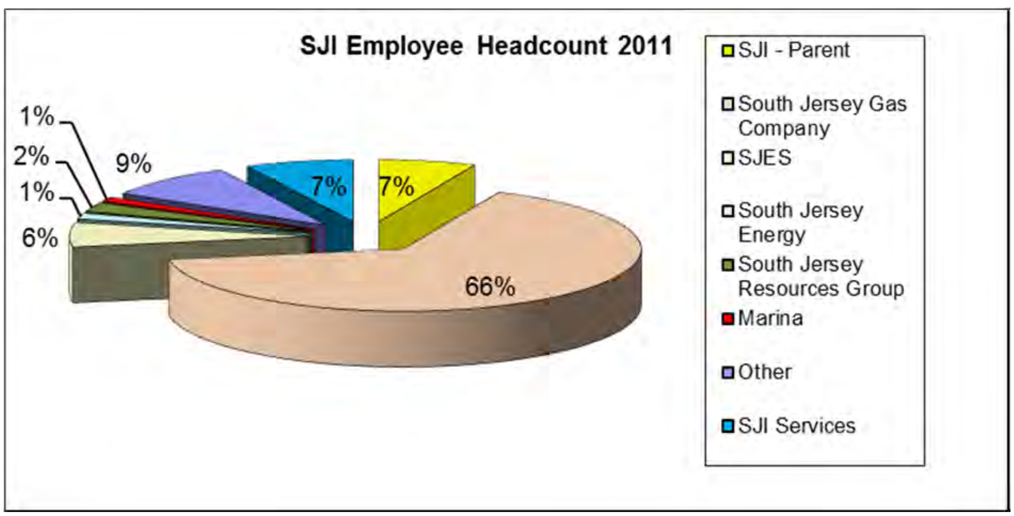
NoteA: In 2009 SJE incurred a loss amounting to approximately 7.4% of SJI's net income on a consolidated basis.

Source: 2011, 2010 and 2009 SJI Form 10-K Filings.

Overview of SJI's Management Organization Structure

As of the end of our audit period, roughly two-thirds of SJI personnel were employed by the Gas Company, as illustrated in the chart below.

Table 5-4 – SJI Employee Headcount 2011



As illustrated in Table 5-5 below, the composition of employees at SJI was relatively consistent during our audit period. However, while the proportion of utility earnings contribution to SJI consolidated (as

[2] When viewed on an "economic earnings" basis, SJG contributed 55%, 54.2% and 60.8% of total SJI economic earnings in 2009, 2010 and 2011, respectively. "Economic earnings" is a non-GAAP financial measure used by the Company and defined in Chapter 3 – *South Jersey Industries Cost Distributions*.

demonstrated in Table 5-2 above) declined during our audit period, the proportion of utility employees to SJI consolidated increased slightly.

Table 5-5 –Employee Headcount

South Jersey Gas Employee Headcount						
SJI Corporate Entity	**12/31/2011**	**% of Total**	**12/31/2010**	**% of Total**	**12/31/2009**	**% of Total**
SJI (Parent Company)	44	7%	36	6%	29	5%
South Jersey Gas Company	438	66%	401	62%	392	64%
SJES and SJES Subsidiaries						
SJES (Holding Company)	42	6%	38	6%	29	5%
South Jersey Energy	10	1%	8	1%	7	1%
South Jersey Resources Group	16	2%	13	2%	11	2%
Marina	8	1%	6	1%	5	1%
Other	60	9%	92	14%	92	15%
SJI Services	49	7%	49	8%	48	8%
Grand Total	**667**	100%	**643**	100%	**613**	100%
Source: Response to Discovery, OC-1.						

SJI and Gas Company Corporate Leadership

SJI Industries – Parent Holding Company

The parent company is headed by the Chairman, President and CEO of SJI Industries, Mr. Edward Graham. At the end of 2011, Mr. Graham had six direct reports, as noted in the table below. These seven individuals are the corporate officer responsible for reviewing corporate operations and determining corporate policy.[3]

[3] Response to Discovery, OC-87.

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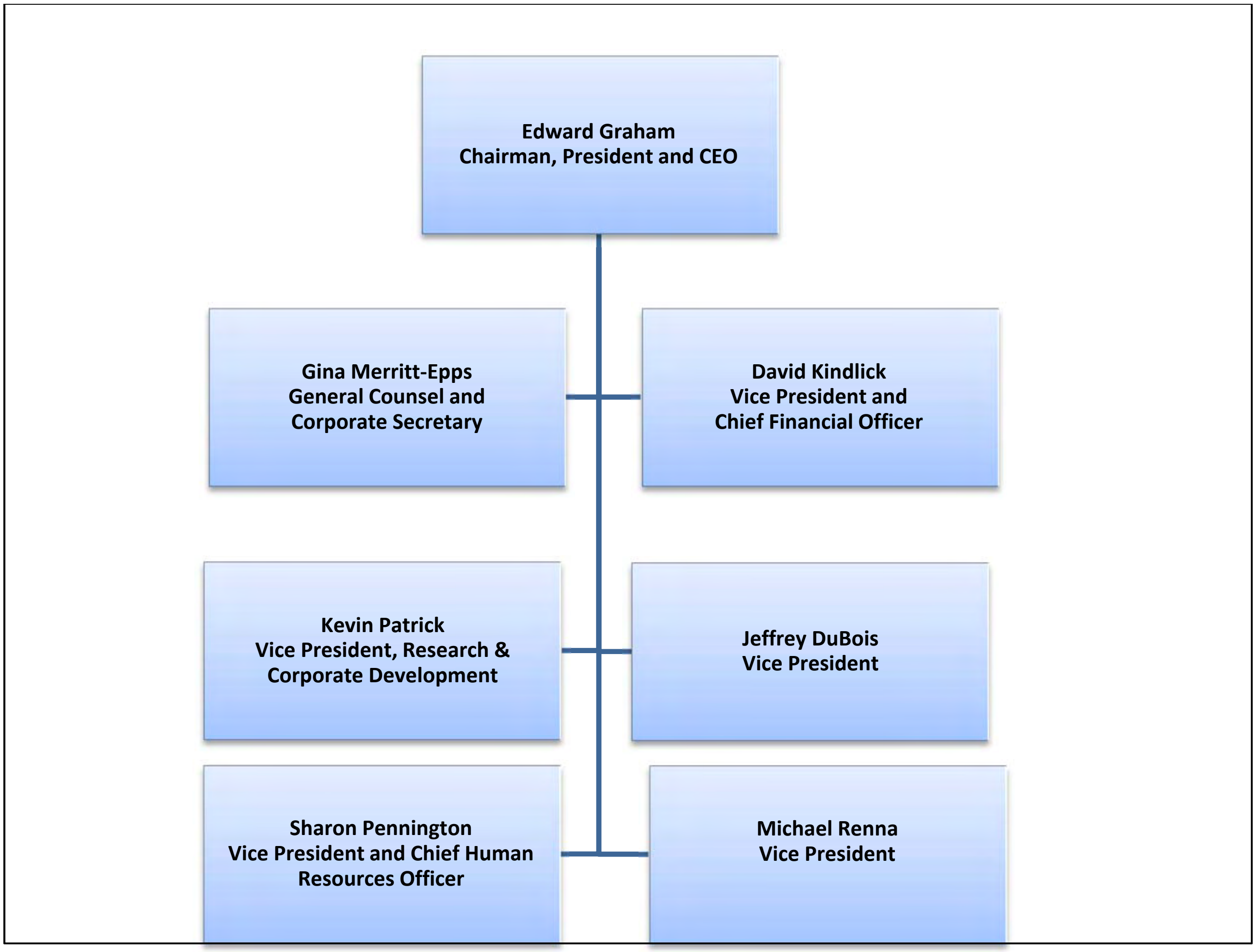
Table 5-6 - SJI's Executive Management[4]



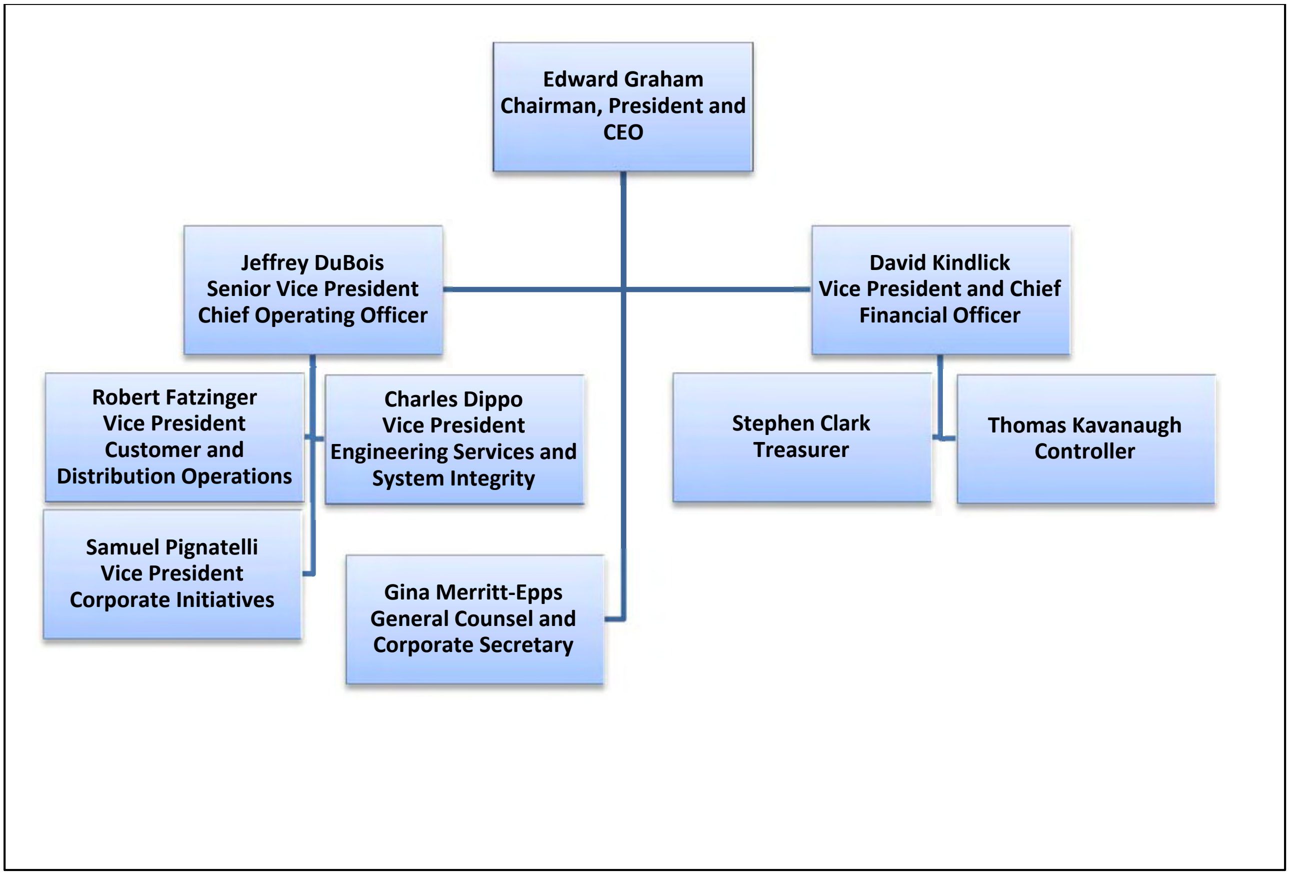
Source: Response to Discovery, OC-5.

Gas Company

Prior to April 2012, the President and CEO of the SJI Industries, Mr. Graham, was also the President and CEO of the Gas Company. The Gas Company corporate officers as of the end of our audit period are illustrated in the organization chart below.

[4] Subsequent to the Company's response to discovery request OC-5, Ms. Pennington was replaced as Vice President, Human Resources by Ms. Kathleen McEndy.

Table 5-7– Gas Company Corporate Officers – Prior to Corporate Reorganization



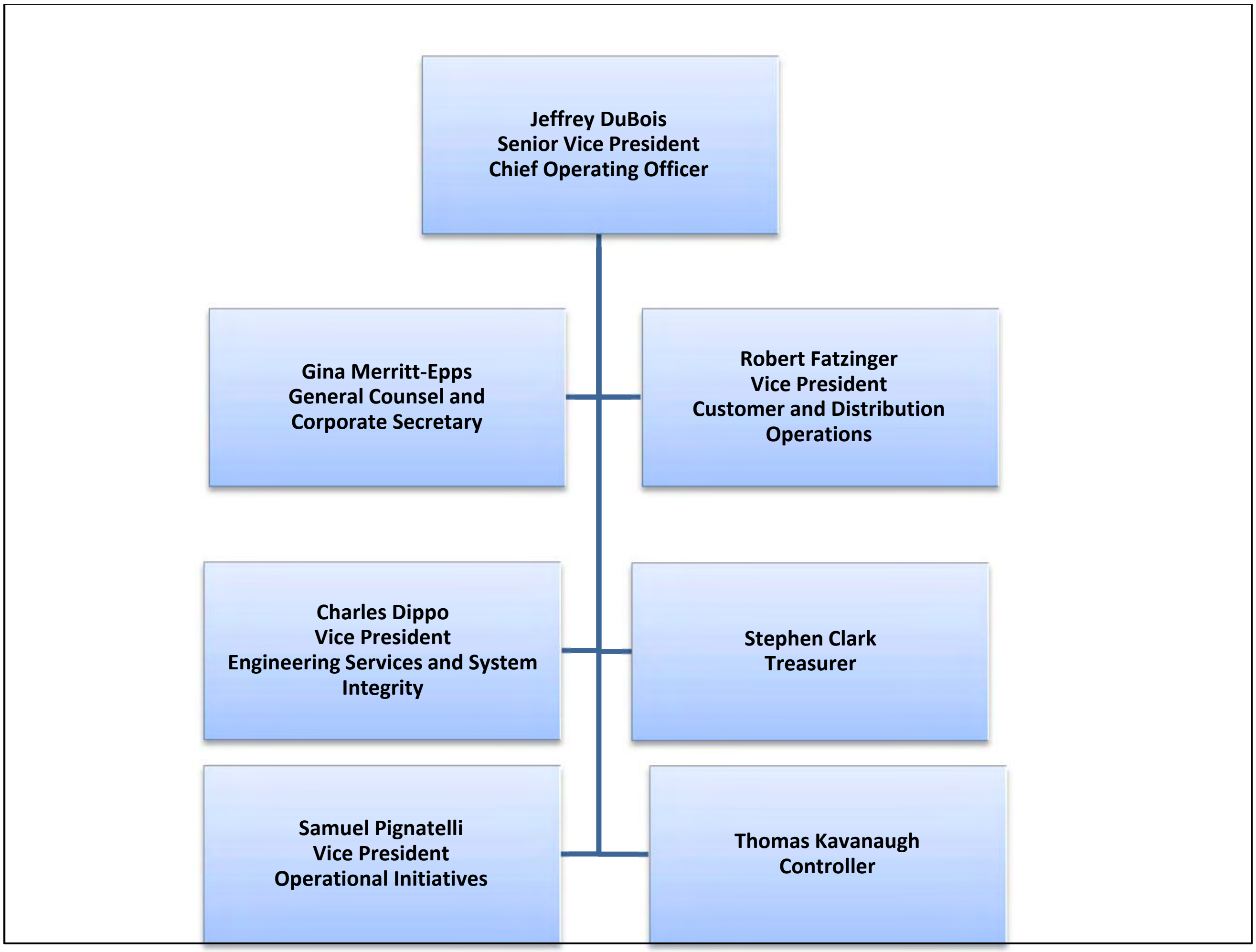
Source: Response to Discovery, OC-5.

In April 2012 various organizational changes occurred at the Gas Company that resulted in the promotion of Mr. DuBois to President of the Gas Company and removed the Chief Financial Officer position from the Gas Company.[5,6] These organizational changes are reflected in the organization chart below.

[5] Mr. Clark assumed the role of principal financial officer at SJG, without a change in title. Response to Discovery, OC-665.

[6] Response to Discovery, OC-005.

Table 5-8 – Gas Company Corporate Officers – Post Corporate Reorganization



Source: Response to Discovery, OC-5.

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6. EXECUTIVE MANAGEMENT AND CORPORATE GOVERNANCE

This Chapter addresses the activities of the board of directors and senior management in the oversight of SJI and SJG operations. Board compensation is also addressed in this Chapter.

Summary of Findings

1. SJI's board members, a group from which SJG board members are selected, are now elected by shareholders to serve one-year terms. Until recently, board members were elected for three-year terms.
2. Upon request and consistent with the required proxy statement disclosures, SJI produced listings of board members' current and past participation on other companies' boards and committees as well as leadership assignments on past SJI committees. SJI had difficulty producing complete listings for periods beyond those required for proxy disclosures.
3. A critical consideration in the selection of a board member to serve on the SJI board is the matching of skill sets needed by the board and those possessed by potential candidates. While <u>accounting</u> has been identified by the Governance Committee as a key area of expertise needed by the board to support the company's strategic vision, no incumbent or recently-added member of the board have claimed such expertise.
4. In recent years, SJI has only highlighted SJI Director Campbell's association with Mannington Mills as a relationship warranting specific disclosure in its proxy statement.
5. All members of the SJI board and members of SJI's subsidiaries' governing bodies participate fully in all discussions and decisions.
6. The SJI Board currently consists of ten members – five of which serve on the SJG board, and the remaining five of which serve on the non-regulated SJES Executive Committee.
7. After consolidating committees several years ago, SJI now maintains five standing committees of the board of directors – the Audit Committee, the Compensation Committee, the Corporate Responsibility Committee, the Governance Committee, and the Executive Committee. The two standing committees of SJG include the Executive Committee and the Offering Committee.
8. The SJI board has an informal committee member and committee chair rotation process.
9. SJI board committee progress is monitored through the use of task charts and calendars.
10. The orientation of new members is largely conducted in face-to-face meetings with management and through information made available electronically on tablet computers.
11. Board members are required to attend one education activity per year. A significant number of them meet this requirement by attending the SJI in-house training provided each year.
12. The SJI board retained a number of experts during the three-year period from 2009 to 2011, including those in the fields of executive and board compensation, board evaluations, and talent acquisition. Excluding the independent accountants, these experts were paid approximately **[Begin Confidential]** **[End Confidential]** during this time period.
13. The SJI board and its committees perform an annual self-evaluation aided by an expert. These evaluations have led to the adoption of action plans to improve the operation of the board.

However, the extent of the deficiencies and the effectiveness of the adopted solutions from a third party's point of view are not readily discernible since the board has chosen not to retain the work product of its expert.

14. The results of assessing the reasonableness of SJI's non-employee board compensation were mixed (some compensation was above the median and other components were below the median). However, the peer companies used to justify the levels of SJI board compensation were substantially larger than SJI.
15. The SJI board has determined that it is in the company's best interest at this time to consolidate the positions of Chairman of the Board and CEO with one person.
16. The Audit Committee charter does not explicitly specify to whom the independent accountants report.
17. Unlike its peers, the audit fees of SJI have grown substantially between 2008 and 2012.
18. Due to the lack of information concerning the balanced scorecard objectives of senior management, it is not possible to determine whether, or to what extent, the interests of senior management are aligned with ratepayers.
19. Employees at SJI are provided a number of different methods to report ethical concerns to management and/or the board. Recently, no significant concerns have been reported.

Summary of Recommendations

1. We recommend the SJI board maintain an up-to-date, comprehensive catalog of each board member's experience on all corporate boards, including, but not limited to, committee assignments, committee chair assignments, lead independent director assignments, etc. Time periods served in each capacity should be tracked. Not only is this information needed in assessing compliance with NYSE rules, but it also important in determining the skill set that each director brings to SJI.
2. In the spirit of full disclosure, the company should reveal in its proxy statement the outside relationships that Directors Campbell, Hartnett-Devlin, and Petrowski have. As the board becomes aware of new relationships that could (by a reasonable person) be viewed as a conflict of interest, such relationships should also be disclosed in the company's proxy statement. If applicable, the board's rationale for concluding that any reported relationship is not an actual conflict of interest should also be disclosed.
3. We recommend that Directors Campbell, Hartnett-Devlin, and Petrowski recuse themselves from any discussions or decisions that the SJI board or its subsidiary boards or executive committees make concerning any matters involving the markets in which they have a specific outside interest and/or relationship. The same would apply to any other director whose outside relationships are specifically disclosed by the company. By doing this, concerns that such directors might not act in the best interest of SJI and its subsidiaries or that such directors might give preferential treatment to the companies in which they have an outside interest or relationship will be alleviated.

4. We recommend that the SJI Governance Committee and the entire board consider candidates who possess accounting expertise, especially those with a CPA or with CFO experience, when next adding or replacing current members. Accounting is the one area, of all key areas of expertise that the Governance Committee identified as being needed, that is missing from the current SJI board.
5. At a minimum, every other year, each SJI director should attend one external continuing education seminar, class, and/or conference on the topic of corporate governance and/or the utility industry. No more than two members should be given credit for attending any particular continuing education offering so as to encourage as much diversity of training as possible. This continuing education requirement should be disclosed in the company's annual proxy statement, and any member who fails to meet the requirement should provide a written explanation for his/her nonperformance in the proxy statement.
6. We recommend the Audit Committee charter be amended to specifically state that the independent accountants report directly to the Audit Committee. This will eliminate any ambiguity surrounding the matter and more directly observe the requirements of the Sarbanes-Oxley Act.
7. Until it is demonstrated that the growth in and level of SJI audit fees are reasonable, we recommend the Audit Committee either put the SJI financial statement audit up for competitive bid in an environment in which all qualified firms have a reasonable expectation of being awarded the work or significantly curtail future increases in audit fees from the incumbent firm, Deloitte & Touche.

Board of Directors

Overview of the SJI and SJG Board of Directors

South Jersey Gas Company (SJG) is a regulated natural gas utility operating in the southernmost counties of New Jersey. SJG is a wholly-owned subsidiary of South Jersey Industries, Inc. (SJI) as is its non-utility affiliate, South Jersey Energy Solutions, LLC (SJES). Given the importance of the SJG utility business to the consolidated operations of SJI, the oversight of SJG is effectively carried out by both the SJI and SJG boards of directors.

Members of the SJI Board of Directors are elected by the corporation's shareholders after being nominated by either the Board or by its shareholders.[1] Historically, members of the SJI Board were divided into three different classes, each class serving a staggered three-year term. However, in response to a shareholder proposal, SJI began taking steps in 2009 to transition towards the election of all Board members each year. 2012 was the first year that all directors stood for election for a one-year term.[2]

[1] SJI proxy statement dated March 20, 2012 (p. 2) and the Amended and Restated SJI bylaws (Section 2.6) provided in response to discovery, OC-246.
[2] SJI proxy statements dated March 18, 2009 (pp. 30-31) and March 20, 2012 (pp. 3-4).

SJI's two primary businesses, the regulated utility business and the non-utility energy business, are overseen by the SJG Board of Directors and the SJES Executive Committee[3], respectively. The composition of these two groups is drawn from the SJI Board of Directors with two exceptions. SJG's president was recently added to the SJG Board of Directors, and SJES' president was similarly added to the SJES Executive Committee, although neither is a member of the SJI Board of Directors.[4] SJI board members are either nominated to serve on the SJG Board of Directors or the SJES Executive Committee, but never both at the same time.[5] SJI's Chairman of the Board also serves as the Chairman of the SJG Board of Directors while one of the other SJI board members acts as chairman of the SJES Executive Committee. Members of both subsidiary governing bodies serve for one year, consistent with the practice of the parent.

Selection and Retention of Board Members[6]

SJI board member selection has evolved over time from a more informal exercise with a regional bias to one that is more systematic and national in scope. The current process begins with a skill set assessment of the SJI board by its Governance Committee and a determination of whether or not the search should be facilitated in-house or with the aid of an outside search firm. A candidate profile is prepared based upon the skill set(s) needed, and after receiving the appropriate approval by the SJI board, the Governance Committee initiates a search. Pursuant to recommendations made by the SJI board chairman and Governance Committee chairman, the Governance Committee narrows the field of candidates for interviews. An interview panel consisting of the SJI chairman, the Governance Committee chairman, and the Lead Independent Director (plus one other SJI board member if deemed necessary by the Governance Committee) meets with the candidates. Vetting and verification with respect to each interviewee is conducted. The interview panel presents a summary of the interviews to the Governance Committee and makes recommendations regarding each candidate. The Governance Committee acts on the panel's recommendations after meeting with the candidate(s). The SJI board acts on the recommendations of the Governance Committee, and assuming a candidate has been selected, the new director stands for election at the next annual meeting of shareholders.[7]

For a variety of reasons (including the mandatory retirement of former directors and two deaths), the SJI board has added five new members since the beginning of 2010.[8] Four of these five members were identified after retaining an outside search firm, the lone exception being the addition of a governmental / political expert (Mr. Victor Fortkiewicz) which the board felt it had the resources and ability to identify in-house. In addition to Mr. Fortkiewicz's expertise, particular skill sets that the new

[3] As an LLC, SJES is governed by an executive committee rather than a board of directors.

[4] SJG and SJES news releases dated November 20, 2012 and review of meeting minutes.

[5] Response to Discovery, OC-454.

[6] Because SJG's board members are a sub-set of the SJI board, the discussion of selection and retention of members will focus on the SJI board.

[7] Response to Discovery, OC-24 (Update).

[8] Victor Fortkiewicz joined the board in late 2010, Shahid Malik joined in early 2011, Sunita Holzer joined in late 2011, and Sarah Barpoulis and Frank Sims joined in early 2012 (review of SJI Board meeting minutes and new releases). Mr. Malik later resigned due to a subsequent conflict of interest.

board members were intended to add included risk management, strategic development, and knowledge of the energy and commodities markets.[9]

SJI places no term limits on its directors. However, directors may not stand for election beyond their 72nd birthday except under special circumstances (such as a potential outgoing director having unique expertise or skills). The SJI board invoked this exception at least once during the time period from the beginning of 2010 to early 2012.[10] As of the date of the release of the 2013 proxy statement, the ages of the current SJI directors were as follows:

Table 6-1 - Ages of the Board of Directors

South Jersey Industries
Ages of the Board of Directors
As of March 18, 2013

Age Range	Number of Directors
45 - 49	1
50 - 54	2
55 - 59	3
60 - 64	2
65 - 69	2
70 - 72	-
Total	10

Source: Derived from SJI's Proxy dated March 18, 2013.

SJI board members may not serve on more than four other boards of publicly-traded companies. Consistent with NYSE rules, if an SJI Audit Committee member also serves on the audit committees of three or more public companies at the same time, the SJI board must determine whether such service impairs the ability of the member to effectively serve on SJI's Audit Committee. This determination will be documented in the annual proxy statement.[11]

When asked to provide a detailed accounting of each board member's current and past participation on other corporate boards along with associated committee and chair assignments, the company was unable to do so. Instead, it referenced high-level summaries of each board member's executive and corporate governance experience, similar to what was disclosed in the company's annual proxy statements.[12] The company also had difficulty providing an accurate listing of the historical composition of its own board committees with associated leadership.[13]

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[9] Interviews of various SJI board members.
[10] Minutes to the SJI Board of Directors meeting dated January 22, 2010.
[11] SJI Corporate Governance Guidelines.
[12] Response to Discovery, OC-15 (Update).
[13] It is unclear whether information originally provided in error was due to a typographical error or the result of incorrect records (see responses to Discovery, OC-15 and OC-459). In its supplemental response to OC-15, the company asserted that retrieval of committee chair information prior to 2000 would be burdensome.

The SJI Board should maintain an up-to-date, comprehensive catalog of each board member's experience on all corporate boards, including, but not limited to, committee assignments, committee chair assignments, lead independent director assignments, etc. Time periods served in each capacity should be tracked. This data is critical not only in assessing compliance with NYSE rules but also in determining the skill set that each director brings to SJI (see discussion in next section).

Composition of the Board of Directors

SJI's policy is to construct a board with a majority of outside directors who are independent as defined by the rules of the New York Stock Exchange (NYSE).[14] NYSE rules mandate that a majority of directors and all audit committee, corporate governance/nominating committee, and compensation committee members must be independent. To arrive at the conclusion that a director is independent, the NYSE provides examples of conflicts of interests that would disqualify him or her. These include ties to the Company through recent employment, non-board compensation, external auditor affiliation, or significant business dealings.[15]

In addition, SJI policy requires directors to be free of any relationships that, in the opinion of the board, would interfere with the exercise of their independent judgment.[16]

Keith Campbell, SJI director since 2000, is long-time chairman of the board of Mannington Mills, Inc. – a residential and commercial flooring manufacturer headquartered in New Jersey.[17] Marina Energy, LLC (a non-regulated affiliate of SJG) operates, maintains, and manages a cogeneration facility that services a Mannington Mills manufacturing facility located in Salem, New Jersey.[18] This relationship began when Marina Energy, LLC won a competitive bid. Payments made by Mannington Mills to SJI subsidiaries represented **[Begin Confidential]** **[End Confidential]** of Mannington Mills gross revenues in 2009, 2010, and 2011, respectively.[19] If these percentages had exceeded 2% for Mannington Mills, NYSE rules state that f, Mr. Campbell is no longer considered "independent".[20]

Another SJI director, Sheila Hartnett-Devlin, serves on the Mannington Mills board of directors with Mr. Campbell.[21] Both Directors Campbell and Hartnett-Devlin currently serve on the Executive Committee of SJES, the parent of Marina Energy.[22] **[Begin Confidential]**

[End Confidential]

[14] SJI Corporate Governance Guidelines, Section 1.
[15] Response to Discovery, OC-322.
[16] SJI Corporate Governance Guidelines, Section 1.
[17] Response to Discovery, OC-15 and review of the Mannington Mills website.
[18] Response to Discovery, OC-240.
[19] Derived from response to Discovery, OC-465.
[20] NYSE Rules: Section 303A.
[21] Response to Discovery, OC-15.
[22] Response to Discovery, OC-14.
[23] Interviews of various SJI board members.
[24] **[Begin Confidential]**

A third SJI director, Joseph Petrowski, is CEO of the Gulf Oil/Cumberland Farms Groups.[25] A Gulf Oil affiliate entered the retail electric market in March 2012. At least one of SJG's non-regulated affiliates, SJE, acquires and markets electricity to retail end users.[26] **[Begin Confidential]**

[End Confidential]

Director Petrowski is currently the Chairman of the SJES Executive Committee.

During the time period from early 2010 to early 2012, the SJI board concluded that all members but Mr. Edward Graham, Chairman of the Board and Chief Executive Officer of SJI, met its stated requirements for board member independence. Mr. Graham did not by virtue of his employment by SJI.[28] In addition, the company chose only to highlight Mr. Campbell's ties with Mannington Mills as a relationship warranting specific disclosure in its proxy statements for the past several years.

[Begin Confidential]

[End Confidential] we believe the company should disclose in its proxy statement the relationships we have detailed above regarding each of the three directors. In addition, any board member relationships that rise to the level of formal or informal review by the SJI board or its Governance Committee for conflicts of interest or that a reasonable person would view as a potential conflict of interest should also be disclosed. The company should also disclose the directors' rationale for concluding that any reported relationship does not constitute an actual conflict of interest. We believe this approach is preferable to the status quo which, for these matters, seems to be based on disclosing no more than the minimum amount of information required by regulators.

We also recommend that Directors Campbell, Hartnett-Devlin, and Petrowski recuse themselves from any discussions or decisions that the SJI board or its subsidiary boards or executive committees make concerning any matters involving the markets in which they have a specific outside interest and/or relationship. While we observed no explicit bias by any of these board members in our review of corporate governance documents, the proposed restriction would alleviate concerns that they might not act in the best interests of SJI and its subsidiaries or that they might give preferential treatment to the companies in which they have outside interests or relationships. This recommendation would also apply to any other director whose outside relationships are specifically disclosed by the company.

While independence is a critical attribute for all outside directors to have, each board member must bring complimentary skills to the group so that the board as a whole operates as efficiently and effectively as possible. The Governance Committee identified the following key areas of expertise that

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[End Confidential] (Response to Discovery, OC-95: June 2011 Accounts Receivable Analysis).

[25] Response to Discovery, OC-15.

[26] SJI 2012 Form 10-K, p. 2.

[27] Minutes to the Governance Committee meeting dated March 22, 2012.

[28] SJI proxy statement dated March 18, 2010 (p. 9), SJI proxy statement dated March 25, 2011 (p. 11), and SJI proxy statement dated March 20, 2012 (p. 14). Mr. Graham was properly excluded from being a member of the Audit, Compensation, and Governance Committees, the three committees which must be composed entirely of independent members per NYSE rules.

[29] Interviews of various SJI board members.

the SJI board should have in order to support the company's strategic vision: enterprise leadership, political/governmental, human resources, legal, utility/energy, finance/financial management, accounting, and enterprise risk management.[30]

According to the company, the independent directors on the current board have the following skill set:[31]

- Sarah M. Barpoulis – enterprise leadership strategic/business planning, utility/energy, finance/financial management, tradable commodities, and energy and enterprise risk management;
- Thomas A. Bracken – enterprise leadership, finance/financial management, enterprise risk management, and political/governmental;
- Keith S. Campbell – enterprise leadership, enterprise risk management, environmental, finance/financial management, human resources, and sales/marketing;
- Victor A. Fortkiewicz – enterprise leadership, finance/financial management, political/governmental, legal, environmental, enterprise risk management, and the utility/energy industry;
- Edward J. Graham – energy risk management, enterprise leadership, enterprise risk management, environmental, finance/financial management, regulatory, and the utility/energy industry;
- Sheila Hartnett-Devlin – enterprise leadership, enterprise risk management, and finance/financial management;
- Walter M. Higgins III – energy production, energy risk management, enterprise leadership, enterprise risk management, environmental, finance/financial management, human resources, and the utility/energy industry;
- Sunita Holzer – enterprise leadership, human resources, organizational development, succession planning, and executive compensation;
- Joseph H. Petrowski – energy risk management, enterprise leadership, enterprise risk management, environmental, finance/financial management, sales/marketing, and the utility/energy industry; and
- Frank L. Sims – enterprise leadership, human resources, finance/financial management, and enterprise risk management.

Additional details of each director's background and experience can be found in Attachment 6-1 at the end of this chapter.

Despite the Governance Committee identifying accounting expertise as a key area of expertise needed by the SJI board in each of the last four proxy statements, none of the current SJI board members is listed as having it. No members of the SJI board are CPAs, and none have CFO experience at a publicly-traded company.[32]

[30] SJI proxy statement dated March 20, 2012 (p. 2).
[31] SJI proxy statements dated March 20, 2012 (pp. 2-3) and March 18, 2013 (pp. 2-4).
[32] Derived from a review of past SJI proxy statements.

We recommend the SJI Governance Committee and the entire board consider candidates who possess accounting expertise, especially those with CPA or CFO experience, when next adding or replacing current members.

The size of the SJI board has fluctuated between eight and eleven members since the beginning of 2010. As shown above, it currently stands at ten. We believe the current size of the board achieves the correct balance of having enough members to provide differing views and special expertise while at the same time not being too unwieldy to manage.

Board and Committee Structure

The members of the governing bodies of SJI and its primary subsidiaries in mid-2012 are summarized in the following table:

Table 6-2 - SJI and Subsidiaries Governing Bodies

SJI and Subsidiaries Governing Bodies As of June 18, 2012		
Entity	Member	Type
South Jersey Industries, Inc.	Sarah Barpoulis	Independent
	Thomas Bracken	Independent
	Keith Campbell	Independent
	Victor Fortkiewicz	Independent
	Edward Graham	Corp Mgmt *
	Sheila Hartnett-Devlin	Independent
	Walter Higgins	Independent
	Sunita Holzer	Independent
	Joseph Petrowski	Independent
	Frank Sims	Independent
South Jersey Gas Company	Thomas Bracken	Independent
	Victor Fortkiewicz	Independent
	Edward Graham	Corp Mgmt *
	Sunita Holzer	Independent
	Frank Sims	Independent
South Jersey Energy Solutions, LLC;	Sarah Barpoulis	Independent
South Jersey Energy Company;	Keith Campbell	Independent
South Jersey Resources Group, LLC;	Sheila Hartnett-Devlin	Independent
Marina Energy, LLC; and	Walter Higgins	Independent
South Jersey Energy Service Plus, LLC	Joseph Petrowski	Independent *
Millennium Account Service, LLC	Joseph Scheufele (SJI)	Corp Mgmt
	David Robbins (SJI)	Corp Mgmt *
	Robert Hollis (Conectiv)	Corp Mgmt
	Margaret Berry (Conectiv)	Corp Mgmt
SJI Services, LLC	Edward Graham	Corp Mgmt *
	David Kindlick	Corp Mgmt
	Jeffrey DuBois	Corp Mgmt
	Gina Merritt-Epps	Corp Mgmt
	Kevin Patrick	Corp Mgmt
	Sharon Pennington	Corp Mgmt
	Michael Renna	Corp Mgmt

Source: Response to OC-14 (Update) and review of SJES Executive Committee minutes

* Chairman of governing body

As previously noted, the presidents of South Jersey Gas Company and South Jersey Energy Solutions, LLC were subsequently added to their respective governing bodies.[33]

The fact that the Executive Committee of SJI Services, LLC consists entirely of corporate management is not that unexpected. This is an entity that provides internal services among the SJI subsidiaries. Its relationships and transactions would not be a primary focus of the independent members of the SJI board.

None of the SJI subsidiaries had standing committees during the time period from 2010 to 2012 except for SJG which had an Executive Committee and an Offering Committee, both made up of two independent directors and Edward Graham, and SJE which had an Executive Committee consisting of 3 independent directors.[34]

On the other hand, SJI had the following standing committees:[35]

- Audit Committee - assists the Board of Directors in fulfilling its responsibility for oversight of the quality and integrity of the accounting, auditing and financial reporting practices of the Company. The Committee's purpose is to oversee the Company's accounting and financial process by reviewing: the financial reports and other financial information provided by the Corporation to any governmental body or the public; the Corporation's systems of internal controls regarding finance, accounting, legal compliance and ethical standards that management and the Board have established; and the Corporation's auditing, accounting and financial reporting processes generally.

- Compensation Committee - assists the Board of Directors in fulfilling its oversight responsibilities related to the performance and compensation of executives and the structure and performance of significant, long-term employee defined benefit and defined contribution plans.

- Corporate Responsibility Committee - provides oversight, monitoring and guidance on matters related to corporate and social citizenship, public and legal policy, environmental stewardship and compliance, political activities, sustainability, quality of work life, and economic and social vitality in the communities and markets in which the Company operates.

- Governance Committee - reviews and recommends Board governance policy, organization, and practice; identifies and recruits director candidates; and recommends changes in director compensation.

- Executive Committee - exercises the powers and authority of the Board of Directors in the management of the business and affairs of the Company to the extent permitted by law and by the Bylaws of the Company.

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[33] SJG and SJES news releases dated November 20, 2012.
[34] Response to Discovery, OC-16 (Update).
[35] Response to Discovery, OC-16 and committee charters.

Because SJI's common stock is traded on the NYSE, it must comply with NYSE rules which dictate the existence of several of the aforementioned committees, including the Audit Committee, the Compensation Committee, and the Governance Committee.[36] However, the decision to maintain other committees is left up to the board's discretion. The following table compares the SJI committee structure to that of a peer group:[37]

Table 6-3 - Board Committee Structures

Board Committee Structures									
Company	Audit (A)	Compensation (B)	Governance (C)	Corporate Responsibility (D)	Executive	Finance (E)	Pension Plan Investment (F)	Capital Funds	Benefits
AGL Resources	√	√	√		√	√			
Atmos Energy	√	√	√		√				
Black Hills	√	√	√						
CH Energy Group	√	√	√			√			
Energen	√	√	√			√			
Laclede Group	√	√	√				√	√	
New Jersey Resources	√	√	√		√				
Northwest Natural Gas	√	√	√			√			
Piedmont Natural Gas	√	√	√			√			√
Southwest Gas	√	√	√				√		
Vectren	√	√	√	√		√			
WGL Holdings	√	√	√		√				
South Jersey Industries	√	√	√	√	√				

Sources: Various 2013 proxy statements (most recent available).
(A) Includes the Audit and Risk Management Committee of Vectren.
(B) Includes the Compensation and Management Development Committee of AGL Resources, the Human Resources Committee of Atmos Energy and WGL Holdings, the Officer Review Committee of Energen, the Leadership Development and Compensation Committee of New Jersey Resources, the Organization and Executive Compensation Committee of Northwest Natural Gas, and the Compensation and Benefits Committee of Vectren.
(C) Includes the Corporate Goverannce Committee of Laclede Group; the Nominating and (Corporate) Governance Committee of Atmos Energy, CH Energy Group, Energen, New Jersey Resources, Southwest Gas, and Vectren; the Nominating, Governance and Corporate Responsibility Committee of AGL Resources; and the Directors and Corporate Governance Committee of Piedmont Natural Gas.
(D) Includes the Corporate Affairs Committee of Vectren.
(E) Includes the Finance and Risk Management Committee of AGL Resources and the Strategy and Finance Committee of CH Energy Group.
(F) Includes the Investment Review Committee of Laclede Group.

SJI's board committee structure is similar to that of most other utilities in its peer group except for its decision to maintain separate Corporate Responsibility and Executive Committees. While SJI has chosen not to maintain a separate Finance Committee, that decision is shared by half its peers.

[36] NYSE Rules, Section 303A.
[37] Employed the same peer group of companies that the SJI board used to determine the adequacy of its own pay (see Response to Discovery, OC-85).

In past years, SJI had other standing committees, but these were consolidated into its current configuration in the 2008-2009 timeframe.[38] As responsibilities of current committees change over time, we expect that the SJI board will take the necessary steps to modify the committee structure so that the proper level of attention is given to all of its assigned duties.

According to the company, there have been no SJI ad hoc committees since the beginning of 2009.[39]

Committee Assignment and Rotation Process

The assignment of board members to most committees begins first with the matching of committee needs and board member skill sets as determined by the SJI chairman and Governance Committee chairman. This discussion leads to a proposal from these two individuals to the Governance Committee of each committee's composition as well as its chair. After due consideration, the Governance Committee makes a recommendation to the entire board for approval. The one exception to this process is the assignment of board members to the SJI Executive Committee. The membership of this committee is determined by position. It consists of the SJI chairman, CEO, Lead Independent Director, and chairmen of the remaining SJI committees.[40]

While there is no formal rotation policy for committee or committee chair assignments, some board members expressed support for periodic rotation as a means of securing fresh perspectives. However, there was also recognition that full-scale rotation was not practical as certain board member's skill sets were tailored for participation on certain boards (e.g., a human resources expert would be most useful serving on the Compensation Committee).[41]

A recent evaluation conducted by the board indicated that clarity was required with respect to the rotation of committee membership and determination of committee composition.[42]

In our experience, mandatory rotation of directors between committees is not common industry practice. While it obviously would be helpful for SJI to address any ambiguities regarding the subject, we do not believe a rigid, formal policy is necessary.

Board Activity

The following table summarizes the number of meetings held by the SJI board and each of its standing committees between 2009 and 2011:

[38] In the past, SJI had an Environmental Committee and a Management/Development Committee, the responsibilities of both which were assumed by the Corporate Responsibility Committee (see Response to Discovery, OC-458).

[39] Response to Discovery, OC-16 (Update).

[40] Response to Discovery, OC-27. A review of the SJI proxy statement dated March 18, 2013 and the most recent charter of the Executive Committee suggests that this committee also includes the chairman of SJES.

[41] Interviews of various SJI board members.

[42] Minutes to the SJI board meeting dated June 14-15, 2012.

Table 6-4 - SJI - Board of Directors' and Related Committees' Meeting Summary

SJI Board of Directors' and Related Committees' Meeting Summary			
Description	2009	2010	2011
Number of meetings held by the board	7	8	8
Number of committee meetings held:			
Audit Committee	8	9	8
Compensation Committee	5	4	5
Corporate Responsabilitiy Committee	3	2	3
Governance Committee	4	5	6
Executive Committee	-	-	3
Sources: SJI proxy statements filed March 18, 2010, March 25, 2011, and March 20, 2012.			

The minimum number of times each group must meet is documented in the various committee charters. The Audit Committee must meet at least 4 times annually while the other four committees must meet at least two times per year.[43] The Executive Committee's requirement to meet at least twice annually was not instituted until March of 2012. Prior to that time, the committee met only as required.[44]

SJI board committee progress is monitored through the use of task charts and calendars.[45] Agendas for committee meetings are guided by these task charts and calendars as well as input from the chairman of the respective committee.[46] The Chairman, CEO, and Lead Independent Director establish the agenda for each SJI board meeting. However, each board member is free to make suggestions concerning the contents of the agenda.[47]

Aside from the regular board and committee meetings that are staggered throughout the year at corporate headquarters, the SJI board usually holds strategic planning meetings in June of each year at an off-premises location. These two-day retreats generally involve presentations by third parties (e.g., investment bankers, subject matter experts, etc.) as well as by management. Regularly scheduled board and committee meetings generally consist of a day of committee meetings and subsidiary board meetings (the latter of which are held concurrently since there is no overlap in membership) followed by any remaining committee meetings on the morning of the second day. The meetings culminate in the SJI board of directors meeting.

With the scheduling of the meetings of the SJG Board of Directors and the SJES Executive Committee at the same time, it is no longer possible for an SJG board member to attend an SJES Executive Committee

43 Audit Committee Charter (rev. 3/22/13), Compensation Committee Charter (rev. 1/18/13), Corporate Responsibility Committee Charter (rev. 1/18/13), Governance Committee Charter (obtained from website on 4/10/13), and Executive Committee Charter (rev. 3/22/13).
44 Response to Discovery, OC-462.
45 Response to Discovery, OC-463.
46 Interviews of various SJI board members.
47 SJI Corporate Governance Guidelines, Section 7.

meeting and vice versa. However, to comply with EDECA regulations, SJES Executive Committee members are prohibited from attending SJG board meetings.[48]

The board's independent directors meet in executive session without management at least two times each year. Members are expected to attend and participate in all regularly scheduled meetings, and when attendance is impossible, they are encouraged to participate via teleconference.[49] We observed no significant issue with board member attendance in our review of corporate governance documents. However, with the recent de-linking of board member compensation from attendance, the company should closely monitor this situation on a prospective basis for potential concerns.

Board Member Orientation, Ongoing Training, and Meeting Preparation

The Corporate Secretary arranges the orientation of all new board members. This consists of meetings with the Chairman and CEO of the company as well as other members of senior management. Site visits are at times offered.[50]

Written materials provided to new board members recently have included:[51]

- A legal entity organization chart;
- An overview of director compensation and benefits;
- The most recent proxy statement;
- The most recent annual report to shareholders;
- A memorandum on director fiduciary duties;
- The board's document retention policy;
- The New Jersey Energy Master Plan;
- Board committee charters; and
- A list of SJI common stock open trading periods for upcoming year.

Additional information is available to board members via company-provided Apple iPads. These devices are enabled to link to monthly information provided by management, such as company news releases, relevant articles on SJI and the industries in which it operates, internal management reports, and analyst reports as well as pre-meeting reading materials. We view the company as an innovator for using iPads to communicate information to directors. This tool not only permits the company to share information instantaneously with its directors, but it serves as an efficient, organized repository of information used by the board to make its decisions.

At least one education session is provided to all directors in conjunction with board meetings on an annual basis. Board members are alerted to continuing education opportunities through the directors' web portal. The company enrolls each director with the National Association of Corporate Directors, an organization that offers relevant training to its members. The company also participates in the NYSE –

[48] Response to Discovery, OC-456.
[49] SJI Corporate Governance Guidelines, Section 3.
[50] Response to Discovery, OC-23.
[51] Response to Discovery, OC-457.

Corporate Board Member Board Education Program, and SJI directors are members of the Association of Audit Committee Members, Inc.[52] According to the company's Corporate Governance Guidelines, each director must attend at least one education activity per year.[53] However, a review of a listing of continuing education opportunities attended by each director in recent years indicates that many of them only attended the in-house training provided by SJI from year to year.[54]

Given the ever-increasing complexities that boards in general now face along with the changing landscape of the utility industry, it is more critical than ever for board members to receive meaningful, independent continuing education. We recommend that each member, in addition to their participation in in-house training, attend at a minimum one external continuing education seminar, class, and/or conference every other year on the topic of corporate governance and/or the utility industry. In order to obtain as much new insight as possible, no more than two board members should be given credit for attending any particular continuing education offering. This continuing education requirement should be disclosed in the company's annual proxy statement, and those members who fail to fulfill the requirement should provide an explanation for their nonperformance in the proxy statement.

Use of Third Party Experts

For the time period from 2009 to 2011, the SJI board and its committees retained the services of four different outside experts to assist it in its responsibilities (exclusive of the independent audit).

The Hay Group was retained by the Compensation Committee in 2009 and 2010 to provide insight on executive compensation, incentive plans, and CEO performance scorecards. In 2011, the Hay Group was replaced by Frederic W. Cook & Co. For the three-year period (2009-2011), the Hay Group and Frederic W. Cook & Co. were paid **[Begin Confidential]** **[End Confidential]** for these particular services.[55]

Frederic W. Cook and Co. was also retained by the Governance Committee beginning in 2010 to review non-employee director compensation. According to the company, **[Begin Confidential]** **[End Confidential]** was paid to Frederic W. Cook and Co. for its work in 2010.[56]

The Governance Committee used Russell Reynolds Assoc. in its search for new directors in both 2010 and 2011. Directors Malik and Holzer were ultimately elected to the SJI board as a result of these searches.[57] Russell Reynolds Assoc. was paid **[Begin Confidential]** **[End Confidential]** for its two years of service.[58]

[52] Response to Discovery, OC-23 (including updates).
[53] SJI Corporate Governance Guidelines, Section 2.
[54] Response to Discovery, OC-417.
[55] Derived from Response to Discovery, OC-19 (Update).
[56] Response to Discovery, OC-19 (Update). A portion of the $182,734 paid to the Hay Group and Frederic W. Cook & Co. may have included 2011 work on non-employee director compensation. The data response is unclear on the matter.
[57] SJI proxy statements dated March 25, 2011 (p. 2) and March 20, 2012 (p. 2).
[58] Derived from Response to Discovery, OC-19 (Update).

Finally, the Governance Committee retained the National Association of Corporate Directors to assist it in its evaluation of the board and its performance assessment of the CEO. This vendor was paid **[Begin Confidential]** **[End Confidential]** for its services in 2010 and 2011.[59]

Internal Self-Evaluation of the SJI Board

The charter of the SJI Governance Committee calls for it to "[r]eview and evaluate the structure, organization, performance, and effectiveness of the Board . . ."

2010 Evaluation[60] [61]

[Begin Confidential]

[59] Derived from response to Discovery, OC-19 (Update).

[60] References to the year of the evaluation are based on when it was discussed by the SJI board and its committees. In all likelihood, the work was actually conducted in the previous year.

[61] Hay Group presentation dated January 22, 2010 made at the SJI Strategic Planning Meeting held on June 17, 2010 and memorandum from the Chairman of the Governance Committee to the Governance Committee dated March 25, 2010 discussed at the Governance Committee meeting dated March 25, 2010.

[End Confidential]

__2011 Evaluation__

In early 2011, the SJI board and its committees reviewed the work performed by the National Association of Corporate Directors (NACD) which had been retained to perform an evaluation of the board and its committees.[62] Unlike the previous year, the board chose not to retain any work product of its expert on the advice of the company's General Counsel.[63]

Information about the evaluation is limited. However, the minutes to the meeting indicate that the overall results were positive, and unnamed opportunities existed to enhance the effectiveness of the board in areas such as **[Begin Confidential]**

[End Confidential]

__2012 Evaluation__

Consistent with the prior year, no work product was retained by the board or company with respect to the board evaluation conducted by NACD that was discussed with the board in early 2012.[66] However, according to the SJI board meeting minutes, there was positive cooperation on such key issues as transparency, governing documents, ethical culture, independence and the relationship between the Board and Management.[67]

[62] Minutes to the SJI board meeting and Executive Committee meeting held January 21, 2011.

[63] Response to Discovery, OC-238. The expert's work product and other corporate governance documentation are not retained out of concern that they could be used against the board in a shareholder lawsuit. No consideration is given to the usefulness of this documentation in a management audit (interview with Gina Merritt-Epps, General Counsel, on March 28, 2013.

[64] Minutes to the SJI board meeting and Executive Committee meeting held January 21, 2011 and SJI board meeting held June 16, 2011.

[65] Minutes to the Governance Committee meeting held September 22, 2011.

[66] Response to Discovery, OC-238.

[67] Minutes to the SJI board meeting held January 20, 2012.

[Begin Confidential]

[End Confidential]

External Evaluation of the SJI Board

We requested copies of all reports issued by third parties since January 1, 2009 that rated the corporate governance structure and/or practices of SJI or any of its subsidiaries. The company asserted that no reports but an April 2012 ISS Proxy Advisory Services report had been retained, and this report was limited to an independent evaluation of the company's then soon-to-be annual shareholders' meeting agenda.[69]

ISS had an overall conclusion in its report that no significant issues merited highlighting. However, it noted "medium" concern regarding director compensation with 6 of 9 evaluated factors indicating ". . . practices that increase concern." These included, but were not limited to:[70]

- The CEO's outstanding equity awards automatically accelerate upon a change in control;
- The company's active equity plans are silent on cash buyouts of underwater options; and
- The equity plans adopted or substantively amended in the last 3 years are silent on repricing.

ISS also noted that the company's total CEO pay was 1.22 times the median of its peers; there was reasonable alignment of CEO pay and company performance at the time ISS released its report; and shareholders would benefit from the amendments to an executive incentive bonus plan.[71]

[68] Minutes to the Governance Committee meeting held March 22, 2012.
[69] Response to Discovery, OC-264.
[70] Response to Discovery, OC-264 (p. 3 of 21 of the attachment).
[71] Response to Discovery, OC-264 (pp. 5, 11, and 15 of 21 of the attachment).

Board Compensation and Stock Ownership

Non-employee board compensation was overhauled for the 2011-12 board year pursuant to findings and recommendations made by the Governance Committee's expert, Frederic Cook & Co., Inc. (Cook). The most significant of these adopted recommendations included:[72]

- All meeting fees, other than those paid when a committee meets in excess of four times per year, were to be eliminated; and the annual retainer was to increase from $40,000 to $70,000 (represents $40,000 for board service and $30,000 for committee service).
- Committee members were to be paid $1,500 per meeting for any meetings in excess of four meetings per year.
- Commencing with the restricted stock granted in January 2012, the vesting period for restricted stock units was reduced from three years to one year.
- The life insurance and accident insurance benefits were eliminated for all directors elected after April 2011, although directors elected prior to that date were grandfathered under the previous program.
- The retainer for the Governance Committee Chairman was increased from $5,000 to $6,000.

These changes were adopted to align SJI's program design with market and good governance practices and to simplify administration.

As a result of these changes, the non-employee director compensation package consisted of the following in late 2011:[73]

- Annual cash retainer for both board and typical committee service of $70,000;
- Committee meeting fees of $1,500 for each committee meeting in excess of 4 per year;
- Annual restricted stock unit grants of $60,000 with a 1-year vesting period;
- Committee chair cash retainers of $10,000 for Audit; $8,000 for Compensation; $6,000 for Governance; and $5,000 for Corporate Responsibility;
- Lead Independent Director cash retainer of $12,500; and
- Other benefits ($50,000 of group life insurance and $250,000 in accident protection insurance for directors elected prior to April 2011; D&O insurance; and reimbursement of travel expenses).

This compensation program results in an average estimated value of director compensation of $136,000 per year, ignoring additional retainers given to committee chairs and the Lead Independent Director.

Cook compared SJI's board compensation to a 13-company utility peer group. However, the peer group identified by Cook consisted of companies that were much larger than SJI. In fact, SJI was below the 25th

[72] SJI proxy statement dated March 20, 2012 (p. 25).

[73] Response to Discovery, OC-85 (Cook Non-Employee Director Compensation Review dated November 18, 2011, p. 7).

percentile in four of five size measures and fell between the 25th and median for the only other size measure (market capitalization).[74]

SJI director total cash compensation was between the 25th percentile and the median of the peer group as demonstrated in the following table:

Table 6-5 - Director Cash Compensation

Director Cash Compensation					
	Board		Committee		
Description	Annual Retainer	Total Mtg Fees	Member Retainers	Total Mtg Fees	Total Cash Compensation
Frequency	100%	85%	8%	85%	100%
75th Percentile	$ 55,000	$ 14,175		$ 21,000	$ 84,500
Median	50,000	13,500		21,000	79,500
25th Percentile	40,000	13,500		21,000	73,750
SJI	$ 40,000		$ 30,000	$ 6,000	$ 76,000
Source: Response to OC-85 (Cook Non-Employee Director Compensation Review dated November 18, 2011, p. 13)					
Note: Percentiles exclude zeros, are independently arrayed, and therefore do not add across.					

When equity compensation was added to the equation, SJI director total compensation was between the median and 75th percentile of the peer group as can be seen in the following table:

Table 6-6 - Total Director Compensation

Total Director Compensation			
Description	Total Cash Compensation	Total Equity Compensation	Total Compensation
Frequency	100%	92%	100%
75th Percentile	$ 84,500	$ 72,750	$ 159,148
Median	79,500	65,506	134,918
25th Percentile	73,750	55,497	125,000
SJI	$ 76,000	$ 60,000	$ 136,000
Source: Response to OC-85 (Cook Non-Employee Director Compensation Review dated November 18, 2011, p. 15)			
Note: Percentiles exclude zeros, are independently arrayed, and therefore do not add across.			

The pay mix of SJI directors was aligned with the median of the peer group and had a heavier weighting on cash compensation than equity compensation (56% cash vs. 44% equity).[75]

[74] Response to Discovery, OC-85 (Cook Non-Employee Director Compensation Review dated November 18, 2011, p. 10). The peer group consisted of AGL Resources, Atmos Energy, Black Hills, CH Energy Group, Energen, Laclede Group, New Jersey Resources, Nicor, Northwest Natural Gas, Piedmont Natural Gas, Southwest Gas, Vectren, and WGL Holdings.

The results of comparisons of SJI's retainers for committee chairs and the Lead Independent Director to the peer group were mixed as shown in the following table:

Table 6-7 - Additional Director Retainers

Additional Director Retainers				
Description	Audit Committee Chair	Comp Committee Chair	Nominating & Gov Committee Chair	Lead Independent Director
Frequency	100%	100%	92%	85%
75th Percentile	$ 12,000	$ 10,000	$ 6,000	$ 15,000
Median	10,000	8,000	5,000	13,500
25th Percentile	10,000	7,000	5,000	10,000
SJI	$ 10,000	$ 8,000	$ 6,000	$ 12,500

Source: Response to OC-85 (Cook Non-Employee Director Compensation Review dated November 18, 2011, pp. 17-18)
Note: Percentiles exclude zeros, are independently arrayed, and therefore do not add across.

All directors are expected to accumulate and hold SJI shares with a value equal to 5 times the annual cash board retainer ($200,000 = $40,000 x 5) within 6 years of election to the board.[76]

As of December 31, 2011, SJI's directors had the following stock ownership levels:

Table 6-8 - Director Stock Ownership vs. Requirement

Director Stock Ownership vs. Requirement As of December 31, 2011						
Name	Length of Service (Yrs)	No. of Shares	Share Price	Holdings	Requirement (if any)	Compliance? (Y / N)
Shirli Billings	28+	11,395	$ 56.81	$ 647,350	$ 200,000	Y
Thomas Bracken	7+	15,554	56.81	883,623	200,000	Y
Keith Campbell	11+	11,596	56.81	658,769	200,000	Y
Victor Fortkiewicz	1+	3,222	56.81	183,042	N.A.	
Sheila Hartnett-Devlin	12+	6,168	56.81	350,404	200,000	Y
Walter Higgins	3+	4,511	56.81	256,270	N.A.	
Sunita Holzer	0+	-	56.81	-	N.A.	
Joseph Petrowski	3+	4,761	56.81	270,472	N.A.	

Source: Response to OC-29, SJI proxy statement dated March 20, 2012, and Marketwatch website.
Note: Requirement is equal to 5 times the annual cash board retainer.

[75] Response to Discovery, OC-85 (Cook Non-Employee Director Compensation Review dated November 18, 2011, p. 16).

[76] Response to Discovery, OC-85 (Cook Non-Employee Director Compensation Review dated November 18, 2011, p. 7)

As can be seen in the preceding table, all of the board members subject to a stock ownership requirement were in compliance as of December 31, 2011.

Separation of CEO and Chairman Duties

Edward Graham currently holds the title of SJI Chairman of the Board and CEO.[77] Mr. Graham has held both positions since 2005 when he assumed the chairmanship from his predecessor, Charles Biscieglia. The office of chairman and CEO at SJI are normally held by one person, and board members indicated that no changes to the current leadership arrangement are likely to occur while Mr. Graham is with the company.[78]

A review of the companies to whom SJI compares itself for board compensation purposes indicates that ten of the twelve companies consolidate the responsibilities of chairman and CEO with one person (the two exceptions being Northwest Natural Gas and Southwest Gas).[79]

The leadership structure adopted by the SJI board is complemented by the contributions of its Lead Independent Director. The Lead Independent Director's role at SJI is ". . . to aid and assist the Chair and the remainder of the Board in assuring effective corporate governance in managing the affairs of the Board and the company." This director acts in an advisory capacity to the Chair and as a liaison between the independent directors and the Chair.[80] When operating properly, this position serves as an integral component of the checks and balances of the corporate governance structure, ensuring that the board operates independently of management, absent from any undue influence.

Since late 2010, Walter Higgins has served as Lead Independent Director at SJI. Mr. Higgins is a long-time utility executive that brings extensive experience from serving in leadership positions at numerous domestic and international companies. A more detailed description of Mr. Higgins' qualifications can be found in Attachment 6-1.

Other Board Matters

Independent Accountants' Reporting Relationship to the Audit Committee

According to Section 301 of the Sarbanes-Oxley Act, "[t]he audit committee of each issuer, in its capacity as a committee of the board of directors, shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer . . . for the purpose of preparing or issuing an audit report or related work, and each such registered public accounting firm shall report directly to the audit committee."

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[77] He is also President of SJI.

[78] According to the SJI Corporate Governance Guidelines, "[f]rom time to time, the office of Chairman/Chief Executive Officer is separated and filled with two individuals . . ."

[79] Review of various recently-released proxy statements. The peer group included a thirteenth member (Nicor), but it became a part of AGL Resources in late 2011 and, as a result, was excluded from our analysis.

[80] SJI Corporate Governance Guidelines, Section 11.

When asked to identify to whom the independent accountants report, the company referenced a section in its Audit Committee Charter which states that in order to fulfill its responsibilities and duties, the Audit Committee shall:[81]

> *Recommend to the Board of Directors the selection of the independent accountants, considering independence and effectiveness and approve the fees and other compensation to be paid to the independent accountants. On an annual basis, the Committee should review and discuss with the accountants all significant relationships the accountants have with the Corporation to determine the accountants' independence.*

Nowhere in this identified excerpt does it explicitly state that the independent accountants report directly to the Audit Committee.

On the other hand, a review of the audit committee charters of each member of the company's peer group (as identified with respect to board member compensation) indicate that 11 of the 12 companies have explicitly stated in their Audit Committee charters that the independent accountants report directly to the Audit Committee or are directly overseen by the Audit Committee.[82]

To more directly observe the requirements of the Sarbanes-Oxley Act and to eliminate any ambiguity surrounding the matter, we recommend the Audit Committee amend its charter to specifically state that the independent accountants report directly to the Audit Committee.

Audit Fees

Between 2008 and 2012, SJI's audit fees increased 67.0% from $988,176 to $1,650,000.[83] An SJI self-selected peer group of four utilities[84] experienced little to no increase in audit fees over the same four-year time period (median increase = 0.0%, mean increase = 0.8%) with the largest increase being only 10.5%.[85] The following graph shows the divergence of SJI's fees from that of its peers:

[81] Response to Discovery, OC-229 (Revised).

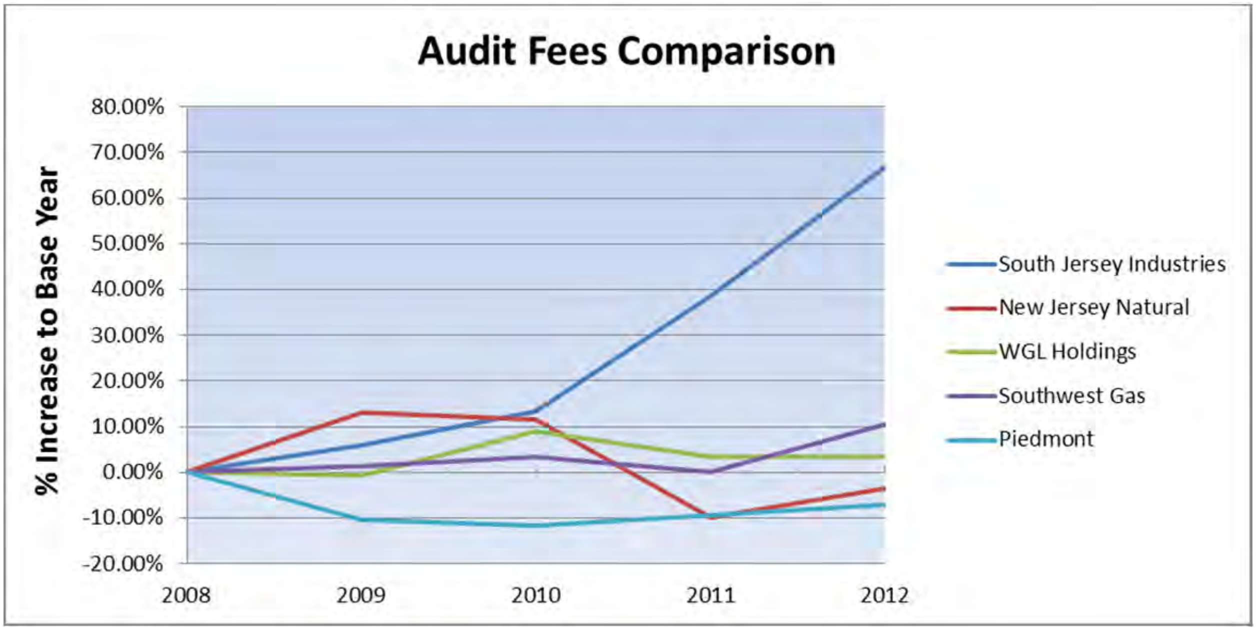
[82] Nicor's audit committee charter was not reviewed since it was acquired by AGL Resources in late 2011.

[83] Obtained from 2009 – 2013 SJI proxy statements.

[84] Specifically chosen by the company to analyze such audit fees.

[85] Derived from audit fees disclosed in the proxy statements of New Jersey Resources, WGL Holdings, Southwest Gas, and Piedmont Natural Gas.

Table 6-9 - Audit Fees Comparison



In addition, SJI's audit fees as a percentage of market capitalization (measured as of July 2012) were also significantly higher than its peers, by approximately 47% (0.103% vs. 0.070%).[86]

The company justifies its rapidly increasing fees to the growth in and complexity of its non-regulated businesses and the number of business segments it has relative to its peers.[87]

When asked when the last time that SJI or its affiliates had solicited bids for the performance of the financial statement audit from more than one accounting firm, what firms provided bids, and why Deloitte & Touche had been selected in the past; the company responded as follows:[88]

> *Give [sic] that only 2 Big Four firms (D&T and PWC) specialize in public utilities and would be considered qualified to conduct our audit, and it is our belief that the audit firms consider an RFP as simply a means to reduce the incumbent price, we have decided to bypass the RFP process.*

In November 2011, the Audit Committee pre-approved out-of-scope audit fees in the amount of $100,000, an amount that was above and beyond a 10 percent increase in audit fees year over year.

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[86] Derived from amounts disclosed in the CFO's presentation to the Audit Committee on September 27, 2012.

[87] Minutes of the Audit Committee meeting dated September 27, 2012 and interviews with various SJI board members.

[88] Response to Discovery, OC-243.

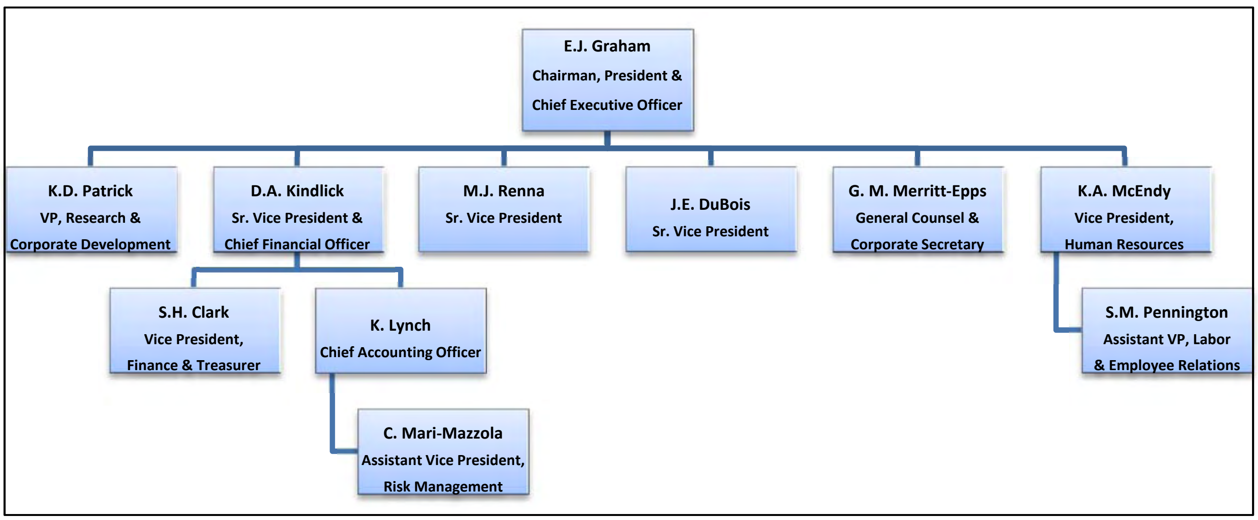
From the information provided to date, it is not clear whether company management and the board's Audit Committee have experienced difficulty in managing SJI's audit fees, in choosing a proper peer group, or both. However, until it is demonstrated that the growth in and level of SJI audit fees are reasonable, we recommend the Audit Committee either put SJI's financial statement audit up for competitive bid in an environment in which all qualified firms have a reasonable expectation of being awarded the work or significantly curtail future increases in fees from the incumbent firm, Deloitte & Touche.

Senior Management

Composition of Senior Management

An organization chart of SJI officers as of March 2013 follows:[89]

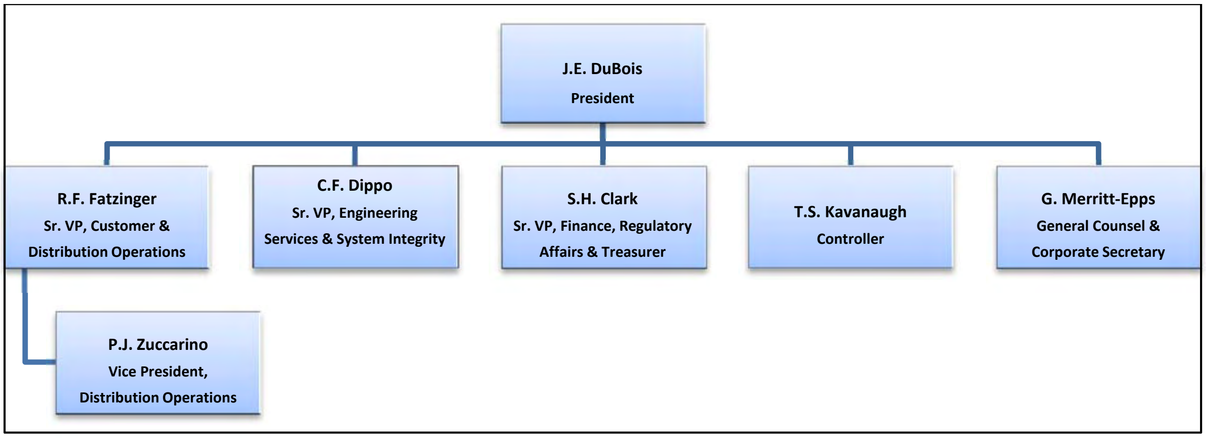
Table 6-10 – SJI Officers Organization Chart



[89] Obtained from the March 2013 organization chart received informally from the company on May 23, 2013.

As can be seen in the following organization chart of SJG, some of the SJI executives also held officer positions in the utility subsidiary:[90]

Table 6-11 – SJG Organization Chart



A more detailed description of the experience of management can be found in Attachment 6-2.

Alignment of Senior Mangement's Interests with Ratepayers

The most tangible way that senior management's interests can be demonstrated to align with that of ratepayers is to evaluate the criteria used in compensating them. A brief discussion of the topic will follow with a more detailed review of executive compensation taking place in the chapter on Human Resources.

Besides base salary, one of the important components of senior management total compensation is the variable annual cash awards that are based on specific performance metrics. These performance metrics consist of economic earnings per share, individual balanced scorecard objectives, and (in some cases) the financial performance of subsidiaries. The weighting of each of these three components is dependent on the senior management position held.[91]

We attempted to obtain the balanced scorecard objectives of senior management (as well as for others) in three different discovery requests:

> <u>OC-236</u> – As referenced in the response to OC-117, please provide an overview of the balanced scorecard program employed by SJI and its subsidiaries from the beginning of 2009 to present. In addition, please provide a comprehensive set of balanced scorecards for SJG, SJI Services, and SJI for the years 2009, 2010, and 2011 showing

[90] Obtained from the April 2013 organization chart received informally from the company on May 23, 2013.
[91] SJI proxy statement dated March 18, 2013 (pp. 26-27).

actual to target comparisons. For each scorecard provided, please list the executive whose organization was held accountable for the attainment of the scorecard metrics.

OC-364 – With respect to the balanced scorecard program, please provide the targeted performance and actual results for each and every manager and their direct and indirect superiors (directors, vice presidents, senior vice presidents, etc.) of SJG, SJI Services, and SJI (the parent) for the years 2009, 2010, and 2011. Targets and actual performance should be specified in detail (e.g., "Meet 4 of 7 targeted subsidiary goals" is an example of inadequate detail). Please list the name and title of each employee for every balanced scorecard provided. If any employee with overall responsibility for any department in SJI, SJG or SJI Services has been omitted, please provide that employee's balanced scorecard information in a same [sic] fashion described above.

OC-365 – Please provide the 2009, 2010, and 2011 balanced scorecard for all departments of SJI, SJG, and SJI Services. If balanced scorecards are done at a different organization level (cost center, company, etc.), please provide those as well.

The company provided no information on any member of SJI senior management that was not already available to the public (e.g., the proxy statement).

Because of the heavy emphasis on the attainment of financial results in senior executive performance metrics, the nature of the individual balanced scorecard objectives is critical in evaluating whether or not senior management's interests are aligned with ratepayers. If the individual objectives are also highly dependent on the achievement of financial goals, the net effect of those objectives and the other performance metrics previously mentioned raises the question – "Are non-financial matters such as customer satisfaction, system safety, and reliability being given the proper attention by management if they have little incentive to focus on them?"

The limited information available to us concerning the company's annual cash awards (i.e., the highly summarized information contained in the company's proxy statements for a sub-set of senior management) suggests that individual balanced scorecard objectives are not focused on financial performance, but they also are not necessarily focused directly or heavily on customer satisfaction, system safety, or reliability. Instead, they include objectives in such areas as succession planning, implementation of IT systems, and integration of internal processes.[92]

Given the lack of information made available to us, we are unable to determine the extent to which senior management interests are aligned with ratepayers.

Ethics and Compliance

SJI has a formal code of ethics that all employees and its board of directors must follow. The code is memorialized in a policy issued by Human Resources, who is also tasked with enforcing it.[93] The code

[92] SJI proxy statements dated March 25, 2011 (p. 24) and March 20, 2012 (pp. 33-34).
[93] Response to Discovery, OC-226 and interview with Gina Merritt-Epps, General Counsel, on March 28, 2013.

has a wide-ranging scope including policies regarding procurement activities, safety, company information, company property and funds, acceptance or solicitation of things of value, legislative and regulatory compliance, affiliate relationships, employment practices, etc.[94]

According to the company, code of ethics training occurs periodically (once every couple of years) with the last comprehensive training occurring in March 2012. The interactive audio-visual scenarios developed for the course are meant to teach practical skills for identifying and resolving ethical dilemmas the students may face.[95]

Alleged violations of the code of ethics can be brought to the attention of management or the board of directors in a number of different ways. A hotline and website have been developed to accept anonymous concerns of employees. Employees may also report their concerns directly to local department/division management, the Vice President of Human Resources, the General Counsel, the Chairman and/or CEO, or the Lead Independent Director. Directors and officers who are reporting concerns are to contact the Chairman/CEO or the General Counsel, and the Lead Independent Director.[96]

The General Counsel is responsible for tracking the progress of investigations. The Corporate Responsibility Committee of the SJI board of directors has oversight responsibilities with respect to any alleged violation of the code of ethics involving non-financial matters while the Audit Committee assumes this responsibility when financial reporting matters are the focus of the alleged violation.[97]

[Begin Confidential]

[End Confidential][100]

[94] Response to Discovery, OC-226.
[95] Response to Discovery, OC-227.
[96] Response to Discovery, OC-226.
[97] Interview with Gina Merritt-Epps, General Counsel, on March 28, 2013.
[98] Response to Discovery, OC-228.
[99] Interview with Gina Merritt-Epps, General Counsel, on March 28, 2013.
[100] Response to Discovery, OC-30 and interview with Gina Merritt-Epps, General Counsel, on March 28, 2013.

Management Interaction with the Board

As previously mentioned, senior management is heavily involved in the orientation of new board members. In addition to the periodic posting of information to the board of directors' website portal, senior management also makes in-person presentations at all regularly-scheduled board and committee meetings.

Board members described their access to management as informal and open. Board members are not required to request permission from the CEO or General Counsel to communicate with management. However, it was also emphasized that interactions with management are designed to elicit information rather than to give direction.[101]

In short, the board's judgment is not designed to be substituted for that of management, which ultimately is charged with the conduct of the company's business. It appeared to us that the board struck the correct balance between monitoring performance without assuming decision-making authority for SJI and its subsidiaries.

[101] Interviews with various SJI board members.

REDACTED

Name of Director	Biographical Information	First Year Served	Recent Committee Assignments	Recent Committee Chairmanships
Sarah M. Barpoulis	Age 48, has been a director since 2012. She is also a director of South Jersey Energy Company. Ms. Barpoulis is a member of the Governance Committee and the Audit Committee. Since 2003, she has provided asset management and advisory services to the merchant energy sector through Interim Energy Solutions, LLC, a company she founded. From 1991 to February 2003 she held several positions with PG&E National Energy Group, Inc., now known as National Energy & Gas Transmission, Inc., last serving as Vice President, Commercial Operations and Trading in 2000. In July 2003, National Energy and certain of its affiliates voluntarily filed for protection under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court of the District of Maryland and emerged from bankruptcy in October 2004 to sell its major operating business units pursuant to its court-approved plan of reorganization. Ms. Barpoulis serves on the following boards: Director, SemGroup Corporation; Executive Committee Member, South Jersey Energy Solutions, LLC; Marina Energy, LLC; South Jersey Energy Service Plus, LLC; and South Jersey Resources Group, LLC; and was previously a director of Reliant Energy, Inc.	2012	Governance Committee Audit Committee	
Thomas A. Bracken	Age 65, has been a director since 2004. He is also a director of South Jersey Gas Company. Mr. Bracken is a member of SJI's Audit Committee, the Executive Committee and is chairman of the Corporate Responsibility Committee. He has served as president of the New Jersey Chamber of Commerce since February 2011; director, Roma Financial Corporation since 2004; president of TriState Capital Bank-New Jersey from January 2008 to February 2011; as president and CEO of Sun Bancorp, Inc. and its wholly owned subsidiary Sun National Bancorp, Inc., from 2001 to 2007; as executive director of the Public Sector Group, First Union Bank from 2000 to 2001; and, as executive vice president, head of Commercial and Governmental Banking for New Jersey, New York and Connecticut, First Union Bank from 1998 to 2000. Mr. Bracken is the: former chairman, Economic Development Corporation of Trenton, Trenton, NJ; former chairman, New Jersey Chamber of Commerce; and former chairman, New Jersey Bankers Association. Currently, Mr. Bracken serves on the following boards: director and chairman, Finance Committee, Cancer Institute of	2004	Audit Committee Executive Committee Corporate Responsibility Committee	Corporate Responsibility Committee

REDACTED

Name of Director	Biographical Information	First Year Served	Recent Committee Assignments	Recent Committee Chairmanships
	N.J. Foundation; director, New Jersey Alliance for Action; director, Public Media NJ; director, Einsteins Alley; director and secretary, Bedens Brook Club.			
Keith S. Campbell	Age 58, has been a director since 2000. He is also a director of South Jersey Energy Company. Mr. Campbell is a member of SJI's Corporate Responsibility Committee, the Executive Committee and is chairman of the Compensation Committee. He has served as chairman of the board for Mannington Mills, Inc. since 1995. Mr. Campbell serves on the following boards: board member, Rowan University, Glassboro, NJ; director, Skytop Lodge, Inc.; director, Federal Reserve Bank of Philadelphia; Executive Committee Member, South Jersey Energy Solutions, LLC; Marina Energy, LLC; South Jersey Energy Service Plus, LLC; and South Jersey Resources Group, LLC.	2000	Corporate Responsibility Committee Executive Committee Compensation Committee	Compensation Committee
Victor A. Fortkiewicz	Age 61, has been a director since 2010. He is also a director of South Jersey Gas Company. Mr. Fortkiewicz is a member of SJI's Corporate Responsibility Committee and the Governance Committee. He has been Of Counsel, Cullen and Dykman, LLP since October 2011. He served as executive director, New Jersey Board of Public Utilities from 2005 to 2010; as assistant counsel, Office of the Governor in 2005; and as president and director, NUI Utilities & Elizabethtown Gas Company from 2003 to 2004.	2010	Corporate Responsibility Committee Governance Committee	
Edward J. Graham	Age 55, has been a director since 2004 and has served as chairman of the board since April 2005. He has been chairman of South Jersey Gas Company since April 2012. He is chairman of SJI's Executive Committee. Mr. Graham has served as president and CEO of SJI since February 2004 and as President and CEO of South Jersey Gas Company from February 2004 to April 2012. He previously served as president of South Jersey Gas Company from 2003 to 2004; as president of South Jersey Energy Company from 2000 to 2003; as vice president of SJI from 2000 to 2001; as senior vice president, Energy Management, South Jersey Gas Company from 1998 to 2000. Mr. Graham serves on the following boards: member of the Economic Advisory Council of the Federal Reserve Bank of Philadelphia; director of Choose New Jersey; director, American Gas Association; director, New Jersey Manufacturers Insurance Company;	2004	Executive Committee	Executive Committee

REDACTED

Name of Director	Biographical Information	First Year Served	Recent Committee Assignments	Recent Committee Chairmanships
	director, New Jersey Business & Industry Association; director, the United Way of Greater Philadelphia and Southern New Jersey; director, Atlantic City Chamber of Commerce; director, Public Media NJ; serves on Drexel University's Energy and Environment Council; member, William J. Hughes Center for Public Policy; and member, Lloyd Levenson Institute of Gaming, Hospitality & Tourism.			
Sheila Hartnett-Devlin, CFA	Age 54, has been a director since 1999. She is also a director of South Jersey Energy Company. Ms. Hartnett-Devlin is a member of SJI's Executive Committee, the Compensation Committee and is chairman of the Audit Committee. She has been vice president, American Century Investments since 2008 and senior vice president since 2011. She held several positions with Cohen, Klingenstein & Marks, Inc. including as managing director, from September 2005 to 2008; executive vice president from 1997 to 2004; senior vice president from 1991 to 1997; vice president from 1985 to 1991; and, chairman, Global Investment Committee from 1996 to 2004. She was also a member of the Investment Policy Committee of Fiduciary Trust Company International from 1995 to 2004. Ms. Hartnett-Devlin serves on the following boards: member, New York Society of Security Analysts; director, Mercy Investment Services, Inc.; member, Investment Committee; director, Mannington Mills, Inc.; Executive Committee member, South Jersey Energy Solutions, LLC; Marina Energy, LLC; South Jersey Energy Service Plus, LLC; and South Jersey Resources Group, LLC.	1999	Executive Committee Compensation Committee Audit Committee	Audit Committee
Walter M. Higgins III Lead Independent Director	Age 68, has been a director since 2008. He has been SJI's Lead Independent Director since November 2010. He is also a director of South Jersey Energy Company. Mr. Higgins is a member of SJI's Executive Committee, Audit Committee and is chairman of the Governance Committee. He has been the Chief Executive Officer and President at Ascendant Group Ltd. since May 2012 and President and Chief Executive Officer of Bermuda Electric Light Company Limited since September 2012. He is the retired chairman, president, and CEO of Sierra Pacific Resources (now called NVEnergy). Mr. Higgins serves on the following boards: member of the board of AEGIS; Executive Committee Member, South	2008	Executive Committee Audit Committee Governance Committee	Governance Committee

Name of Director	Biographical Information	First Year Served	Recent Committee Assignments	Recent Committee Chairmanships
	Jersey Energy Solutions, LLC; Marina Energy, LLC; South Jersey Energy Service Plus, LLC; and South Jersey Resources Group, LLC.			
Sunita Holzer	Age 51, has been a director since 2011. She is also a director of South Jersey Gas Company. Ms. Holzer is a member of SJI's Compensation Committee and the Corporate Responsibility Committee. She has served as executive vice president and chief human resources officer, CSC since June 2012 and served as executive vice president, chief human resources officer, Chubb Insurance Company from 2003 – June 2012. Ms. Holzer is an advisory board member, National Council for Research on Women.	2011	Compensation Committee Corporate Responsibility Committee	
Joseph H. Petrowski	Age 58, has been a director since 2008. He is also a director of South Jersey Energy Company. He has been South Jersey Energy Solutions' chairman since April 2012. Mr. Petrowski serves as a member of SJI's Executive Committee, the Audit Committee and the Governance Committee. He serves as CEO of the Gulf Oil/Cumberland Farms Groups. Mr. Petrowski serves on the following boards: board member, Financial Economics Institute of Claremont McKenna College; board member, Gulf Acquisition, LLC; board member, Cumberland Farms, Inc.; Executive Committee Member, South Jersey Energy Solutions, LLC; Marina Energy, LLC; South Jersey Energy Service Plus, LLC; and South Jersey Resources Group, LLC.	2008	Executive Committee Audit Committee Governance Committee	
Frank L. Sims	Age 62, has been a director since 2012. He is also a director of South Jersey Gas Company. Mr. Sims serves as a member of the Compensation Committee and the Audit Committee. He has served as Board member, Piper Jaffray Co. since 2004; board member, PolyMet Mining Co. since 2008; chairman of board, The Minneapolis Federal Reserve Bank, (2005–2007) Minneapolis, MN; corporate vice president and platform leader, Cargill, Inc. (2002-2007) Minneapolis, MN.	2012	Compensation Committee Audit Committee	
Source: 2013 SJI Proxy Statement (pages 4-7).				

Name of Officer	Title	Organization	Experience	Education
Edward J. Graham	Chairman, President and CEO	SJI, Inc.	Mr. Graham joined the company in 1981 and held various professional and managerial positions prior to election as an officer of South Jersey Gas in 1988. Mr. Graham's previous employers include the Golden Nugget, Inc. and Midlantic Banks, Inc. He is a member of the Economic Advisory Council of the Federal Reserve Bank of Philadelphia. He is also an officer and member of the board of directors of Choose New Jersey, serves on the board of directors of the American Gas Association, the New Jersey Manufacturers Insurance Company, the New Jersey Business & Industry Association, the United Way of Greater Philadelphia and Southern New Jersey, the Atlantic City Chamber of Commerce, the Public Media NJ, serves on Drexel University's Energy and Environment Council, is a member of the William J. Hughes Center for Public Policy and a member of the Lloyd Levenson Institute of Gaming, Hospitality and Tourism. In addition, Mr. Graham is a trustee of The Foundation of the New Jersey Alliance for Action, served as chairman for the 2007 Heart Walk and was honorary chairperson of the 10th Annual Special Olympics Fall Classic.	Mr. Graham holds a bachelor degree from Rider University and a master of business administration in finance and investment degree from Drexel University.
	Chairman	SJG Company		
Kevin D. Patrick	Vice President, Research & Corporate Development	SJI, Inc.	Mr. Patrick joined SJI in 2007, and has brought more than 25 years of experience in corporate and strategic planning to the company. Mr. Patrick oversees corporate development, information technology as well as product and administrative services. As chief strategy officer for the organization, he is focused on core business performance, economic and peer company research, building emerging business models and evaluating long-term strategic options for SJI. Prior to joining SJI, he served as vice president and CFO for the $5 billion eastern division of Albertsons, Inc. (now SuperValu). Prior to that, he was the assistant vice president of corporate planning and development for Brown-Forman Corporation. He also served as director of corporate planning & development for Citizens Communication Company (now Frontier Communications).	Mr. Patrick holds a BBA in finance from Connecticut State University, Ancell School of Business and an MBA from the University of Connecticut.

REDACTED

Name of Officer	Title	Organization	Experience	Education
David A. Kindlick	Senior Vice President and CFO	SJI, Inc.	Mr. Kindlick first joined the company in 1979 as an internal auditor. Through his dedication and commitment to success, he advanced through several management and professional positions before being appointed to his current SJI positions in 2012. Mr. Kindlick serves as the Treasurer on the board of trustees for Virtua and is chairman of the finance and investment committee. He also serves on the Virtua board executive committee, the compensation committee and the audit committee. In addition, he serves on the executive advisory council for the Rutgers University School of Business.	Mr. Kindlick holds a bachelor of accounting degree from The College of New Jersey and a master of financial investments degree from Drexel University.
Michael Renna	Senior Vice President President and COO	SJI, Inc. SJES	Mr. Renna joined South Jersey Industries in 1998 and through his hard work and commitment to success; he advanced through a number of managerial and professional positions. Mr. Renna holds the office of president and chief operating officer of South Jersey Energy Solutions, and is at the helm of one of New Jersey's most dynamic and successful energy companies. Additionally, Mr. Renna is president and chief operating officer of Marina Energy, which develops and operates large scale commercial energy projects, including the thermal facility that serves the Borgata Hotel Casino & Spa. He was appointed to his current positions with SJI in 2012, SJES and Marina Energy in 2011, and SJE in 2004.	Mr. Renna holds an undergraduate degree in finance from the University of Delaware and a master of business administration degree from Cornell University.
Jeffrey E. DuBois	Senior Vice President President	SJI, Inc. SJG Company	Mr. DuBois first joined SJG in 1987 as a retail marketing representative, and he advanced through several management level positions to earn appointment to his current positions with SJI and SJG in 2012. In November 2012, Mr. DuBois was appointed to SJG's board of directors. Jeff is actively involved with a number of professional and community organizations. Most notably, he serves on the American Gas Association's Leadership Council and is Chairman of the Board of Trustees for the Southern New Jersey Development Council. He is also active and serves as a Board Member on the Board of Directors for the Northeast Gas Association, New Jersey Utilities Association, Ronald McDonald House of Southern New Jersey, New Jersey Chamber of Commerce and New Jersey State Safety Council. Additionally, Jeff is secretary for the Cumberland County College Board of Trustees, where he serves as chairman of the personnel committee.	Mr. DuBois holds a bachelor of industrial technology degree from Rowan University.

REDACTED

Name of Officer	Title	Organization	Experience	Education
Gina M. Merritt-Epps, Esq	General Counsel & Corporate Secretary	SJI, Inc. SJG Company SJI Services, LLC	Ms. Merritt-Epps first joined SJI in 2006 as Director of Legal Affairs. Through her hard work and commitment to success, she progressed quickly and, in 2009 was appointed Corporate Counsel and Secretary. She was elected to her current positions in 2012. Prior to working at SJI, Ms. Merritt-Epps was employed as Assistant County Counsel for the Atlantic County Department of Law. Ms. Merritt-Epps is member of the Society of Corporate Secretaries and Governance Professionals, the National Association of Corporate Directors, the Energy Bar Association, and the American Association of Blacks in Energy. She also serves on the American Gas Association's Legal Committee. She formerly served on the District I Ethics Committee for the Supreme Court of New Jersey, the Board of Directors for the Delaware Valley Chapter of the Association of Corporate Counsel, the New Jersey Judicial and Prosecutorial Appointment Committee for Atlantic County, and the Atlantic County Bar Association.	Ms. Merritt-Epps holds a bachelor of political science degree from Pennsylvania and juris doctor from Howard University School of Law.
K. A. McEndy	Vice President, Human Resources	SJI, Inc.	Ms. McEndy joined SJI in 2013 as a Vice President of Human Resources. She is a member of SJI's Contribution and Trust Committees and serves as Secretary for the Compensation Committee. Recently, Ms. McEndy was Principal at The McEndy Group, LLC. Prior to that, she was Senior Vice President, Human Resources and Administration at both Independence Blue Cross and Keystone Mercy Healthplan. She also served as Senior Vice President, Customer Service of Cigna Corporation. Ms. McEndy is a member of the Forum of Executive Women.	Ms. McEndy has a bachelor's degree from Fairfield University and master of business administration from St. Joseph's University.
Stephen H. Clark	Vice President , Finance & Treasurer Sr. Vice President, Finance, Regulatory Affairs & Treasurer	SJI, Inc. SJG Company	Mr. Clark first joined the company in 1997, as manager of investor relations, with the task of establishing that function for SJI. His work ethic and dedication to success helped him to progress through a number of managerial and officer positions before being elected to his current roles with South Jersey Gas, and South Jersey Industries in 2012.	Mr. Clark holds a bachelor of political science from Rutgers College and an MBA, finance from College of William and Mary.
Kenneth A. Lynch	Chief Accounting Officer	SJI, Inc.	Mr. Lynch joined SJI in 2003 as Director, Internal Audit. Through his hard work and commitment to success, he advanced to assistant vice president of financial reporting and risk management in 2006 before being elected to his current role in 2012. As Chief Accounting Officer for South Jersey Industries, Mr. Lynch oversees all aspects of the company's accounting	Mr. Lynch received his undergraduate degree in accounting and finance from Drexel University and a master's degree in taxation

Name of Officer	Title	Organization	Experience	Education
			and financial reporting functions and also serves as the primary advisor to management on US GAAP, financial disclosure and internal control matters. In addition, he is responsible for SJI's risk management, insurance and tax functions and serves as CAO and treasurer of the company's non-regulated subsidiary, South Jersey Energy Solutions. Mr. Lynch is active in many professional and civic organizations, serving on the board of directors and as chairman of the Finance and Audit committee of the Treatment Research Institute, based in Philadelphia. He also holds professional affiliations with the American Institute of Certified Public Accountants, Pennsylvania Institute of Certified Public Accountants, Financial Executives International, Risk Management Society, National Association of Credit Management, SEC Compliance Council and the New Jersey Utilities Association.	from Villanova University. Mr. Lynch is a Certified Public Accountant.
Sharon M. Pennington	Assistant Vice President, Labor & Employee Relations	SJI, Inc.	Ms. Pennington joined SJG as Director of Human Resources in 2002 and was appointed to her current position in 2013. Ms. Pennington holds professional affiliations with the Forum of Executive Women, Maryland Bar, New Jersey Bar, New Jersey Utility Association, Society of Human Resources Management, and Women's Leadership Initiative.	Ms. Pennington has a bachelor's degree from Glassboro State College and juris doctor from Rutgers School of Law.
C. Mari-Mazzola	Assistant Vice President, Risk Management	SJI, Inc.	Ms. Mari-Mazzola joined SJI in 2004 as an Internal Auditor III. She has served as a Director of Internal Audit, Assistant Vice President of Internal Audit, Vice President and Treasurer for South Jersey Energy Solutions and a Secretary and Treasurer for South Jersey Resources Group and SJX. She also has served as Vice President for South Jersey Resources Group and South Jersey Energy Services. In 2013, she was appointed to serve SJI as an Assistant Vice President, Risk Management. Her community affiliations include serving as Chairman of the Southern New Jersey March of Dimes, board member of the United Way of Gloucester County, and member of the Board of Advisors for the American Cancer Society.	Ms. Mari-Mazzola has a bachelor's degree in accounting from LaSalle University, and she is a Certified Public Accountant.
Robert F. Fatzinger	Senior Vice President, Customer & Distribution Operations	SJG Company	Mr. Fatzinger joined SJG as Director of Appliance Service and Warranty Programs in 2001. In 2007, he was promoted to Vice President of Customer and Distribution Operations. He assumed his current title in 2012. Mr. Fatzinger provides leadership and direction to Customer and Distribution Operations functions of SJG, including gas distribution operations, customer service and dispatch, sales and marketing, and safety and technical training. He is a member of the Environmental Committee and the SJG Risk Management Committee.	Mr. Fatzinger received his bachelor of electrical engineering from Lehigh University.

REDACTED

Name of Officer	Title	Organization	Experience	Education
Charles F. Dippo, P.E	Senior Vice President, Engineering Services & System Integrity	SJG Company	Mr. Dippo joined SJG as Construction Supervisor in 1979. In 2003, he was promoted to Vice President of Engineering Services and System Integrity. He was promoted to his current position in 2012. Mr. Dippo manages and directs engineering services involving the design and technical specifications of all company facilities, system planning, pipeline operations, corrosion control, system integrity, construction and all associated technical services related to the Company's transmission and distribution infrastructure. He is also responsible for gas supply, off-system sales, gas control allocations, measurement, SCADA/ telecommunications, LNG plant operations, coordination of system infrastructure security and emergency preparedness. Mr. Dippo is a member of the SJG Risk Management Committee. Mr. Dippo holds professional affiliations with the American Gas Association, American Society of Civil and Gas Engineers, National Society of Professional Engineers and the New Jersey Utilities Association.	Mr. Dippo holds a bachelor of civil engineering from Lehigh University and a master of engineering management from Drexel University.
Thomas S. Kavanaugh	Controller Treasurer	SJG Company SJI Services, LLC	Mr. Kavanaugh joined SJI in 1991 as a Staff Accountant and through several management level positions to earn appointment to his current positions of Controller of SJG and Treasurer of SJIS. He is a member of SJI's Trust Committee and holds professional affiliations with New Jersey Utilities Association, Atlantic Cape Community College, and American Gas Association.	Mr. Kavanaugh has a bachelor of accounting and an MBA, finance from Rutgers University, and he is a Certified Public Accountant.
P. J. Zuccarino	Vice President, Distribution Operations	SJG Company	Mr. Zuccarino joined South Jersey Gas Company in 1984 as File Clerk. Through dedication and hard work, he has assumed more and more responsibility. He was promoted to his current position of Vice President, Distribution operations in 2013. His professional affiliations include membership and/or leadership positions with the American Gas Association, the Atlantic County Emergency Management, LDC NJ Utilities, the NJUA Operations Committee, and the Northeast Gas Council.	Mr. Zuccarino has a bachelor's degree from Stockton State University.
Source: SJI's website / Investors / Corporate Governance / Management Team and OC-49.				

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7. STRATEGIC PLANNING

Strategic Planning is centered on SJI's vision of an energy efficient future and how to be an energy company of first choice for their customers, shareholders, and employees. The Strategic Plan describes how this vision will be carried out. In the Strategic Plan for 2011 through 2015, SJI intends to make the transition from a traditional utility business model to an energy services provider model, using natural gas as the platform.[1]

Strategic planning fundamentally involves the following process:

- Development of a plan or vision for the long-term direction of the Company;
- Identification of objectives that can be used to measure performance;
- Development of an implementation plan; and
- Evaluation of performance and adoption of adjustments as needed by changed circumstances and actual events.

Corporate objectives should be aspirational in order to incent management to perform at its full potential and deliver the best possible results. Objectives relevant to SJI would include:

- Growth in earnings per share and dividends;
- Return on invested capital;
- Increases in shareholder value measured against peers;
- High customer satisfaction; customer service; and
- Enhancement of corporate image.

The achievement of strategic objectives is a key element or indication of the likelihood of future financial performance. Therefore, it is important to employ both financial and strategic objectives in employing a balanced scorecard to measure corporate performance. For SJI, financial forecasting is a subset of the strategic planning process. The development of the financial plan and strategic plan are performed simultaneously.[2] Ultimately, the strategic plan must produce performance goals that result in the Company being in a favorable position relative to its peers. Absent such results, the validity of the plan and/or its execution must be reconsidered.

Strategic planning is an ongoing and continuous process. A strategic plan must be modified when external conditions warrant re-evaluation. The plan must constantly be evaluated against industry and competitive conditions.

[1] Response to Discovery, OC-4.
[2] Interview with Kevin Patrick, VP Research and Corporate Development, January 22, 2013.

Summary of Findings

1. Strategic Planning is centered on SJI's vision of an energy efficient future and how to be an energy company of first choice for their customers, shareholders, and employees.
2. Every five years SJI undergoes a comprehensive strategic planning process that culminates in a new five-year Strategic Plan. In interim years, a yearly review is added on to the end of the five-year plan so that the documentation continues to project SJI's strategy up to five years into the future.
3. The vision statement for SJI is broad in stating the company's desire to become an industry leader in several areas. The operations and future plans of the Company, as shown in its Strategic Plan, appear to push the company towards its vision.
4. Although the mission statement appears to be appropriately aligned with the vision of the company, the mission statement does not specifically mention the direction SJI will take to serve its employees as described in its vision statement.
5. Balanced scorecards were only provided for 2010 and 2011 for Mr. Patrick, VP – Research and Development. His 2010 scorecard did not contain any detail as to how he achieved his performance objectives.
6. SJI's Strategic Plan is not only addressed to the executive team and the Board of Directors, it is communicated to all of the non-executive employees of SJI as well. The CEO of SJI personally visits each company site annually to discuss the company's performance, initiatives and operations.
7. The portion of the 2011 – 2015 Strategic Plan that is dedicated to the utility does not contain much information regarding specific plans for the utility in the future. Most of the discussion in the 2011 – 2015 Strategic Plan discusses current or past economic conditions and how the utility operated to best position itself to produce positive results.
8. SJI considers itself to have an "Always On" philosophy when assessing potential mergers and acquisitions. In this philosophy, SJI executives continuously monitor market conditions and discuss potential M&A opportunities with the guidance of the SJI VP of Research and Corporate Development.
9. SJI identifies its principal strategic strengths to include: the Conservation Incentive Program (CIP), strategic alliances, and the activity in the Marcellus Shale. The Company's most significant current challenge is its aging workforce.

Recommendations

1. Overland recommends that SJI track its progress toward its goals in becoming an industry leader in the areas mentioned in its vision and mission statement by making more extensive use of benchmarking studies as a basis to more effectively demonstrate its progress.
2. Overland recommends that SJI document and retain balanced scorecard information for all of its employees, complete with the results of how the employee achieved the balanced scorecard objectives and the quantitative assessment of the employee's level of achievement. This

information should be retained for all years that are subject to SJI's document retention policies and guidelines.

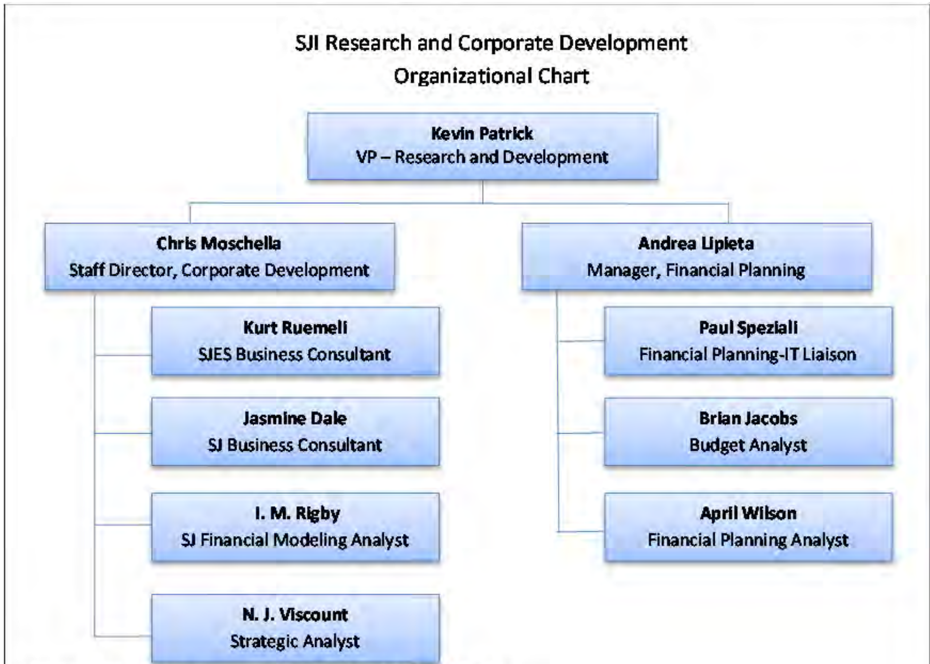
3. The SJI five-year strategic plan should include more of a forward looking view of how the utility will operate for the five years covered by the 2011 – 2015 Strategic Plan. Included in this view should be a more detailed assessment of any anticipated regulatory filings (e.g. rate case filings) and financial metrics as they relate to credit ratings (see Chapter 9 – Finance, Risk Management and Cash Management).

Overview

The strategic planning function is a department within the parent company, SJI. The CEO, his direct reports, the corporate secretary, and the head of Human Resources are involved in strategic planning that is considered by executive management and the Board of Directors.[3] The employee that has overall responsibility for the strategic planning function is Kevin Patrick, VP Research and Corporate Development. Mr. Patrick's subordinates are placed in the Financial Planning department within the parent company. Mr. Patrick reports directly to the Chairman and CEO, Ed Graham. Mr. Patrick is also considered an executive officer of SJI. An important group within the strategic planning function is the Business Consulting Group. This group consists of two "consultants", one for the utility, and the other for non-regulated operations. The purpose of this group is to help the business units of SJI to plan their operational activities and develop financial forecasts.[4] The organizational chart for those employees involved in the strategic planning process is shown below.

[3] Ibid.
[4] Ibid.

Table 7-1 - SJI Research and Corporate Development Organizational Chart



Source: Response to Discovery, OC-96 and updated with OC-5

A five-year Strategic Plan is the primary output of the strategic planning process and the Financial Planning group. Every five years SJI does comprehensive strategic planning that culminates in a new five-year Strategic Plan.[5] For the interim years, a yearly review is added on to the end of the five-year plan so that the documentation continues to project SJI's strategy up to five years into the future. Included in the Strategic Plan are financial forecasts, capital expenditure forecast, discussion of major projects, and an environmental review based on the current economy.

SJI Vision, Mission, and Values Statement

At the outset of this Chapter, we provided a summary of the SJI vision that called for the Company to be an energy company of first choice with an eye toward an energy efficient future. The CEO is responsible for driving the company towards achieving this vision.[6] In its 2011-2015 Strategic Plan, more detailed vision, mission, and values statements were disclosed. These are found below.

Vision Statement

To be the Energy Company of First Choice for Customers, Shareholders and Employees
Be an Energy Industry Leader in:

- Growth, Innovation, Service, and Energy Efficiency;
- One-Stop Energy Shopping;

[5] Ibid.
[6] Interview with Ed Graham, Chairman and CEO of SJI, March 27, 2013.

- Entrepreneurial Leadership, Strategic Alliances, Empowered Employee Base, Demonstrated Green Energy Expertise; and
- Serving the Collective Good of Customers, Shareholders, and Employees.[7]

The vision statement for SJI is broad in stating the Company's desire to become an industry leader in several areas. The operations and future plans of the Company as shown in its Strategic Plan appear to push the company towards its vision. It would benefit SJI to track its progress toward becoming an industry leader in these areas by making more extensive use of benchmarking studies. The expanded use of benchmarking studies is a recommendation that appears in several areas of our management audit report. By expanding the use of benchmarking studies, SJI can more effectively demonstrate its progress towards becoming an industry leader or, at a minimum, track improvements in identified programs, policies, and procedures in the areas it has mentioned in its vision statement.

Mission Statement

Create Value through Customer-Focused Energy Solutions that are Environmentally Friendly and Maximize Long-Term Shareholder Value through:

- Expanded Menu of Products and Services with a Focus on Green Energy Solutions;
- Competitively Priced, Innovative, and High Quality Services;
- Improved Growth of Stock;
- Value Added Provider of Green Energy Solutions; and
- Returns Exceeding Traditional Regulation.

The mission statement appears to be appropriately aligned with the vision of the company. The mission statement provides direction for achieving the vision of the company with respect to customers and shareholders. The mission statement does not mention specifically the direction the company will take to serve its employees as described in its vision statement.

Values Statement

Live up to Commitments and Conduct Business Guided by the Highest Set of Principles
Commitments to Customers, Shareholders, Employees, Community and Our Environment with:

- Integrity;
- Highest Standards of Safety;
- Innovation;
- Performance;
- Stewardship; and
- Respect.

[7] Response to Discovery, OC-4 "South Jersey Industries, Inc. Consolidated 2011-2015 Strategic Plan".

These are the values that management has determined will guide the behavior and the decision making process at SJI. It is beneficial to have a values statement as it demonstrates to internal and external stakeholders of SJI the principles on which the company will operate.

Performance Assessment

The Research and Corporate Development group at SJI did not have a departmental balanced scorecard during the audit period. Overland used Mr. Patrick's balanced scorecard to analyze the objectives, targets, and performance results that determine how well the Research and Corporate Development team performed at SJI. Balanced scorecards were only provided for 2010 and 2011 for Mr. Patrick. His 2010 scorecard did not contain any detail as to how he achieved his performance objectives. Therefore, the discussion on his performance assessment (and indirectly the Research and Development Group's) is limited to 2011.

Like all other balanced scorecards at SJI, Mr. Patrick's BSC objectives were divided into four categories: financial, customer, internal process, and learning and growth. Each objective was given a percentage weight so that all of the objectives in total weighed 100%. Mr. Patrick achieved at least a 3 (satisfactory) rating for all of the objectives in his 2011 balanced scorecard and an overall score of 4.00, which generally indicates that his performance exceeded expectations.

The balanced scorecard objective that received the largest weighting was "Complete departmental succession planning and development". This objective was given a weight of 25%. As discussed later in the Human Resources Chapter, succession planning was given a high priority at SJI in 2011. Mr. Patrick was able to achieve a rating of 3 for this objective by developing a succession plan and development plans for his direct reports.

Other objectives in Mr. Patrick's 2011 balanced scorecard are listed below:

- Develop the 2011-2015 Strategic Plan and have it available for CEO and Executive review;
- Complete in a timely manner the monthly forecasting and annual enterprise budgeting;
- Complete list of IT projects;
- Complete list of facility projects;
- Improve productivity and reduce cost through better vendor management; and
- Manage with quality and timeliness the 2011 Budget Cycle.[8]

Communicating the Strategic Plan

There is a process for developing and communicating the strategic plan for both the executives at SJI and the SJI Board of Directors. This process typically begins in March when the Research and Corporate Development (RCD) group present the Board of Directors with the topics that the group intends to cover with the CEO and Executive Team during the SJI Strategy Summit. The Board is able to provide input and insight into the topics that will be covered during the summit. The RCD group carries its agenda along

[8] Response to Discovery, OC-96.

with the feedback from the Board to the off-site SJI Strategy Summit that takes place in June. At this summit, the CEO, Executive Team, and other key SJI associates participate in a two-day Annual Strategic Planning Session to discuss the initiatives and other agenda items for the five-year plan that will help improve SJI's value to its shareholders and customers. In addition, a draft of the budget for the next year is discussed during this planning session.

The agenda for the 2011 Strategic Planning Meetings contained both internal and external presentations. There were two presentations made by outside consultants. **[Begin Confidential]** **[End Confidential]** There were also internal presentations from the Presidents of both the utility and non-regulated businesses. These presentations discussed long-range strategic planning even beyond the five-year Strategic Plan mentioned above. The utility presentation contained a ten-year view, while the non-regulated businesses discussed future operations through 2020.[9]

After the Strategic Planning Session in June, the RCD group gathers the information and inputs it into the Hyperion system to create the quantitative data for the Strategic Plan. This data along with the initiatives discussed during the Planning Session are presented to the Board of Directors at the Board's final meeting of the year. The Strategic Plan for 2011-2015 contained the following strategic initiatives that were discussed during the audit period.[10]

- South Jersey Resources Group (SJI Wholesale Business)
  - **[Begin Confidential]**

    [End Confidential]
- South Jersey Energy Services (Wholesale and Retail Business)
  - **[Begin Confidential]**

    [End Confidential]
  - Combined Heat and Power (CHP) facilities
    - **[Begin Confidential]**

      [End Confidential]
- South Jersey Gas (Regulated Utility)
  - **[Begin Confidential]**

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[9] Agenda from the June 2011 Strategic Planning Meetings obtained from Boardbooks software provided by SJI.
[10] Response to Discovery, OC-4 "South Jersey Industries, Inc. Consolidated 2011 – 2015 Strategic Plan".

➢

[End Confidential]

SJI's strategic plan is not only addressed to the executive team and the Board of Directors, it is communicated to all of the non-executive employees of SJI as well. The CEO of SJI personally visits each company site annually to discuss the company's performance, initiatives and operations. These meetings, which are attended by all of the employees at that location, include a period of time when employees can ask the CEO questions about the company's strategy and how the company plans to achieve its strategic goals.[11]

Evaluating the Utility's Strategic Plan

The portion of the Strategic Plan that is dedicated to the utility does not contain much information regarding specific plans for the utility in the future. Most of the discussion in the Strategic Plan discusses current and past economic conditions and how the utility operated to best position itself for success. Noticeably absent is an estimated timeframe for the utility's next rate case filing. **[Begin Confidential]**

[End Confidential]

How quickly the utility is able to upgrade its infrastructure is largely dependent on the continuation of the Capital Investment Recovery Tracker (CIRT). The program allows the utility to receive a return of and return on investment as the capital is spent. The utility has used this program to help accelerate capital spending on its infrastructure since 2009.[13] This program is discussed in more detail in Chapter 9 – Finance.

SJG's most recent rate case was decided in September 2010. The outcome of the rate case and its effect on the utility is discussed in Chapter 9. In the current economic environment, and based on capital commitments facing the industry, electric and gas utilities currently tend to file rate cases every few years.

[Begin Confidential]

[11] Response to Discovery, OC-97.
[12] Ibid.
[13] SJI 2012 10-K.

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[End Confidential]

Mergers and Acquisitions Process

Utility mergers generally evolve to create a more cost-efficient operation and to expand geographic coverage. The industry activity in mergers and acquisitions over the last ten to fifteen years has been fairly robust. The principal underlying factors have included deregulation and industry restructuring. Significant foreign investment in US utilities has also occurred in recent years.

SJI considers itself to have an "Always On" philosophy when assessing potential mergers and acquisitions.[14] In this philosophy, SJI executives continuously monitor market conditions and discuss potential M&A opportunities with the guidance of the SJI VP of Research and Corporate Development. At times M&A opportunities are presented to SJI from external parties (e.g. investment bankers).[15] The Research and Corporate Development department and relevant business unit(s) receive and analyze information about companies or assets that are on the market. The analysis typically involves a review of the target's financial results.[16]

[Begin Confidential]

[End Confidential]

[14] Response to Discovery, OC-99.
[15] Interview with Kevin Patrick, VP of Research and Corporate Development.
[16] Response to Discovery, OC-99.
[17] Ibid.
[18] Response to Discovery, OC-292.

Marcellus Shale

[Begin Confidential]

[19] Response to Discovery, OC-294.
[20] Ibid.
[21] Response to Discovery, OC-288.
[22] Response to Discovery, OC-294.
[23] Response to Discovery, OC-294 and 2011 and 2012 SJI 10-Ks.

[End Confidential]

Diversification's Effect on the Utility

SJG did not own any non-utility investments or operations from 2009 to 2012.[25] The utility maintains its own leadership structure by having a President and COO that reports to the CEO of SJI. Overland reviewed the Board of Directors for the entities within SJI and observed the people making up the Board of Directors for the utility did not serve on the Board of Directors or Executive Committees of any non-regulated affiliate of SJI.[26] EDECA Standards also provide regulation for separating the management and assets of the utility from the non-regulated affiliates. These standards are discussed in Chapter 2 – Overview of Affiliate Relationships and Transactions. SJI has also taken measures to insulate the utility from any negative effects of its association with the non-regulated affiliates through ring-fencing procedures. These measures are discussed in Chapter 9 – Finance.

SJI Strengths, Weaknesses, Opportunities, and Threats (SWOT)

Performing a SWOT analysis provides an overview of the company's current strategic position in the marketplace. It evaluates internal and external forces that the Company must understand and address going forward to be successful. Overland relied upon interviews of SJI employees and the discovery process in developing the following SWOT analysis.

Strengths

[Begin Confidential]

Weaknesses

[24] Response to Discovery, OC-294.
[25] Response to Discovery, OC-121.
[26] Response to Discovery, OC-14.

[End Confidential] Chapter 15 – Human Resources discusses the programs and initiatives SJI is using to successfully transfer knowledge from its more experienced employees to their successors and to prepare the successors for leadership roles within the company.

Opportunities

[Begin Confidential]

Threats

[27] Interview with Ed Graham, Chairman and CEO of SJI, March 27, 2013.
[28] Interview with Ed Graham, Chairman and CEO of SJI, March 27, 2013.
[29] Response to Discovery, OC-294.
[30] Response to Discovery, OC-294.
[31] Interview with Ed Graham, Chairman and CEO of SJI, March 27, 2013.

[End Confidential]

[32] Ibid.

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8. External Relations (Government Relations & Regulatory Affairs)

South Jersey Industry's external affairs organization is the Government Relations and Regulatory Affairs (GRA) department. GRA's primary functions include providing strategic regulatory support, legislative and rulemaking monitoring and advocacy, municipal government relations and project facilitation, and facilitating regulatory compliance.

Summary of Findings

1. The GRA department is responsible for interfacing with the New Jersey BPU and the Ratepayer Advocate (RPA). It is also response for all legislative, political and governmental activities affecting the operations of SJI and its subsidiaries.
2. The Regulatory Affairs component of GRA was part of the Rate department prior to 2011. GRA was moved from SJI Services to SJG in 2012.
3. Until the function was moved to SJIS Corporate Communications in 2012, GRA was responsible for oversight of corporate contributions (donations to charitable organizations), which are incurred by and allocated from the parent organization. Approximately three-fourths of the cost of charitable donations, averaging approximately $380,000 annually during the review period, was allocated to SJG.
4. The FERC's Uniform System of Account rules require that donations to charitable organizations be recorded "below-the-line," in account 426.1, Donations Expense. SJG records its share of these costs "above-the-line," in account 923, Outside Services Expense.
5. SJI provided information showing that very small amounts, averaging approximately $6,000 per year, were paid to outside lobbyists during the years 2009-2011.
6. GRA tracks the costs of legislative monitoring, advocacy and "social investment" employee activities using project codes. In 2011 these projects accumulated costs of $112,000, a majority of which was charged to SJG. SJG's share of the costs was charged "above-the-line," to ratepayer-funded account 920, General and Administrative Salaries Expense.

Recommendations

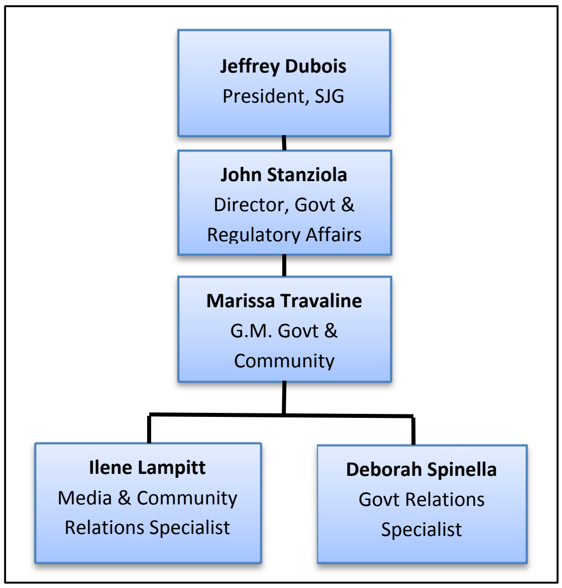
1. SJG should record its share of corporate donations in below-the-line account 426.1, Donations Expense, instead of account 923, Outside Services Expense.
2. The "government" component of GRA, handled primarily by the General Manager, Government and Community Relations, is a corporate function performed on behalf of SJI and all of its subsidiaries. SJI should consider incorporating this function in its parent organization or in SJI Services, instead of in SJG.
3. The BPU should determine whether the costs incurred by employees in conducting legislative analysis, advocacy and "social investment" activities should be funded by ratepayers or by shareholders. To the extent the BPU determines that any of these activities should be funded

by shareholders, SJG should record its share of the activities “below-the-line,” in FERC account 426.4 – Expenditures for Certain Civic, Political and Related Activities.

Organization, Staffing and Key Functions

The GRA department is headed by John Stanziola, Director. Mr. Stanziola reports directly to Jeffrey Dubois, President of SJG. The organization as of August, 2012 is shown below.

Table 8-1 – External Relations Organizational Chart



Prior to 2010, Mr. Stanziola held the title Director, Regulatory Affairs and was a member of the Rates and Regulatory Affairs department.[1] The Regulatory Affairs component was moved from Rates to Government Affairs in 2010, and Mr. Stanziola moved with it. In 2012 the department’s employees were moved from SJI Services to SJG. All four GRA employees communicate at least occasionally with the NJBPU.[2]

Key responsibilities of GRA, as described in the Company’s response to our data request, include:[3]

- Regulatory Support – This includes providing guidance and assistance on regulatory matters, including rates, compliance, service quality, public policy and customer support.
- Legislative / Rulemaking, Monitoring, Advocacy and Implementation - The department monitors and reports on all relevant legislation and administrative regulations at the state and federal levels. In addition to leading advocacy communication and implementation efforts, it assesses the value of using statewide and national business and industry alliances to advance corporate objectives.

[1] The Rates Department is headed by Sam Pignatelli, Vice President, Rates & Regulation.
[2] Response to Discovery, OC-102.
[3] Response to Discovery, OC-100.

- Municipal Outreach and Project Management - GRA collaborates company-wide on all projects and initiatives requiring municipal outreach, by establishing communication in support of company objectives.
- Research and Drafting - GRA staff provides analysis and assessment of government and regulatory issues to management. This information is frequently supported and supplemented through involvement with external business and industry organizations such as the American Gas Association (AGA).
- Supporting Compliance with Public Disclosure Rules **–** GRA provides support in meeting compliance with state and federal entities' disclosure requirements.
- Strategic Guidance / Internal Consulting **–** GRA consults internally with senior management and internal clients on government and regulatory matters.
- Management of Government Relations Consultants – GRA recommends external consultants and manages their activities.

Job descriptions for GRA employees list the following additional responsibilities:[4]

- Maintaining a "pro-active regulatory affairs corporate strategy before the NJBPU."
- Strengthening the Company's corporate image before the NJBPU and the Ratepayer Advocate.
- Provide a proactive approach to changes in state and federal regulatory policy. (Note: The qualifications for the General Manager, Government and Community Relations include "extensive knowledge of and experience in [the] New Jersey state legislative process as well as direct knowledge of local and federal policy processes.")
- Position SJG's senior management in an unofficial advisory capacity before Commissioners and senior staff of the NJBPU and the Ratepayer Advocate.
- Oversee internal and external legislative and lobbying-related communications and functions.
- Manage corporate philanthropic and social investment activities, including the United Way campaign.
- Develop policy analysis to keep groups within the Company up to date with knowledge of legislative and regulatory initiatives.
- Maintain contacts with community leaders, including elected officials. Identify community concerns and develop / maintain working relationships.
- Coordinate sponsorship recognition opportunities, such as image ads, banners, displays, in conjunction with Corporate Communications.
- Coordinate media relations activities, including writing and distributing news releases and arranging for media coverage.
- Coordinate SJG's consumer advisory council meetings.

Actual and Budgeted Costs

The table below summarizes cost centers controlled by the GRA function during the review period.

[4] Response to Discovery, OC-71.

Table 8-2 – South Jersey Gas / SJI Services / SJI Parent Org., Government & Regulatory Affairs Dept. Budgeted & Actual Costs

South Jersey Gas / SJI Services / SJI Parent Organization Government and Regulatory Affairs Dept. Budgeted & Actual Costs								
Description	2009		2010		2011		2012 (1)	
	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget
Government Relations (3011)	448,000	315,000	488,000	395,300	512,600	(417,100)	2,700	-
Government Relations (863)	319,300	290,500	315,464	326,791	401,944	399,260	372,997	356,066
Total	767,300	605,500	803,464	722,091	914,544	(17,840)	375,697	356,066
Sources: OC-500 & OC-723 (1) Budget responsibility for corporate contributions recorded in cost center 3011 was transferred to cost center 3010 in 2012. Cost center 3010 is part of Public Relations / Corporate Communications, a different organization.								

Marissa Traverline, General Manager, Government and Regulatory Affairs, is responsible for both of GRA's cost centers.[5] Cost center 863 resided within SJIS during the years 2009 through 2011 and was moved to SJG in 2012.[6] It consists primarily of the compensation, transportation and office expenses of the employees in the Government and Regulatory Affairs department. Cost center 3011 resides within the SJI parent organization and consists of corporate contributions. In 2012 budget responsibility for corporate contributions was transferred from Ms. Traverline to Joan Brigandi, Director of Corporate Communications in SJIS. 2012 corporate contributions expense, which totaled $593,000 (a 47% increase over 2011) was moved to cost center 3010 – Public Relations, which, like cost center 3011, resides in SJI's parent organization.

Lobbying and Legislative Influence Activities

We requested SJI and SJG identify outside lobbyists, describe the work they performed and the amounts spent during the review period. The information provided is summarized in the following table.

Table 8-3 – South Jersey Industries and South Jersey Gas, Amounts Paid to Outside Lobbyists

South Jersey Industries and South Jersey Gas Amounts Paid to Outside Lobbyists				
Lobbyist	Activities	2009	2010	2011
Salmon Ventures Ltd.	Supported local government outreach efforts on behalf of SJI businesses	5,000		
MC2 Public Affairs (Fred DeSanti)	Provided state-level legislative advocacy in support of initiatives that offered revenue or savings opportunities for SJI businesses.		5,553	8,254
Source: OC-101				

In addition to overseeing activities of paid lobbying, GRA is responsible for overseeing corporate contributions and community welfare activities and for monitoring legislation and advocacy. The "basic function" of the General Manager, Government and Community Relations is described as

[5] Response to Discovery, OC-639, "DR #639 SJG Responsibility List 2009-2012.xls."
[6] Responses to Discovery, OC-500 and OC-723.

"responsibil[ity] [for] all legislative, political, governmental and select regulatory activities." SJI tracks the internal labor directly associated with these efforts using project designations. During 2011 GRA incurred approximately $112,000 in these projects, and probably incurred similar amounts in the years 2009, 2010 and 2012. The 2011 costs and their allocation to affiliates are summarized below.

Table 8-4 – SJI Services (SJIS), Legislative Research & Advocacy & Social Investment Projects

SJI Services (SJIS) Legislative Research & Advocacy and Social Investment Projects Loaded Labor Costs - January Through December 2011									
Project Description	Allocated	Directly Charged							
		Marina	SJE	SJES	SJESP	SJG	SJI	SJIS	Total
GCR-ELEC compliance, reporting, lobbying activity	492			1,115		-	7,279	785	9,671
GCR-Interface gov't official		561			36	11,832	1,728		14,157
GCR-Legislative review, research, update	736	2,550	2,794	216	2,770	8,773	39,194	180	57,213
GCR-Social Investment	31,027					-			31,027
Total	32,255	3,111	2,794	1,331	2,806	20,605	48,202	965	112,068
Source: OC-340, 3rd Supplement									

Based on data provided in response to request OC-320, the amounts charged to all of the above projects were charged on SJIS books to above-the-line account 920 – General and Administrative Salaries Expense. As the table shows, more than half the total accumulated in these projects was either allocated from SJIS or charged directly by SJIS to SJI's parent organization. Whether charged directly to SJG or allocated from SJIS or the parent, most of the costs were ultimately distributed above-the-line to SJG.

Corporate Contributions

Corporate contributions include donations to charitable organizations. These are budgeted and incurred by SJI's parent organization. During the years 2009 through 2011 they were budgeted and incurred in the parent organization's Government Relations cost center. In 2012 they were moved to the parent organization's Public Relations cost center and responsibility was transferred from GRA to the Corporate Communications department. The table below summarizes corporate contributions for the four years ending in 2012 and the amounts allocated to SJG.

Table 8-5 – South Jersey Industries, Corporate Contributions

South Jersey Industries Corporate Contributions				
	2009	**2010**	**2011**	**2012**
Total Amount	448,000	488,000	512,600	593,000
SJG Percentage	77.24%	75.46%	74.46%	*74.00% (est.)*
SJG Amount	333,600	363,400	381,700	*438,820 (est.)*
Sources OC-723 (2012 Total Amount); OC-743 (2009-2011 Amounts & Percentages)				

SJG's share of corporate contributions is determined by the management service fee allocator, a three-factor formula based on measures of relative size, discussed in Chapter 3. The FERC Uniform System of Accounts requires that "corporate donations for charitable, social or community welfare purposes" be recorded "below-the-line" in account 426.1.[7] SJG indicated that it recorded its share of corporate contributions "above-the-line," in account 923, Outside Services.[8]

[7] 18 CFR, Ch.I, Pt. 101, 426.1 Donations.
[8] Response to Discovery, OC-743-C.

9. Finance, Risk Management, and Cash Management

This Chapter addresses SJI and SJG's financing activities, the utility's cost of capital, and the implications of diversification on utility operations. We also discuss in this Chapter SJG's Risk Management and Cash Management functions.

Summary of Findings

Finance

1. There have been multiple title and position changes recently within the higher level positions in the Finance Department of SJI. High turnover can lead to inconsistencies in the leadership of the department and how leadership carries out the objectives of the department and the company overall.
2. The Company currently tracks the metrics calculated by the rating agencies. However, it does not consider forecasted estimates of these metrics based on its internal financial forecasts.
3. Non-utility operations at SJI are substantial and are likely to become even more significant in the future. In 2011 the impact on SJI's net income from SJI's non-utility operations grew to over 40% of the consolidated total and SJI's non-utility revenues comprised over half of SJI's total operating revenues.
4. One particularly significant unregulated business that is likely to grow in the future is SJI's business activities in the Marcellus Shale region. While these investments may prove profitable, they are also volatile and increase financial risk to the holding company and, by extension, SJG.
5. The Company's current ring-fencing provisions are not adequate to achieve SJI's stated goal. Specifically, SJI's stated goal for its ring-fencing measures are to ensure that "SJG's credit ratings, assets and cost of capital are reflective of a standalone company without negative influences from its holding company or affiliates." Comments made from rating agencies, however, make it clear that SJG's non-utility affiliates are negatively influencing the rating agencies' view of SJG's creditworthiness.
6. SJI has increased its dividend significantly above its stated goal during the past few years. SJI's dividend policy seeks to increase dividends by at least six to seven percent annually. The dividend increased by more than 10% per year over the five year period through 2011.
7. SJG's stated dividend policy is to achieve a dividend payout ratio that approximates SJI's. Given SJI's targets regarding dividend growth, as well as its track record for exceeding these dividend targets in recent years, undue pressure may be put on SJG's payouts in periods when unregulated cash flows are lower than expected.
8. In August 2012, Moody's granted SJG a one notch upgrade to its senior secured, senior unsecured, and corporate credit rating, citing improved financial performance and credit metrics.

9. In general, equity analysts view SJI favorably to its peers. This is driven by the company's record of earnings and dividend performance; its strong financial position; and a positive view of management performance.
10. When Overland reviewed the balanced scorecard for the CFO (leader of the SJI Finance Department), it found that the CFO's scorecard in 2010 and 2011 contained no metrics that showed specific expectations for how targets would be achieved. The 2009 balanced scorecard for the CFO did not contain performance objectives or metrics.
11. **[Begin Confidential]**

[End Confidential]

12. The Finance Department does not prepare a debt financing forecast for the utility or other affiliates within SJI.

Risk Management

1. SJI uses a qualitative methodology in assessing and managing its business risks as opposed to a quantitative approach. This means that the company relies on its internal control environment to identify and mitigate business risks instead of calculations of risk measures and their results.
2. To identify and monitor significant business risks and set limits and guidelines for the management of these risks, SJI has established an Enterprise Risk Management Framework. The framework provides a bottom-up approach to managing risk, where the business unit leaders "own" the risks and the processes of mitigating them.
3. SJI formed the Risk Management Committee to enforce the Risk Management Policy and Procedures and monitor the gas purchasing process at SJG.
4. The Risk Management function of SJI has evolved from primarily managing credit risks to an enterprise wide function that manages the following risks: marketplace, earnings, cash flow, financial reporting, operational, political, reputation, environmental, and strategic risks. This robust function is more closely aligned with industry trends in risk management and provides more comprehensive awareness of risks within SJI.
5. The Risk Management function uses the Enterprise Risk Management – Integrated Framework developed by the Committee of Sponsoring Organizations of the Treadway Commission as a basis for the framework surrounding the management of risks at SJI. The framework incorporates the components of the Internal Control Framework used in Sarbanes-Oxley.
6. SJI's business objectives include: long-term annual earnings per share (EPS) growth of 6-7%, annual dividend increases of at least 6-7%, while executing a low to moderate risk platform. More specifically, SJI aims to operate the utility on a low risk platform while the non-utility affiliates operate on a moderate risk platform. Overland views the non-utility affiliate operations as falling in a range of moderate to high risk.
7. The Risk Management Department has developed a risk inventory that is a compilation of approximately 200 events that could prevent SJI from achieving its business objectives.

8. Each risk in the SJI Risk Inventory is given an inherent risk score based on the potential financial impact to SJI and the probability of occurrence during the next five years.
9. The discussion of entity-wide risks and the action plans to reduce their effects on the company are generally observed in the quarterly Risk Management Committee meetings and the monthly and annual reports to the Board of Directors.
10. Internal audit plays a key role in monitoring risk through its annual testing of the design and operating effectiveness of the controls that were developed to reduce the impact and frequency of the occurrence of the identified risks.
11. SJES is in the process of implementing Open Link Financial's Endur energy trading and risk management (ETRM) system. The system was originally intended to be operational on January 1, 2013. SJES has encountered some delays in the implementation process and has yet to become operational.
12. The Risk Management Department also uses an application called CERTUS to "ensure the transparency and accuracy of internal controls for Sarbanes-Oxley and ERM purposes".
13. **[Begin Confidential]**

[End Confidential]

14. Mr. Lynch's 2011 balanced scorecard did not contain a description of how he performed against the performance objectives that were set at the beginning of that year.
15. Mr. Lynch stated in his interview that SJI makes use of benchmarking studies in many different areas with respect to risk management. However, when Overland requested all of the benchmarking studies from SJI in our discovery request OC-56, no benchmarking studies relating to risk management were provided.

Cash Management

1. SJG does not participate in any formal money pool arrangements with its affiliates.
2. SJG is responsible for making large payments on behalf of its affiliates for certain common costs (including insurance payments). These payments appear to be in conflict with the policies set forth in SJG's cost allocation manual.[1]
3. In July 2011, SJG began a commercial paper program under which it may issue unsecured notes to qualified investors of up to $200 million. This commercial paper program is backstopped by a $200 million revolving credit facility that can be extended until May 2017.

[1] A recommendation regarding SJG's payments on behalf of affiliates was made in Chapter 2 – *Affiliate Overview*. Although this recommendation could also be considered a Cash Management recommendation, to avoid redundancy we are not including the recommendation in this chapter.

Recommendations

Finance

1. The balanced scorecard for the person responsible for the Finance Department should have specific objectives that cover all components within the Finance Department, specific and detailed metrics to describe the expectation of how the objective is to be achieved, and documentation of the actual result and a comparison to the expectation, which will determine the rating for that particular objective.
2. The Company currently does not consider forecasted estimates of credit metrics in its decision-making process. The Company should develop these estimates based on internal financial forecasts and use these metrics to help guide its strategic planning decisions. This analysis should be reviewed by both senior management and the Board of Directors.
3. Representatives of SJI and SJG should conduct meetings with the rating agencies and BPU Staff to develop a plan to enhance current ring-fencing provisions to a level sufficient to ensure that SJG's credit ratings are more reflective of SJG as a standalone company and negative influences from the activities of SJG's affiliates are minimized.
4. The dividend policy for SJG should be revised such that SJG's dividends are not linked, directly or indirectly, to the financial performance of the unregulated affiliates.

Risk Management

1. It appears that SJI is in the process of implementing the use of the quantitative metric, Value at Risk (VaR), to measure trading risks. Since VaR is a widely used metric in the utility industry to measure company risk, SJI should strive to obtain the information necessary to measure its VaR so that it can monitor the company's risk over time and also benchmark it against other similar utility holding companies.
2. Mr. Lynch's balanced scorecard should contain more performance objectives that are considered stretch objectives. These objectives encourage the Risk Management function to reach higher standards of risk management relative to industry peers. Mr. Lynch's balanced scorecard should contain a description of how he performed against the objectives that were set for him at the beginning of each year.
3. SJI should more extensively use benchmarking data to compare its risk management function metrics to those of its peers.

Finance

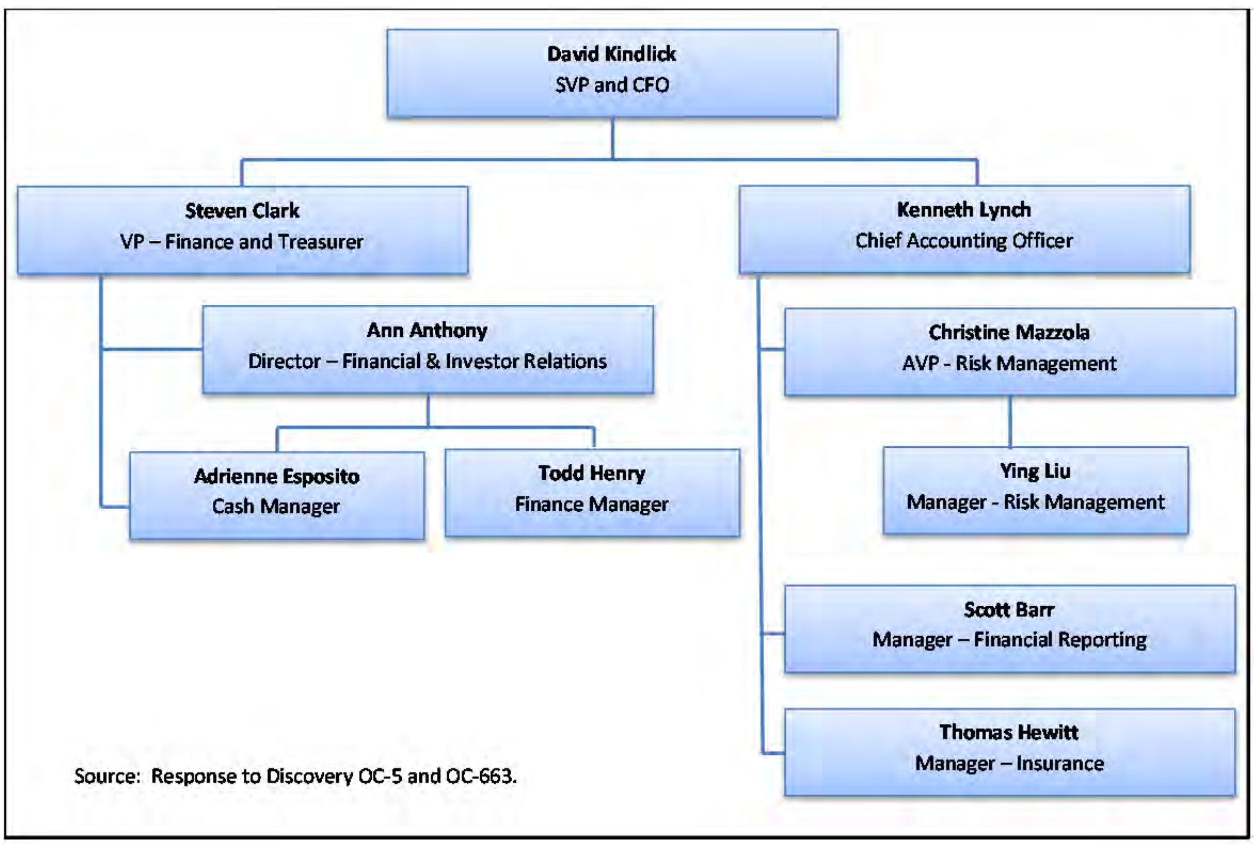
Organization

The Finance Department of SJI is led by David Kindlick, Senior Vice President and Chief Financial Officer. The Treasury, Accounting, Risk Management, Cash Management, and Regulatory Affairs functions all report up to Mr. Kindlick. Subsequent to the audit period (2009-2011), there have been several changes to the titles and responsibilities of those that directly report to Mr. Kindlick. These changes are summarized below:

- Mr. Kindlick became Senior Vice President and CFO. His former title was Vice President and CFO.
- Stephen Clark became Vice President, Finance and Treasurer. This title is in addition to his SJG title of Senior Vice President, Regulatory Affairs & Treasurer.
- Kenneth Lynch became the Chief Accounting Officer. His previous title was Assistant Vice President, Financial Reporting and Risk Management.
- Christine Mazzola became the Assistant Vice President, Risk Management. Her previous title was Vice President, Retail Marketing.

These changes were announced on November 20, 2012 and became effective January 1, 2013.[2] Mr. Clark assumed the role of principal financial officer for SJG in April 2012 and currently holds that responsibility.[3] An organization chart of the Finance Department down to the manager level is presented below.

Table 9-1 – SJI Finance Department Organization



[2] South Jersey Industries Press Release, November 20, 2012.
[3] Response to Discovery, OC-665.

SJG and SJI Credit Ratings and Rating Methodology

Table 9-2 – SJG and SJI Corporate and Securities Credit Ratings

South Jersey Gas and South Jersey Industries Corporate and Securities Credit Ratings						
		Senior Secured Debt	**Corporate Rating**	**Senior Unsecured Debt**	**Outlook**	**Short-term Rating**
Standard & Poor's	2009	A	BBB+	BBB***	Stable	---
Moody's	2009	A2*	Baa1**	Baa1	Positive	---
Standard & Poor's	2010	A	BBB+	BBB***	Stable	---
Moody's	2010	A2	Baa1	Baa1	Positive	---
Standard & Poor's	2011	A	BBB+	BBB***	Stable	A-2
Moody's	2011	A2	Baa1	Baa1	Stable	P-2
Standard & Poor's	2012	A	BBB+	BBB***	Stable	A-2
Moody's	2012	A1	A3	A3	Stable	P-2
Corporate and Securities Credit Ratings						
		Senior Secured Debt	**Corporate Rating**	**Senior Unsecured Debt**	**Outlook**	**Short-term Rating**
Standard & Poor's	2009	---	---	---	---	---
Standard & Poor's	2010	---	---	---	---	---
Standard & Poor's	2011	---	BBB+	---	Stable	---
Standard & Poor's	2012	---	BBB+	---	Stable	---
Source: Response to Discovery OC-108 and updated with Response to Discovery, OC-695.						
*Upgraded August 3, 2009 as part of an industry-wide action						
** Assigned August 5, 2009 as part of an industry-wide action						
***Implied rating						

The South Jersey Gas S&P rating of BBB+/stable has been for some time.[4] Consistent with SJG ratings, South Jersey Industries received an initial rating of BBB+/Stable as of June 17, 2011.[5] However, the effect of a weaker economy is expected to have a greater effect on unregulated businesses, such as wholesale trading, retail marketing, and merchant gas storage operations.[6] Of the 40 US natural gas distributors and integrated gas companies in the S&P gas utility sector SJG and SJI are rated 28th and 29th, respectively, in terms of ratings and outlook.[7] Both entities are found to have a "Strong" business risk profile and a "Significant" financial risk profile.[8] The New Jersey BPU is considered by S&P as "credit supportive", with only seven state jurisdictions having a "more credit supportive" rating.[9]

[4] Response to Discovery, OC-7, S&P Research dated August 24, 2011; covering 2006-2010.
[5] Response to Discovery, OC-7, S&P Research dated October 6, 2011.
[6] Ibid.
[7] Response to Discovery, OC-7, S&P Issuer Ranking 1.11.2012.
[8] Response to Discovery, OC-695-6, S&P Research dated September 24, 2012.
[9] Response to Discovery, OC-695-7, S&P Comment on State Regulatory Bodies dated December 28, 2012.

SJG's first mortgage bonds are rated 'A' by S&P, which is two notches higher than the corporate credit rating, reflecting collateral coverage for these securities.[10] The current Moody's rating on SJG first mortgage bonds is A-1, also reflecting a two notch spread over its issuer ratings of A-3.[11]

The Moody's issuer rating for SJG was Baa1, with an outlook that changed from positive to stable in March 2011, largely due to an increasing exposure to SJI unregulated businesses held in SJES.[12] In August 2012, Moody's increased the utility's ratings one notch for the senior secured, senior unsecured and corporate ratings, citing improved financial performance and credit metrics that aligned more with the lower range of the A-rating category.[13]

Moody's credit rating methodology uses four key factors in determining credit ratings for regulated utilities. These factors and their weightings are listed below:

- Regulatory Framework (25%);
- Ability to Recover Costs and Earn Returns (25%);
- Diversification (10%); and
- Financial Strength, Liquidity, and Key Financial Metrics (40%).

Each factor is given a numeric value that corresponds with a particular rating (i.e. Aaa = 1, Aa = 3, etc.). Moody's then aggregates the scores, taking into account the corresponding weights, to determine the composite rating.[14] The table below shows the utility's metrics as of 12/31/2011 that were used to determine the utility's metrics.

[10] Response to Discovery, OC-695-6, S&P Research dated March 30, 2012.
[11] Response to Discovery, OC-695-7, Moody's Announcement SJG Upgrade dated August 10, 2012.
[12] Response to Discovery, OC-6, Moody's Investors Service dated March 4, 2011.
[13] Response to Discovery, OC-695-6, Moody's Announcement SJG Upgrade 8-10-2012.
[14] Response to Discovery, OC-7, Moody's Methodology 8.2009.

Table 9-3 – South Jersey Gas Company – Rating Factors

South Jersey Gas Rating Factors		
Regulated Electric and Gas Utilities Industry [1][2]	**12/31/2011**	
Factor 1: Regulatory Framework (25%)	**Measure**	**Score**
a) Regulatory Framework		Baa
Factor 2: Ability to Recover Costs and Earn Returns (25%)		
a) Ability to Recover Costs and Earn Returns		A
Factor 3: Diversification (10%)		
a) Market Position (5%)		Baa
b) Generation and Fuel Diversity (5%)		n.a.
Factor 4: Financial Strength, Liquidity and Key Financial Metrics (40%)		
a) Liquidity (10%)		Baa
b) CFO - pre-WC + Interest/Interest (3 Year Avg) (7.5%)	6.0x	A
c) CFO - Pre-WC /Debt (3 Year Avg) (7.5%)	20.10%	Baa
d) CFO - Pre-WC - Dividends / Debt (3 Year Avg) (7.5%)	15.60%	Baa
e) Debt / Capitalization (3 Year Avg) (7.5%)	42.50%	A
Rating:		
a) Indicated Rating from Grid		Baa1
b) Actual Rating Assigned		A3
Source: Response to Discovery, OC-695-6, Moody's SJG Upgrade to A3 8-13-2012.		
[1] All ratios are calculated using Moody's Standard Adjustments.		
[2] As of 12/31/2011(L); Source: Moody's Financial Metrics.		

The Company currently tracks the metrics calculated by the rating agencies. However, it does not consider forecasted estimates of these metrics based on its internal financial forecasts. As such, the Company cannot necessarily assess the effect of its strategic and investment planning on ratings. The Company should include this analysis in its planning process and it should be reviewed by both senior management and the Board of Directors.[15]

Moody's considers SJG to have a constructive relationship with the NJBPU. According to Moody's, the utility is generally able to recover costs and investments in a reasonable, timely manner. Moody's specifically cites the favorable outcome of the most recent rate case, the Conservation Incentive Program (CIP), and the Capital Investment Recovery Tracker (CIRT) as reasons for their conclusion. However, Moody's found that the utility's regulatory environment was less favorable than others regarding the lack of a pension expense tracker and the inability to recover bad debt expenses associated with commodity and delivery charges. Moody's rating on the utility's diversification factor is inhibited by the increase in commitments and obligations of the non-regulated business lines within SJI

[15] Interview with David Kindlick, CFO on January 22, 2013.

and the potential pressure the non-regulated business could place on the utility for SJI to meet its earnings targets. SJI has recently showed improved credit metrics.[16]

Impact of Non-Utility Operations

As a stand-alone company, SJG is a regulated utility with no significant non-regulated business interests. As part of a larger holding company, however, SJG's risk profile is impacted by the non-regulated activities of its affiliates. As discussed in Chapter 5 – *Organizational Structure*, the impact on SJI earnings from non-utility operations grew from 32.5% of SJI's total net income in 2009 to 41.8% in 2011.[17] Clearly, SJI's non-utility operations are substantial and are likely to become even more significant in the future.

Current and Future Risks from Non-Utility Operations

In assessing the potential risk that the non-utility operations of SJG's affiliates could pose for SJG, we first determined the nature of the different businesses in which SJI participates. We then used our experience to assign a risk category (Low, Medium, High) to the different business segments.

In 2011, SJI reported the following business segments to the SEC in its annual 10-K filing:

[16] Response to Discovery, OC-695-6, Moody's SJG Upgrade to A3 8-13-2012.

[17] When viewed on an "economic earnings" basis, the impact on SJI earnings from non-utility operations declined from 45% in 2009 to 39.2% in 2011. "Economic earnings" is a non-GAAP financial measure used by the Company and defined in Chapter 3 – *South Jersey Industries Cost Distributions*.

Table 9-4 –Relative Risk of SJI Business Segments

South Jersey Gas Relative Risk of SJI Business Segments			
Segment	**Segment Description**	**Primary Affiliate(s)**	**Risk Category (1)**
Gas Utility Operations	Distributes natural gas to residential, commercial and industrial customers.	SJG	Low
Wholesale Energy	Markets wholesale natural gas storage, commodity and transportation (SJRG); Owns oil, gas and mineral rights in the Marcellus Shale region (SJEX).	SJRG; SJEX	High Risk
Retail Gas & Electric	Acquires and makets natural gas and electricity to end-users.	SJE	High Risk
On-Site Energy Production	Develops and operates energy-related projects.	Marina	Medium to High
Appliance Services	Installs and services residential and small customer HVAC systems and services appliances under warranty.	SJESP	Medium
Source: SJI 2011 10-K filing Note1: "Risk Category" assessments made by Overland.			

The relative impact of these different segments on SJI's consolidated operations was as follows:

Table 9-5 - Operating Revenues for SJI by Business Segment

South Jersey Gas Operating Revenues for SJI by Business Segment			
Segment	Operating Revenues	Risk (1)	% of Total
Gas Utility Operations	$412,449	Low	49%
Wholesale Energy	68,370	High Risk	8%
Retail Gas & Electric	307,399	High Risk	36%
On-Site Energy Production	39,919	Medium to High	5%
Appliance Services	17,056	Medium	2%
Source: SJI 2011 10-K filing Note1: "Risk" assessments made by Overland.			

As indicated above, SJI operations are split roughly one-half between operations that we would consider low-risk (i.e., the rate-regulated operations of SJG) and operations we would consider medium to high risk (i.e., the unregulated operations of SJESP, SJRG, SJEX, SJE and Marina).

[Begin Confidential]

[18] In addition to its wholesale marketing activities primarily conducted through SJRG, SJI also owns resource rights (oil, gas and mineral) in the Marcellus Region and collects royalties from drillers who lease the land through its subsidiary South Jersey Exploration (SJEX). Response to Discovery, OC-006; SJI 2011 10-K filing.

[19] Response to Discovery, OC-294.

[20] For comparison purposes, the Gas Utility Operations posted operating income of $101.8 million and 102.7 million in 2012 and 2011, respectively. SJI 2011 10-K filing.

[21] Interview with David Kindlick, CFO on January 22, 2013.

[End Confidential]

Ring-Fencing

Given the relatively dependable nature of the earnings and cash flow of a rate-regulated utility, public utilities are commonly considered to be low-risk from a credit perspective. This is particularly true in a regulatory environment considered credit-supportive, such as New Jersey. However, when a utility is part of a broader holding company, the utility faces additional risks because a financially weak parent could siphon off cash from the utility and/or, in the extreme, force the utility subsidiary into a consolidated bankruptcy filing. State commissions and utility holding companies have attempted to address these concerns by imposing additional mechanisms to protect the utility. This process is generally called "ring-fencing" because these additional measures act as a protective "fence" that provides separation between the utility and its potentially riskier affiliates.

The SJI Chief Accounting Officer (who is also Chairman of SJI's Risk Management Committee) stated in Discovery that the goal of SJI's ring-fencing provisions is:[22]

> *…to ensure that SJG's credit ratings, assets and cost of capital are reflective of a standalone company without negative influences from its holding company or affiliates.*

We believe this is an appropriate goal. SJI's current ring-fencing provisions, however, are inadequate to meet this objective.

There is no question that the SJI unregulated business segments result in somewhat lower SJG credit ratings than would exist on a stand-alone basis. The two rating agencies that issue a rating for SJG (Moody's and Standard & Poor's) make this point clear in their rating reports. In March 2011, Moody's affirmed its Baa1 Issuer Rating for SJG, but updated its outlook from positive to stable. In Moody's statement regarding the change, the rating agency focused mainly on the negative influence of SJG's non-utility affiliates.[23,24]

> ***The change in rating outlook to stable from positive reflects our concerns about the growth in South Jersey Industries, Inc.'s (SJI) off-balance sheet commitments and obligations to support unregulated businesses held under SJG's affiliated company, South Jersey Energy Solutions LLC.*** *This is particularly relevant given the concentration that these investments have to certain industries, as well the collective scope of these*

[22] Response to Discovery, OC-258.

[23] Response to Discovery, OC-6, Moody's Investors Service dated March 4, 2011.

[24] In August 2012 SJG's Issuer Rating was upgraded from B1 to A3. In its report, Moody's stated that, "SJG's rating is capped by the growing holding company indebtedness incurred at SJG's parent company, South Jersey Industries, as well as the off-balance sheet commitments and obligations associated with the group's unregulated businesses which are held under SJG's affiliated company, South Jersey Energy Solutions LLC." Response to Discovery, OC-695-6.

> *commitments relative to SJI's size and market capitalization. While the rating acknowledges the importance of SJG's ring-fencing type provisions under the New Jersey PUHCA guidelines, we also believe the provisions provide some flexibility, as they cap SJG's debt-to-capitalization ratio at not more than 70%, which we believe **prevents SJG from being fully insulated from the group's remaining activities from a rating perspective**. Moreover, Moody's is somewhat concerned about the possibility that additional distribution pressure may occur at SJG for the parent to meet its dividend growth targets given the volatility in earnings that can occur at some of the company's unregulated businesses. To that end, Moody's observes that in November 2010, SJI raised its dividend by 11%, and over the past five years, SJI's board has approved dividend increases averaging over 10%, well above the 6 – 7% based targeted level cited in its dividend policy. While expectations for higher SJG earnings will help support these dividend growth targets, Moody's believes that consistent earnings contributions from the more volatile unregulated operations will be needed in order to meet various corporate objectives. In the end, **while the standalone credit metrics at SJG may warrant consideration of a higher rating at the utility, SJG's current rating factors in our collective concerns about these potential issues for the utility family.*** (emphasis added)

Standard & Poor's (S&P) has made similar statements regarding SJG's credit rating. In March 2012 S&P affirmed its BBB+ rating on SJG, but made the following comments concerning its non-utility operations:[25]

> ***SJI's strengths are partly offset by its participation in various unregulated businesses. Standard & Poor's generally views unregulated businesses as riskier than regulated operations because of greater cash flow variability.** As part of its unregulated segment, SJI provides wholesale energy services related to natural gas storage, pipeline transportation, and commodity activities. **Performance in this segment can be affected by volatility in commodity prices, which results in earnings volatility.*** (emphasis added)

S&P is the only rating agency that issues a rating for both SJG and SJI. S&P has issued the same corporate credit rating on both SJI and SJG since it began rating SJI, further demonstrating the lack of separation between SJG and the risks of SJI's non-utility operations.[26] In order to achieve the Company's stated goal of implementing ring-fencing measures sufficient for SJG's credit ratings to reflect its standalone company credit risk profile, SJG needs to significantly enhance its ring-fencing provisions.

One recent example of the impact that a robust set of structural protections can have on a utility's credit rating occurred at Baltimore Gas & Electric (BG&E) in 2009. After additional ring-fencing measures were announced, there was an immediate upgrade of BG&E's corporate credit rating to BBB+, two ratings

[25] Response to OC-695-6.
[26] Response to Discovery, OC-006.

notches above that of its parent Constellation.[27] Examples of ring-fencing provisions that BG&E implemented that are not currently in place at SJG included the following:[28]

- A bankruptcy remote, special purpose entity between the parent and the utility;
- A non-consolidation opinion from an outside law firm concluding that the utility would not be drawn into a holding company bankruptcy;
- A restriction that the utility could not pay a dividend to its parent if the utility's equity ratio after the payment would fall below 48%.[29]

We recommend that representatives of SJI and SJG conduct meetings with the rating agencies and BPU Staff to develop a plan to enhance current ring-fencing provisions to a level sufficient to ensure that SJG's credit ratings are more reflective of SJG as a standalone company and negative influences from the activities of SJG's affiliates are minimized.

Based on our experience in this area, we believe that more specific restrictions regarding the use of utility funds for payment of affiliate liabilities; more specific criteria regarding SJG's equity ratio; and more specific restrictions regarding SJG's dividend distributions to SJI would be a reasonable baseline starting point for additional ring-fencing provisions.

SJG Capital Structure

The authorized capital structure for SJG was set on September 16, 2010.[30] On this date, the NJ BPU issued an Order in Docket Number GR10010035 that approved a settlement that assumed a rate of return on common equity of 10.3% and an overall rate of return of 8.21%.[31] This settlement also assumed a capital structure composed of 51.2% common equity and 48.8% debt.[32] The only studies of its weighed average cost of capital that SJG acknowledged had been performed since January 1, 2009, were the underlying computations made by its rate-of-return witness for this rate filing.[33,34]

The actual capital structure and the weighted average cost of capital during the audit period is provided below.

[27] An equivalent upgrade for SJG using its current rating would imply an upgrade of SJG's corporate credit rating from BBB+ to A.

[28] "S&P: Baltimore Gas & Electric Co. Upgraded To 'BBB+', Removed From CreditWatch; Outlook Stable." S&P Press Release, November 2, 2009.

[29] It is our understanding that the current restriction on SJG's equity ratio is 30%. Response to Discovery, OC-006, Moody's Ratings Report, July 12, 2011.

[30] Response to Discovery, OC-759, Final 2010 Rate Case Board Order.

[31] The previous rate settlement was approved in July 2004. Response to Discovery, OC-006.

[32] Response to Discovery, OC-105; OC-759, Final 2010 Rate Case Board Order.

[33] Response to Discovery, OC-043.

[34] Due to this recent determination of CNG's cost of capital, we did not perform a redundant calculation using a similar peer group of utilities without significant non-utility activities.

Table 9-6 - Actual SJG Capital Structure and Weighted Average Cost of Capital

South Jersey Gas Capital Structure and Weighted Average Cost of Capital			
As of December 31, 2008			
Type of Financing	Cost of Financing	Percentage of Capital Structure	Weighted Average
Short-Term Debt	1.06%	14.11%	0.15%
Lont-Term Debt	5.96%	36.32%	2.17%
Common Equity	10.00%	49.58%	4.96%
		Weighted Average Cost of Capital	7.27%
As of December 31, 2009			
Type of Financing	Cost of Financing	Percentage of Capital Structure	Weighted Average
Short-Term Debt	0.80%	13.25%	0.11%
Lont-Term Debt	5.93%	34.51%	2.05%
Common Equity	10.00%	52.25%	5.23%
		Weighted Average Cost of Capital	7.38%
As of December 31, 2010			
Type of Financing	Cost of Financing	Percentage of Capital Structure	Weighted Average
Short-Term Debt	0.71%	9.59%	0.07%
Lont-Term Debt	5.58%	42.97%	2.40%
Common Equity	10.30%	47.44%	4.89%
		Weighted Average Cost of Capital	7.35%
As of December 31, 2011			
Type of Financing	Cost of Financing	Percentage of Capital Structure	Weighted Average
Short-Term Debt	0.69%	8.30%	0.06%
Lont-Term Debt	5.49%	40.24%	2.21%
Common Equity	10.30%	51.46%	5.30%
		Weighted Average Cost of Capital	7.56%
Sources: Response to Discovery, OC-043.			

SJG has access to capital on a short-term basis through its bank credit facilities and the commercial paper market. Interest costs on short-term borrowings ranged from 0.43% in fall 2011 to approximately 1.40% in June 2011. During the audit period from 2009 to 2011, the rates short-term borrowings were generally at or below 1%. During the audit period, SJG generally relied upon its bank facilities through mid-July 2011. At that time, it began accessing the commercial paper market to cover its short-term capital requirements.[35]

[35] Response to Discovery, OC-52.

SJG Long-Term Debt

A table with the roll forward of debt for SJG from 2009 to 2011 is shown below.

Table 9-7 – Debt Rollforward ($M)

South Jersey Gas Debt Rollforward ($M)							
Description	**As of 12/31/2009**	**Issuances**	**Redemptions**	**As of 12/31/2010**	**Issuances**	**Redemptions**	**As of 12/31/2011**
First Mortgage Bonds (A)	$ 260	$ 115	$ (10)	$ 365	$ -	$ (25)	$ 340
Tax-Exempt First Mortgage Bonds	25	-	-	25	-	-	25
Total Debt	**$ 285**	**$ 115**	**$ (10)**	**$ 390**	**$ -**	**$ (25)**	**$ 365**

Source: Derived from SJG 2010 and 2011 10-K
(A) The maturity of these bonds ranged from 2010 to 2036. They are secured by essentially all property of SJG pursuant to its First and Refunding Mortgage.
Note 1: Balances for Long-Term Debt include current maturities of long-term debt.

The only encumbrances on SJG's assets are the First Mortgage Bonds (and related medium-term notes) issued by SJG. Non-utility affiliates do not pledge any utility assets to support non-utility activities.[36] SJG's debt is scheduled to mature through 2036. A schedule of SJG's debt maturities is summarized in the following table.

[36] Response to Discovery, OC-38.

Table 9-8 – Scheduled Debt Maturities ($Ms) for Outstanding LT Debt as of December 31, 2011

South Jersey Gas Scheduled Debt Maturities ($Ms) for Outstanding Long-Term Debt as of December 31, 2011			
Year	First Mortgage Bonds	Tax-Exempt First Mortgage Bonds	Total
2013	$ 25	$ -	$ 25
2014	21	-	21
2015	10	-	10
2016	27	-	27
2017	15	-	15
2018	30	-	30
2019	10	-	10
2025	10	-	10
2026	60	-	60
2027	80	-	80
2033	32	-	32
2034	10	-	10
2035	10	-	10
2036	-	25	25
Total	$ 340	$ 25	$ 365
Source: SJG 2011 10-K			

In terms of total long-term debt outstanding, 27% matures in Years 1 – 5, 11% matures in Years 6 – 10, 41% matures in Years 11 – 15, and 21% matures in Years 16 – 24.

The utility issued $120 million in medium term notes in 2012, $35 million of this amount was issued concurrently with the early redemption of $35 million in medium term notes (due April 2027). The utility is projected to increase financing again in 2013 by $50 million. The only other long-term debt carried at SJI or its affiliates as of December 31, 2011 are three series of unsecured variable-rate revenue bonds that Marina issued through the New Jersey Economic Development Authority. These bonds total $61.4 million and mature as follows: $25 million in 2021, $20 million in 2031, and $16.4 million in 2036. In 2012, SJI increased its debt financing by issuing $115 million of Senior Notes. Both SJI and SJG have revolving credit facilities to fund capital requirements and any other short-term financing needs. The revolver debt is then refinanced with bond issuances from SJG's Medium Term Note Program and SJI's private debt offerings. As of the writing of our report, neither SJG nor SJI has prepared a debt financing forecast for years subsequent to 2013.[37] That is, SJI and SJG do prepare annual budget assumptions about its cash requirements. However, longer-term forecasts of financing assumptions are not developed in the financial forecast process.

[37] Response to Discovery, OC-667.

Dividend Policy of SJI and SJG

The stated dividend policy was declared by the SJI Board of Directors in its October 25, 2006 meeting. This policy is as follows:[38]

> *[To] increase dividends on South Jersey Industries, Inc. common stock at least six to seven percent annually to be in line with the long-term earnings per share target with a target maintaining a dividend payout ratio of fifty to sixty percent.*

Decisions regarding amount of dividends to be paid to SJI common stock shareholders are performed by the SJI Board of Directors, generally at its November meeting.

The dividend policy of SJG was set by the SJG Board at its meeting in September 2010. SJG's dividend policy is as follows:

> *[To] achieve a dividend payout ratio which approximates that of its parent company, SJI, and to meet or exceed all applicable regulatory requirements related to common equity balances…the Dividend Policy of the Company will be established to achieve a dividend payout ratio which equates to that established for SJI in its annual financial plan.*

Dividend payout ratios are traditionally calculated as follows: Dividend Payout Ratio = Yearly Dividends / Net Income. SJI's dividend policy is based on economic earnings instead of net income. Dividend payout ratios for SJI (using both net income and economic earnings) and SJG during the audit period are provided in the table below.

[38] Response to Discovery, OC-699.

Table 9-9 - SJI and SJG Payout Ratio

South Jersey Gas SJI and SJG Payout Ratio (in thousands)			
SJI Payout Ratio (Economic Earnings)			
Year	**Dividends**	**Economic Earnings**	**Payout Ratio**
2009	$36,338	$71,255	51%
2010	40,611	80,983	50%
2011	45,000	86,983	52%
SJI Payout Ratio (Net Income)			
Year	**Dividends**	**Net Income**	**Payout Ratio**
2009	36,338	58,105	63%
2010	40,611	66,652	61%
2011	45,000	89,291	50%
SJG Payout Ratio			
Year	**Dividends**	**Net Income**	**Payout Ratio**
2009	10,002	39,195	26%
2010	45,905	43,925	105%
2011	12,664	52,889	24%
Sources: Response to Discovery, OC-033; SJI 2011 10-K Filing.			

In November 2009, SJI increased its indicated annual dividend by 11% to $1.32 per share.[39] The dividend has increased by more than 10% per year over the five year period through 2011.[40] The current SJG dividend policy assumes that the Gas Company will pay dividends consistent with the payout ratio assumed by SJI.[41] Given SJI statements to the investment community about dividend growth, as well as its track record for dividend increases in recent years, undue pressure may be put on SJG payouts in periods when unregulated cash flows may be reduced due to volatility in year-to-year performance. Overland recommends that the current dividend policy be revised such that SJG's dividends are not linked, directly or indirectly, to the financial performance of the unregulated affiliates.

Equity Analyst Views of SJI

SJI is currently followed by six analysts. The firms providing equity research include:[42]

- Brean Murray Carret & Co
- CapStone
- Hilliard Lyons

[39] Response to Discovery, OC-8, Brean Murray Equity Research dated August 6, 2010.
[40] Response to Discovery, OC-8, Capstone Investments dated May 25, 2011.
[41] Response to Discovery, OC-272.
[42] Response to Discovery, OC-8.

- U.S. Capital Advisors
- Wells Fargo Securities
- Williams Capital

Overland reviewed the reports from these equity analysts from early 2012 and found most of the views of SJI to be similar. Almost all of the analysts gave SJI stock a "Buy" rating. Only one of the listed equity analysts above did not consider SJI stock to be a strong buy, instead giving them a "Neutral" rating. The analysts gave a fairly broad range for their target SJI stock price in the near term, from a low of $57 to a high of $63. The analysts were largely unconcerned with the slight decline in SJI's stock price in 2011 as non-utility revenue did not meet expectations. The analysts generally maintained a positive outlook for the future stock performance of SJI due to the growth prospects of non-utility operations, specifically those projects involving the Marcellus Shale. The analysts did not perceive SJI's long-term EPS growth target of 6-7% to be too aggressive given the company's position at the end of 2011.[43] In general, industry analysts view SJI favorably to its peers. This is driven by the company's record of earnings and dividend performance; its strong financial position, which are reflected in strong credit ratings; and a positive view of management performance.

Factors Impacting Stock Performance

In addition to the business activities of SJG's non-regulated affiliates discussed above, there are several other factors that have impacted SJI's stock performance during the audit period and will continue to have an impact in the future. The stock performance is impacted by factors on both the regulated and non-regulated sides of SJI.

In SJG's most recent rate case decision, 10.3% ROE allowance was authorized by the BPU. The BPU decision also provided for an $18.7 million revenue requirement increase, which the rating agencies viewed as positive, and a demonstration of a credit supportive relationship with the BPU.[44] The BPU has also granted full decoupling and trackers for accelerated infrastructure replacement and energy efficiency spending.[45]

SJG results have benefited from the accelerated capital spending plan approved in 2009, which provided for $100 million in accelerated capital spending to be recovered from a Capital Investment Recovery Tracker (or CIRT).[46] This was supplemented by another $60 million in April 2011.[47] This program has been under continuing review and extensions, with additional commitments of $40 million in 2012 and $50 in 2013.[48] The incremental earnings from this program are approximately $2.6 million per year for each annual $50 million investment. SJG expects to replace all remaining bare steel and cast iron mains over a 10 year period.[49] In January 2010, the BPU approved an extension of the Conservation Incentive

[43] Response to Discovery, OC-695.
[44] Response to Discovery OC-6, Moody's Investors Service dated March 4, 2011.
[45] Response to Discovery, OC-8, U.S. Capital Advisors dated September 12, 2011.
[46] Response to Discovery, OC-8, Brean Murray Equity Research dated August 6, 2010.
[47] Response to Discovery, OC-8, Brean Murray Equity Research dated August 24, 2011.
[48] Response to Discovery, OC-8, Capstone Investments dated October 10, 2011.
[49] Response to Discovery, OC-8, CapStone Investments dated October 10, 2011.

Program for up to four years. The plan provides for CIP recoveries, which are offset by BGSS reductions.[50]

SJG customer growth is in the range of 1.5% to 2.0%. This is driven primarily by customer conversions to natural gas from other fuels. The current price advantage over heating oil, electricity and propane is significant. SJG is targeting 20,000 conversions over the next five years in a market that has 150,000 conversion opportunities. This level of growth will add approximately $2-3 million of incremental annual earnings.[51]

Finance Department Performance Metrics

Overland reviewed the balanced scorecard of the Chief Financial Officer of SJI to observe what measures are being tracked by the Company with respect to the performance of the Finance Department. Mr. Kindlick earned average BSC scores of 3.8 in 2010 and 3.0 in 2011. He did not have a documented quantitative score in 2009. Mr. Kindlick never received a score below a 3 for any of the Finance Department objectives during those two years. The absence of any ratings during the past three years that are less than satisfactorily achieved indicates that the scorecard objectives in the Finance Department could be improved by adding more challenging objectives.

The table below summarizes the 2010-2011 balanced scorecard for the CFO.

[50] Response to Discovery, OC-8, Brean Murray Equity Research dated August 6, 2010.
[51] Response to Discovery, OC-8, Wells Fargo Securities dated October 11, 2011.

Table 9-10 – 2011 BSC for David Kindlick, Senior Vice President and Chief Financial Officer

[Begin Confidential]

South Jersey Industries						
2011 BSC for David Kindlick, Senior Vice President and Chief Financial Officer						
Year	Area	Target	Result	Weighting	Rating	Score

[End Confidential]

The table above shows the major projects that were completed by the Finance Department in 2010 and 2011. However, the balanced scorecard for the CFO contained no metrics that show what the expectation would be for how the target is to be achieved. For example, there are no timetables or deadlines for the completion of the projects in the balanced scorecard shown above. **[Begin Confidential]**

[End Confidential] The 2009 balanced scorecard for the CFO did not even contain targets or objectives. That particular scorecard only listed the projects successfully completed during the year. Overland recommends that the balanced scorecard for the person responsible for the Finance Department have specific objectives that cover all components within the Finance Department, specific and detailed metrics to describe the expectation of how the objective is to be achieved, documentation of the actual result and a comparison to the expectation, which will determine the rating for that particular objective.

Risk Management

Understanding the various risks of operating a business is critical to the going concern of the company. Without a general understanding of a company's business risks, a company can suffer consequences from reduced profitability to going out of business entirely. There are many ways that a company can inventory, track and mitigate the risks it faces.

Background

SJI uses a qualitative methodology in assessing and managing its business risks as opposed to a quantitative approach. This means that the Company relies on its internal control environment to identify and mitigate business risks instead of calculations of risk measures and their results. SJI defines risk as, "[T]he possibility that an event will occur and adversely affect the achievement of corporate objectives." To identify and monitor significant business risks and set limits and guidelines for the management of these risks, SJI has established an Enterprise Risk Management Framework. The framework provides a bottom-up approach to managing risk, where the business unit leaders "own" the risks and the processes of mitigating them. This framework has the following goals, to ensure that SJI has:[52]

- Clear corporate objectives.
- A current inventory of significant risks that could adversely affect the achievement of those objectives.
- Assessment scores for each significant risk.
- Plans from each business leader explaining how the impact of the most significant risks are being mitigated.
- Listing of specific controls designed to mitigate the impact of the most significant risks.
- Certification from business line leaders that controls are designed effectively and are still in place.

To carry out the goals of the Framework, SJI created a Risk Management Department. This department has several documented objectives and procedures that enable it to carry out these goals:[53]

- Conduct one-on-one meetings with each business line leaders at least once each year to ensure that prior year risks are still relevant and any new risks have been identified.
- Obtain updated risk assessment scores for the current risks.
- Obtain an understanding of the controls for the significant risks.
- Ask each business line leader six months after the one-on-one meeting if they are aware of any new risks that should be added to the inventory.
- Distribute self-assessments to each business line leader asking if the controls related to the significant risks are still in place and operating effectively.
- Monitor the responses to ensure that:
    - ➢ All responses are received,

[52] Response to Discovery, OC-94.
[53] Ibid.

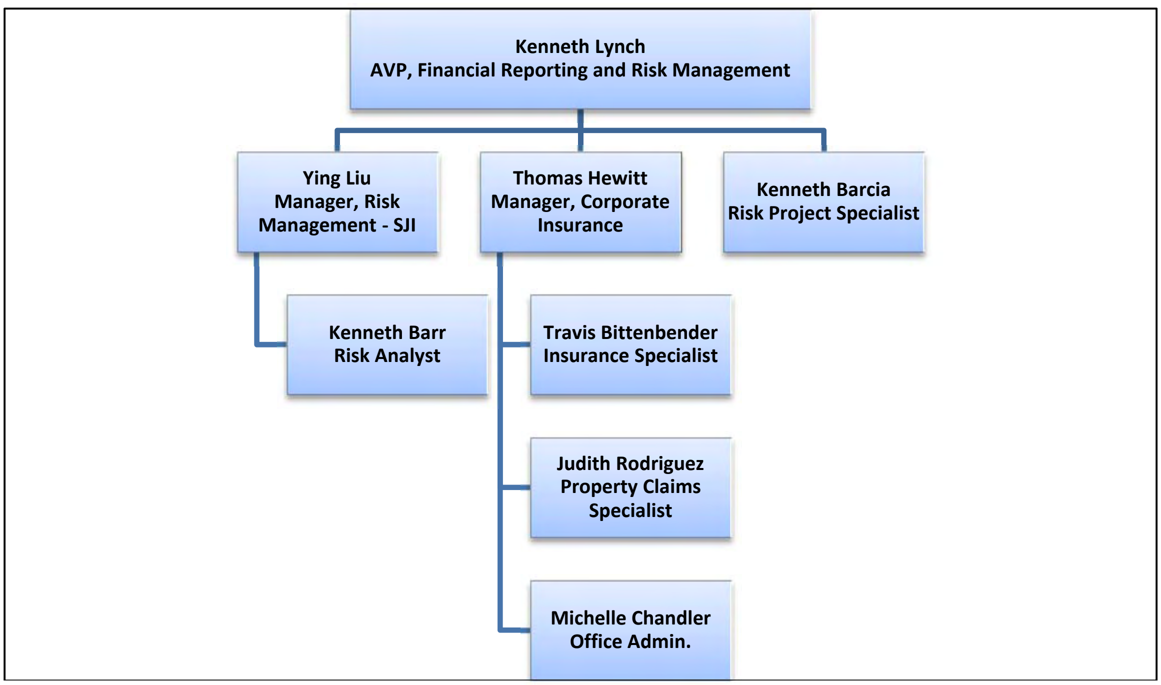
- Any new risks are assessed and added to the inventory and,
- Identified controls are still operating and effective.

- Produce a quarterly dashboard report of the key risk indicators to the Board of Directors which will include:
  - Results of current activities designed to mitigate the significant risks that could adversely affect the achievement of corporate objectives.

Organization

The Risk Management Department was led by Kenneth Lynch, Assistant Vice President, Financial Reporting and Risk Management during the audit period (2009-2011). Subsequent to the audit period, Mr. Lynch's title changed to Chief Accounting Officer and Christine Mazzola was appointed to be Assistant Vice President, Risk Management.[54] However, Mr. Lynch retains overall responsibility for the risk management function at SJI. Mr. Lynch reports directly to the CFO.[55] Below is the organizational chart for the Risk Management Department during the audit period.

Table 9-11 – Risk Management Organization Chart[56]



In addition to the Risk Management Department shown in the chart above, the utility has the SJG Risk Management Committee to enforce the Risk Management Policy and Procedures and monitor the gas purchasing process at SJG. The Risk Management Committee generally meets quarterly. As of March 2012, the members on this committee included the CEO, CFO, CAO, Corporate Counsel and Secretary,

[54] Kenneth Lynch's Bio on SJI website and November 20, 2012 press release regarding executive promotions.

[55] Response to Discovery, OC-5.

[56] Source: Response to Discovery, OC-5 and OC-94. Note: Travis Bittendbender was replaced by Jerry Cephas on November 5, 2012.

VP - Research and Corporate Development, and Director of Rates and Revenue Requirements from SJI as well as the COO, Treasurer, VP – Customer and Distribution Operations, VP – Engineering Services and System Integrity, and Director of Gas Supply and Off System Sales from SJG. The last position, along with the Gas Supply Department management, is responsible for reviewing the gas purchasing process and reviewing all transactions to ensure compliance with the utility's Risk Management Policy. The RMC provides the executives of SJI and SJG an opportunity to monitor the risks of the utility at a high level to ensure that business objectives are being met and risks are kept to a minimum. There is no specific title of Risk Manager at SJG.[57]

Identifying Risks

The Risk Management function of SJI has evolved from primarily managing credit risks to an enterprise wide function that manages the following risks: marketplace, earnings, cash flow, financial reporting, operational, political, reputation, environmental, and strategic risks.[58] This function uses the Enterprise Risk Management – Integrated Framework developed by the Committee of Sponsoring Organizations of the Treadway Commission as a basis for the framework surrounding the management of risks at SJI. The framework incorporates the components of the Internal Control Framework used in Sarbanes-Oxley. SJI has a process for identifying risks and placing them into a risk inventory; however, before identifying its risks, SJI determines its business objectives. On an entity-wide basis, these objectives include: long-term annual EPS growth of 6-7%, annual dividend increases of 6-7%, while executing a low to moderate risk platform. More specifically, SJI aims to operate the utility on a low risk platform while the non-utility affiliates operate on a moderate risk platform. [59]

Risk identification at SJI involves identifying events (internal and external) that would prevent SJI from achieving the objectives mentioned above. The Risk Management Department has developed a risk inventory that is a compilation of approximately 200 events that could prevent SJI from achieving its business objectives.[60] This risk inventory is developed through the leaders of each business unit (e.g. Marina, SJG, etc.). The Risk Management Department works with these leaders via interviews to organize their identified risks and place them into the inventory.[61]

Risk Assessment

After the risks are identified and placed into the risk inventory, each risk is given an inherent risk assessment (evaluating the risk before mitigation measures). This assessment prompts the appropriate business leader to consider the financial impact to SJI and the probability of occurrence during the next five years. Each risk is given a score of one to five, so that the total overall score, considering both parameters, is between two and ten. A higher number means a higher risk to SJI. The scores are determined for each risk based on discussions between the Risk Management Department and the

[57] Response to Discovery, OC-482.
[58] Response to Discovery, OC-94 and Interview with Ken Lynch, CAO on March 27, 2013.
[59] Response to Discovery, OC-94.
[60] Response to Discovery, OC-95.
[61] Interview with Ken Lynch, CAO on March 27, 2013.

management of the various business lines. A more detailed description of the rating system applied to SJI risks is shown below.

Risk Assessment criteria (score each from 1 to 5 where 1 = low and 5 = high)

- Potential business/financial impact to SJI (score from 1 to 5) where the event would have:
  - 1 – Almost no impact
  - 2 – Minor impact
  - 3 – Some impact
  - 4 – Significant impact
  - 5 – Extremely significant impact

- Probability of occurrence during the planning period (score from 1 to 5 where the event is:
  - 1 – Extremely unlikely to occur – less than 5% probability
  - 2 – Is not likely to occur – less than 35% probability
  - 3 – Equal chance to occur – approximately 50% probability
  - 4 – Is likely to occur – greater than 65% probability
  - 5 – Very likely to occur – greater than 95% probability

When probability and financial impact are assessed together, SJI can assess a particular risk as very high (V), high (H), moderate (M) or low (L) as shown in the table below.

Table 9-12 - SJI Risk Assessment Matrix

South Jersey Industries Risk Assessment Matrix						
	Impact					
Probability		No Impact	Minor Impact	Some Impact	Significant Impact	Extremely Significant Impact
		1	2	3	4	5
Very Likely	5	H	H	V	V	V
Likely	4	M	H	H	V	V
Possible	3	M	M	H	H	V
Not Likely	2	L	M	M	H	H
Extremely Unlikely	1	L	L	M	M	H
Source: Response to Discovery, OC-94.						

Risk Response

Once the risks have been assessed, SJI determines which of the risks require action to be taken to reduce the effect of specific risks on SJI. The Risk Management Department discusses potential action plans to reduce the effects of various risks of the Company. These action plans can take the form of: avoidance, reduction, sharing or acceptance.[62] The action plans to reduce the effects of risk on SJI are developed into control activities. These activities are designed and implemented based on discussions

[62] Response to Discovery, OC-94.

with the appropriate business unit leaders. The activities can range from monitoring to physical and electronic security to segregation of duties.

Risk Assessment Communication

After the SJI's business risks have been identified, assessed, and have had a plan developed to reduce their effect, the risks and the action plans are communicated to management, executives and the Board of Directors of SJI. Risk management is a part of many communications and reports throughout SJI, as there are risks (or potential risks) in every segment of the operations of SJI and its affiliates. The discussion of entity-wide risks and the action plans to reduce their effects on the Company are generally addressed in the quarterly Risk Management Committee meetings and the monthly and annual reports to the Board of Directors. The quarterly RMC meetings generally cover the following topics:[63]

- Discussion of the Gas Supply's hedging analysis
- Recent interactions with the NJBPU
- Discussion of the Company's receivables and related reserves
- Status of compliance with FERC regulations

Other topics relating to risk are brought forward and discussed as necessary. For every meeting, the Gas Supply department prepares a detailed report of hedging positions for current and prospective BGSS years. After these reports are presented to and reviewed by the RMC, they are submitted to the NJBPU.[64]

There are various reports concerning risk management that are provided to the Board of Directors of SJI. The most prominent of these reports is the Risk Dashboard. The Risk Dashboard from November 2011 is presented as an example in Attachment 9-1. This report provides the Board with the five most significant risks to SJI. Included in this report is an analysis that shows how the key indicators that are used to measure these risks have fluctuated in recent months. In January 2012, the risks (and key indicators) included in this report were:

- Default of customers and/or counterparties
  - Accounts receivable aging
  - Fixed commodity price market exposure
- Significant volatility in the natural gas and power markets
  - Percentage of natural gas in storage hedged
  - Market value of unhedged NYMEX based contracts
  - Henry Hub Gulf Coast Natural Gas Spot Price
- Inability to access sufficient capital, at a reasonable costs, to meet liquidity needs
  - Available liquidity
- Service interruptions to a major customer/distribution area
  - Routine Maintenance Programs

[63] Response to Discovery, OC-200.
[64] Ibid.

- Change in regulatory/political climate on a state and national level
    - Monitoring of significant legislative and regulatory initiatives

The risks and their key indicators have changed very little, if at all, during the audit period.[65] In addition to Risk Dashboard, the Risk Management Department creates an annual report for the Board of Directors that includes: a snapshot of significant risks, risk scores, related controls, assessment results and results of internal audit testing (if applicable).[66]

Monitoring and Mitigating Risks

The risks that have been identified at SJI are continuously monitored and mitigated when appropriate. Internal audit plays a key role in monitoring the risks through its annual testing of the design and operating effectiveness of the controls that were developed to reduce the impact and frequency of the occurrence of the identified risks. Internal Audit and its control testing are discussed in another section in this Chapter. The tools most frequently used to monitor risks are: internal controls, self-assessments, adhering to professional standards, and feedback from internal and external sources on control issues.[67] SJI uses a specific metric to assess and monitor the credit risks of the counterparties in transactions involving SJI and its affiliates. The metric used by SJI is the 2-month Accounts Receivable balance, including mark-to-market exposure.[68] These balances are netted against any amount that an SJI affiliate owes to the counterparty. The credit limit for each counterparty is established by the business line involved in transactions with the counterparty and approved by the Risk Management Department. The wholesale business line assesses and determines the credit policy for wholesale customers and retail does the same for its customers. Both wholesale and retail use a company's financial statements as well as credit ratings to determine the credit limits of the counterparty. A counterparty's credit profile is reviewed annually.[69] Any counterparties that are above their credit limit are monitored by the RMD. In some cases, after a review by the RMD, the counterparty is contacted for an agreement to increase their credit limit. The following table shows the Total Gross Receivables greater than two months old for the utility, SJES companies, and SJI in total.

Table 9-13 – SJI Total Gross Receivables

SJG and SJES Total Gross Receivables ($000)			
	December 2009	**December 2010**	**November 2011**
SJG	17,073	18,890	20,231
SJES Companies	2,569	3,903	2,897
Total	**19,642**	**22,793**	**23,128**
Source: Response to Discovery, OC-95			

[65] Response to Discovery, OC-95.
[66] Response to Discovery, OC-94.
[67] Response to Discovery, OC-94.
[68] Response to Discovery, OC-95.
[69] Interview with Kenneth Lynch, CAO, March 27, 2013.

SJI stated that the sharp increase in gross receivables greater than 60 days old for SJES towards the end of 2010 and into the first half of 2011 was due to two factors: changes in the Borgata tariff that caused a delay in payment and billing disputes at Resorts. Both issues have been resolved according to SJI.[70] The utility's receivables over 60 days increased also. However, no reason for the increase was provided by SJI.

Mr. Lynch stated in his interview that SJI makes use of benchmarking studies in many different areas with respect to risk management. However, when Overland requested all of the benchmarking studies from SJI in our discovery requests OC-56 and OC-757, no benchmarking studies relating to risk management were provided. Overland did obtain some benchmarking studies relating to insurance coverages and premiums. Those benchmarking studies are discussed in the Insurance/Claims section of Chapter 17 – Support Services. SJI should more extensively use benchmarking data to compare its risk management function metrics to those of its peers.

Information Systems Utilized in Risk Management

SJI is in the process of upgrading their information systems within the risk management function of the Company. The Company recognized a need for an enterprise-wide energy trading and risk management system (ETRM). The system being replaced and used during the audit period for managing energy trading and the risk associated with it was called RADAR. RADAR was Microsoft Office based and labor intensive. SJES is in the process of implementing Open Link Financial's Endur ETRM system. The system was originally intended to be operational on January 1, 2013.[71] SJES encountered some delays in the implementation process and at the time of this report, the system had yet to be implemented. When the new system is operational, it will provide the Company with more automated controls in the risk management process and provide energy traders with a more efficient process in which to record their transactions.[72] The new Endur system will be the record keeping system for all forward positions for SJRG, SJG and SJE. Endur will provide front, middle, and back office support for these transactions, which includes tracking and management of physical and financial trading, physical scheduling, transportation and storage.[73]

The Risk Management Department also uses an application called CERTUS to "ensure the transparency and accuracy of internal controls for Sarbanes-Oxley and ERM purposes". Risk assessments and control self-assessments are distributed from the application as well as various reports that can be generated.[74] The Risk Inventory mentioned earlier in this section is maintained within CERTUS. The Risk Inventory includes the SJI affiliate, inherent risk level, description of the risk, description of the control mitigating

[70] Response to Discovery, OC-95.
[71] Response to Discovery, OC-291.
[72] Interview with Kenneth Lynch, CAO, March 27, 2013.
[73] Response to Discovery, OC-291.
[74] Response to Discovery, OC-268.

the risk, notation on whether the control was effective, the strength of the control and the residual risk level (after implementation of the control).[75]

Performance Assessment

Overland reviewed the balanced scorecard of Ken Lynch who is the responsible for the risk management function at SJI. During the audit period, Mr. Lynch had various performance objectives relating to his role as the leader of the risk management function. The table below highlights the most important of these objectives.

Table 9-14 - Ken Lynch's Risk Management Balanced Scorecard Excerpt 2009-2011

[Begin Confidential]

South Jersey Industries
Ken Lynch's Risk Management Balanced Scorecard Excerpt 2009-2011

Year	Objective	Measure	Target	Result	Rating

[End Confidential]

The excerpt of Mr. Lynch's balanced scorecards above removes the financial reporting section of the scorecard as well as the risk management objectives that relate to updating processes that were already in place. **[Begin Confidential**]

[75] Response to Discovery, OC-95.

[End Confidential]

It appears that SJI did attempt to use the quantitative measure of Value at Risk (VaR) to assess risks involved with trading natural gas. It is unclear how successful SJI was in assessing risks through VaR as there were issues with continuity in the RMD in 2009 and information systems issues in 2010. Furthermore, there were no BSC objectives relating to VaR on Mr. Lynch's scorecard in 2011. However, in a Major Issues Report in December 2011, Overland found that the necessary corrections had been made to the VaR program and that SJI was in the process of testing and analyzing the results of the corrected program.[76] Since VaR is a widely used metric to measure company risk, SJI should strive to obtain the information necessary to measure its VaR so that it can monitor the Company's risk over time and also benchmark it against its peers.

Overland also observed that the balanced scorecard for 2011 only contained the end of the year scores for each scorecard objective and not a description on how or why each objective was or was not achieved as was shown in 2009 and 2010. The balanced scorecard should contain a description of how the employee performed against the objectives that were set at the beginning of the year.

Cash Management

Organization

The Cash Management function at SJG is headed by SJG/SJI Treasurer. The SJG/SJI Treasurer direct reports and direct superior are illustrated in the Finance Organization chart provided above in Table 9-1.

Cash Forecasting

The cash forecasting process at SJG is largely driven by the annual budget. Treasury works with members of SJG management to identify the potential drivers that could impact the need for cash. For SJG these key drivers include planned capital expenditures and forecast gas purchases. Ultimately, this results in a rolling forecast of monthly cash requirements. This information is then loaded into the Hyperion Financial Modeling System to generate a rolling forecast of monthly cash requirements.[77]

Daily Cash Management Process

In the past, cash management forecasts were performed at SJI by each department. This process is now the responsibility of SJI's Cash Management Department (CM). Each day the CM receives the necessary information that allows the CM to determine the Company's cash needs. Specifically, the CM receives the current cash book balance for each company along with any payments that the company needs to

[76] Response to Discovery, OC-432.
[77] Response to Discovery, OC-040.

make that day. The CM then uses this information to develop a "Daily Cash Position Report." This report shows the current cash available and the current cash requirements. This report is used to determine how much cash will need to be borrowed or how much cash is available to be invested. This is done for each company.

After generating the Daily Cash Position Report, the CM determines how much borrowing is required. The amount of borrowing required is determined by taking the opening book balance and adding all incoming funds and subtracting all outgoing funds.

CM also completes a daily schedule of short-term debt/investment for the day. Any borrowings for the day are recorded on this schedule. In addition to the amount of funds borrowed, this schedule also has other relevant information including the bank that the money was borrowed from, the approved credit limit, the interest rate, the maturity date and the date the cash was borrowed. This same information is recorded for any investments made with excess cash.[78]

Available Liquidity

As illustrated in the table below, SJG utilizes a variety of different credit facilities to meet its capital requirements. The Company uses its lines of credit and its commercial paper program (discussed below) to fund capital expenditures as incurred.

Table 9-15- Available SJG Credit Facilities - 2009 through 2011

South Jersey Gas SJG Credit Facilities (in thousands)				
Year	**Type of Facility**	**Total Facility**	**Usage**	**Available Liquidity**
2009	Revolving Credit Facility	100,000	85,000	15,000
	Line of Credit	40,000	10,000	30,000
	Uncommitted Bank Line	55,000	14,400	40,600
	Available Liquidity as of December 31, 2009			85,600
2010	Revolving Credit Facility	100,000	50,000	50,000
	Line of Credit	40,000	-	40,000
	Uncommitted Bank Line	40,000	8,900	31,100
	Available Liquidity as of December 31, 2010			121,100
2011	Commercial Paper Program / Revolving Credit Facility	200,000	126,600	73,400
	Uncommitted Bank Line	20,000	-	20,000
	Available Liquidity as of December 31, 2011			93,400
Source: 2009, 2010 and 2011 SJI Annual Reports.				

[78] Response to Discovery, OC-053, document titled "SJI Treasury Investments Narrative 03 30 11.doc"; November 14, 2013 interview with Stephen Clark, SJI and SJG Treasurer.

SJG's available liquidity has fluctuated somewhat during the audit period. Liquidity was $85.6 million, $121.1 million, and $93.4 million at year end 2009, 2010 and 2011, respectively. As of year-end 2011, both Moody's and S&P considered SJG's level of available liquidity as "adequate."[79]

SJG altered its liquidity profile during the audit period by establishing a commercial paper program to replace other SJG credit facilities that expired in 2011. Under this program, SJG issues up to $200 million of short-term, unsecured promissory notes. The commercial paper program replaced a $100 million credit facility as well as a $40 million line of credit that expired in August 2011.[80] The maturity dates of these notes vary but by law cannot exceed 270 days. This commercial paper program is backstopped by a $200 million revolving credit facility that can be extended until May 2017. The revolving credit facility provides protection for SJG, because if SJG ever encountered a situation where it could not issue as much commercial paper as it required, it could draw down the funds available in this revolving credit facility.[81]

Cash Pooling

When asked in discovery to describe any money pool arrangements to which SJG is a party, the Company responded that SJG is not a party to any type of money pooling arrangement.[82] Although not a money pool, SJG makes many large payments on behalf of its affiliates, including those related to employee benefits (e.g. payments to insurance providers such as Blue Cross/Blue Shield). SJG then has to wait to get reimbursed from its affiliates. Requiring SJG to pay large common corporate costs on behalf of the entire holding company is unreasonable and is also in general conflict with the Company's cost allocation manual that states:

> *If, while acting as an agent for SJG, SJI requires funds to be transferred from SJG to SJI, such funds shall not be transferred more than 24 hours prior to SJI making payment to the third party beneficiary (i.e. Pension, insurance and FIT payments).*[83]

Although the requirement quoted above indicates that the time lag between funds transferred from SJG to SJI shall not exceed 24 hours, the Company's current procedure allows SJG to go several weeks without receiving a reimbursement for payments made on behalf of SJG's affiliates.

We recommend that the Company shift the responsibility of any common corporate costs currently being paid by SJG to either the parent company level or the service company.[84,85]

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[79] Response to Discovery, OC-006. Moody's July 7, 2011 Report; S&P December 20, 2011.

[80] Response to Discovery, OC-006, Moody's July 7, 2011 Report.

[81] 2009, 2010 and 2011 SJI Annual Reports.

[82] Response to Discovery, OC-036.

[83] Response to Discovery, OC-627, Procedure for the Allocation, Recording and Invoicing of Affiliated Company Transactions – Cost Allocation Manual.

[84] Response to Discovery, OC-627. We would also note that in the referenced data request response, the Company agreed with this recommendation. Specifically, Overland asked why certain common costs were being paid by the gas company instead of the service company. The Company responded as follows: "Historically, all such contracts were is (sic) SJG's name as

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CONFIDENTIAL INFORMATION HAS BEEN REDACTED

10. Accounting and Property Records

This chapter discusses the accounting functions performed on behalf of SJG. The organization of the accounting department is described, and the various accounting information systems employed in this function are discussed. The testing of internal controls is summarized and reviewed. Company compliance with generally accepted accounting principles (GAAP) and a review of asset impairments are also addressed.

Summary of Findings

1. After our primary audit period but before the release of our report, a new Chief Accounting Officer position at the parent company was established and the Chief Financial Officer position at the gas company was eliminated.[1]
2. During our primary audit period, the retirement of assets was a recurring internal control issue at SJG.
3. SJG has implemented, or will soon implement, various new IT systems that should enhance the efficiency and effectiveness of SJG's accounting functions.
4. Both SJG and SJI received unqualified or "clean" audit opinions from their external auditors on their financial statements in each of the years reviewed.
5. SJG has not recorded an impairment loss since 2008, and impairments recognized by affiliates have been relatively insignificant.
6. SJI's external audit firm opined that SJI maintained effective internal controls over financial reporting for each of the years reviewed by Overland, but the number of internal control deficiencies identified showed a significant upward trend.
7. The Director of SJI's Internal Audit Department has direct and regular contact with both the SJI CEO and SJI's Board of Directors.
8. The SJI Internal Audit Department recently completed a major project to illustrate the key processes in the Company using flowcharts.
9. The actual number of hours required to complete internal audits has differed significantly from the hours budgeted.
10. SJI's external auditors identified substantially more deficiencies during the primary audit period than were identified by the SJI Internal Audit Department.
11. The Internal Audit Department is evaluated after each audit through evaluation surveys sent to each auditee.
12. Based on recommendations from its external auditor, SJG has recently revised its methodology for calculating bad debt reserve.
13. The Company's capitalization policy is written at an extremely high-level and would not provide sufficient guidance for anything but the most basic capital/expense decisions.

[1] "Primary audit period" is defined as the period from January 2009 through December 2011.

Recommendations

1. Internal Audit should perform a focused review of the SJG Property, Plant and Equipment internal control procedures, particularly in regards to the retirement of SJG assets, to ensure that these controls are effectively designed and are being adequately followed.
2. The SJI Internal Audit department should make a concerted effort to develop more accurate budgets and it should regularly report the budget-to-actual variance of its audits to members of management.
3. Given the increasing complexity of SJI's operations, as well as the increasing number of control deficiencies identified by SJI's external auditors, the Company should engage a third party to conduct an external quality review of the SJI Internal Audit Department.
4. The Company should develop a comprehensive capitalization policy that could be referenced by Company employees when making complex decisions about whether to record an expenditure as an asset or as an expense.

Accounting and Property Records

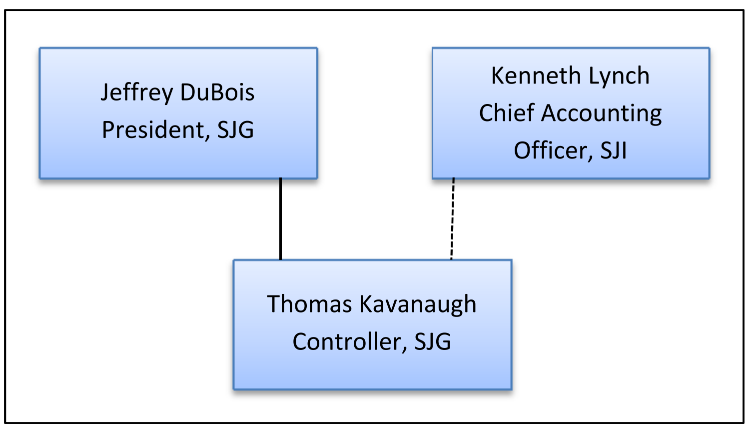
Organization and Staffing of Accounting

The accounting department at SJG is led by the Controller of SJG. As the head of the SJG accounting department, the SJG Controller is responsible for ensuring that SJG's books and records are maintained in accordance with the Uniform System of Accounts prescribed by the Board of Public Utilities and in accordance with GAAP. During the primary audit period we reviewed, the SJG Controller reported to the Chief Financial Officer (CFO) of SJG who was also the CFO of SJI. In April 2012 various organizational changes occurred that, among other things, eliminated the CFO position at SJG. As of the writing of our report there was no CFO position at the gas company level. Also subsequent to our primary audit review period, the Chief Accounting Officer (CAO) position was established as an SJI officer position. The SJI CAO oversees all aspects of the SJI's accounting and financial reporting functions. The SJG Controller has dotted line responsibility to the SJI CAO.[2] See below for the SJG accounting department organization chart before and after the reorganization described above.[3,4]

[2] Response to Discovery, OC-661; Interview with Kenneth Lynch, SJI CAO on March 27, 2013.
[3] Response to Discovery, OC-005.
[4] Response to Discovery, OC-005.

Table 10-1 – Accounting Organization Chart - Pre Organization Change

Table 10-2 – Accounting Organization Chart - Post Organization Change



SJG's Accounting department increased slightly during the primary audit period, but generally fluctuated around 15 people. The increase was largely due to two Property Cash Records Analyst positions that were added between the beginning of 2009 and the end of 2011. These additional positions became necessary to help process the increased construction activity that has occurred due to increased natural gas conversions and accelerated infrastructure replacement programs approved by the NJBPU. In addition to a relatively consistent headcount the SJG Accounting department also had limited turnover, especially at its more senior positions. Roughly 70% of the individuals in the SJG Accounting department in the beginning of 2009 were still in the SJG Accounting department at the end of 2011, including four of the five direct reports of the SJG Controller.[5]

Work Order and Plant Accounting

Given the capital intensive nature of the utility industry, fixed asset accounting is of particular importance to SJG. Below we provide a description and assessment of SJG's methods for accounting for its Property, Plant and Equipment (PPE).

On an annual basis, a capital budget is prepared for new, continuing and retired projects and approved by the SJG Board of Directors. After the budget is approved it is sent to the Financial Planning Department and the Property Records Manager so that additional details can be added regarding the capital projects. At various intervals throughout the process, all relevant details (capital amounts, etc.) are confirmed with what was originally approved by the Board. Ultimately, the budgeted projects are entered into SJG's asset management system, Powerplant.

Once input into Powerplant, different types of work authorizations are established: Blanket Authorizations–these are managed on a calendar year basis and represent the collection of minor capital jobs with low cost per job and unpredictable timing; Special Authorizations–these are used for jobs that exceed the expenditure limit for a blanket authorization; and Retirement Authorizations – these are used when replacing existing company equipment and facilities.
The accounting for SJG's property is mainly the responsibility of SJG's Property Records Department. Each capital project is assigned a unique authorization number by the Property Records Department. This number is then used by the Property Records Department to track the charges against the authorized amount. These authorizations are tracked on a monthly basis to ensure expenditures are not exceeding authorized amounts. On a monthly basis, the Powerplant system generates a report that identifies all authorizations that are over/under budget.[6]

The key controls, as identified by management, of the PPE process include the following:

- Monthly the Property Records Analyst reconciles Powerplant to the general ledger.
- Quarterly the SJG Controller inquires via email of members of management to determine if assets are impaired.
- Accounting reviews and approves the retirement and disposal of capital assets on a monthly basis.
- Increases to budget authorizations are reviewed and approved by the President of SJG.
- A physical inventory is performed every two years, and the general ledger is updated to reflect actual inventory.

[5] Response to Discovery, OC-005; Interview with Thomas Kavanaugh, SJG Controller on January 10, 2013.
[6] Response to Discovery, OC-053, SJG PPE Process Narrative.

- Annually the calculation of the Asset Retirement Obligation (ARO) is updated through inquiries with management and reviewed by the SJG Controller.
- On a quarterly basis the Manager of Property Records reviews certain inputs (discount rate, inflation rate) that may impact the calculation of the Company's AROs.

There were recurring internal control deficiencies identified by the Internal Audit Department and the Company's external auditors related to the PPE cycle. Specifically, these deficiencies were related to asset retirements not being appropriately communicated from SJG Operations personnel to the accounting department. Given the recurring nature of these internal control issues, we recommend that they conduct a focused audit over the PPE cycle to ensure that the controls are being adequately followed, or modify the design of the controls if found to be inadequate.

Billing

Currently, SJG utilizes an in-house billing system that was first installed in January 1975.[7] During the 2010-2012 timeframe SJI's Customer Service and Information Technology departments worked together to assess the risks associated with the legacy customer information system (CIS). As part of this evaluation, the Company hired Applied Energy Group (AEG), an outside consultant, to perform a full risk assessment of the existing CIS. AEG, not surprisingly, concluded that SJG's legacy CIS was outdated and individuals with detailed knowledge of the system were nearing retirement age. AEG also believed that this system posed significant risks to the Company and recommended that the company replace it. In particular, SJG's legacy CIS was found to require too much manual effort required for billing of accounts, and it was difficult to install new rates into the system.[8] In November 2011, the executive management of the Company approved the plan to replace the existing CIS with one developed by Oracle. The new system is expected to be more intuitive and it is also expected to minimize the manual entries required for the billing changes. [9] The cost of the new system is budgeted for $28.6 million and the system is expected to go live in the summer of 2014.[10,11]

Payroll

The SJI payroll process is conducted on a centralized basis for all employees of SJI and its subsidiaries. Processing the Company's payroll is a joint effort between the Payroll Department and the Human Resources Department. The Payroll Department is responsible for ensuring that only valid employees are paid at authorized pay rates, calculating payroll taxes in accordance with applicable state and federal guidelines, and recording payroll expenses in the general ledger. Company payroll is processed on a biweekly basis and each full time employee is paid on an 80-hour pay period.

[7] Response to Discovery, OC-055.
[8] Overland did not perform a detailed review of the legacy CIS but we reviewed the outside consultant's findings and believe its conclusions to be reasonable.
[9] Response to Discovery, OC-271.
[10] Response to Discovery, OC-640.
[11] Response to Discovery, OC-279.

The Payroll Department uses multiple software applications to conduct these operations. The table below summarizes the systems used and their purpose.

Table 10-3 - Payroll Software Applications

South Jersey Industries Payroll Software Applications	
System	**Purpose**
Lawson Payroll Module	To generate payroll
BSI Tax Factory	To calculate appropriate taxes and that feed into the Lawson Payroll Module
Excel Add-ins	To generate reports for month-end deductions, overtime, standby, quarterly tax filings
Excel	To capture the monthly timesheets used for inter-company billing
Sources: Payroll Process Narratived, Response to Discovery, OC-053.	

The process of distributing checks is also performed by the payroll department. Once the pay statements and paychecks are printed, they are sorted by location and subtotaled. The checks are then sealed and compared to the total count on a payroll report to ensure they agree.

Segregation of duties controls prevents the Payroll Department from entering employees into the system or changing their pay rates. The various payroll data are input by the Human Resources Department.[12] On a weekly basis the Human Resources Department determines what, if any, properly approved Personnel Actions (e.g. promotion, pay change, termination) need to be entered into the Lawson system.[13]

Any changes are then checked for accuracy by the Manager of Compensation & Benefits and are then routed to the Director of Human Resources and the Vice President of Human Resources for their review and signatures. Once the Personnel Actions have been approved by the appropriate management personnel, the new information is uploaded to the system by the Manager of Compensation & Benefits.[14]

During the audit period, there have been no control deficiencies, significant deficiencies or material weaknesses related to the payroll process noted by SJI's external auditors.

[12] Response to OC-053.
[13] "Personnel Actions" requires one of the following for authorization: approved Compensation Committee Meeting minutes, Job Awards resulting from an approved Personnel Requisition or an approved Request for Change of Personal Information form.
[14] Response to OC-053.

SJI's payroll procedures discussed above are sufficient and provide adequate segregation of duties.[15]

GAAP Compliance

Review of Financial Statements

SJG produces annual financial statements (Form 10-K) and associated footnotes that are subject to external audit and filed with the Securities and Exchange Commission (SEC). SJG's Form 10-K's are generally filed in late February/early March of each year.[16]

Our review of SJG's year-end financial statements and associated footnotes for the years 2009 through 2011 indicates that the Company's external audit firm, Deloitte, issued an unqualified or "clean" audit opinion over SJG's financial statements in each year of our review.[17] Although it issued a clean opinion over SJG's financial statements for all years reviewed by Overland, Deloitte did identify various audit adjustments during this period. These audit adjustments were either recorded on SJG's financial statements, or, if not recorded, were deemed immaterial by the external auditors.[18]

SJI also files year-end consolidated financial statements that are subject to external audit. As SJG's parent company, SJI's financial statements include the consolidated operations of all SJI subsidiaries, including SJG. SJI also received a clean audit opinion over its financial statements from Deloitte for the years 2009 through 2011. Unlike SJG, SJI is required to have its internal control environment audited on an annual basis because it is a publicly traded company. SJI's external auditor concluded that SJI maintained effective internal controls over financial reporting for each year under review.[19,20] However, as discussed in the "Results of Sarbanes-Oxley Testing " section below, SJI's internal control deficiencies increased sharply during our primary audit period.

Asset Impairments

In general, companies record asset impairments when the amounts recorded on their balance sheet are overstated and not supported by the future benefits expected to be realized from their use. A few examples of assets that can become impaired over time are investments available-for-sale, long-lived assets, and goodwill. While each of these types of assets is subject to its own unique method of

[15] We would also note that during the audit period, there have been no control deficiencies, significant deficiencies or material weaknesses related to the payroll process noted by SJI's external auditors.

[16] SJI is categorized as a "large accelerated filer" by the SEC and is required to file its Form 10-K within 60 days after its fiscal year. SJG is categorized as a "non-accelerated filer" and is not required to file its Form 10-K until 90 days after its fiscal year. Even so, both SJI and SJG generally file their financial statements to coincide with SJI's filing deadline (i.e. late February/early March).

[17] An unqualified opinion is issued when the external audit firm believes that a company's primary financial statements (balance sheet, income statement, and statement of cash flows) were found to be fairly presented in all material respects. We would also note that SJG received an unqualified opinion for its 2012 financial statements

[18] Response to Discovery, OC-054 and OC-274.

[19] SJI also received clean audit opinions over its financial reporting and internal controls for 2012.

[20] Unlike the audit of SJI, the external auditors are not required to opine on the effectiveness of SJG stand-alone internal controls.

impairment testing and measurement, the objective of all impairment, work performed is to fairly present, in all material respects, the amounts disclosed in financial statements.

When necessary, the SJG accounting department performs impairment analysis for SJG's assets. To test for possible impairment in long-lived assets, the SJG accounting department contacts the relevant department heads and inquires if they are aware of any indications of impairments. If the accounting department determines that there are indications of asset impairment then an impairment analysis will be performed. There were no indications of asset impairment in SJG's fixed assets during the primary audit period. Goodwill is also reviewed on an annual basis by the SJG accounting department to ensure that a full impairment analysis is not necessary. A goodwill impairment analysis was not deemed necessary during the primary audit period. Marketable equity securities are also reviewed by the SJG accounting department to determine if an impairment charge is required. Generally, an equity security will be considered impaired if its loss in value is deemed as "other than temporary." There were no impairments of SJG marketable equity securities during our primary audit period of 2009 through 2011. However, in 2008, due largely to the stock market crash of 2008, SJG recorded an impairment loss of approximately $700 thousand. While the fact that an impairment has been recorded by a company should generally warrant additional scrutiny of management, impairments are not necessarily the result of poor management decisions, such as over-paying for an asset. In some cases, such as the stock market decline in 2008, circumstances that are completely (or largely) out of the control of management can cause companies to record impairments.

SJI also did not record any impairment charges during our primary audit period. However, for the year ended December 31, 2012 SJI recorded two impairment charges that totaled $3.5 million in non-utility impairment losses for the year ended December 31, 2012.[21] These two impairments represent approximately 3% of SJI's pre-tax income for 2012. Along with their relative insignificance, they had no impact on SJG.

Internal Controls

Organization and Staffing of Internal Audit

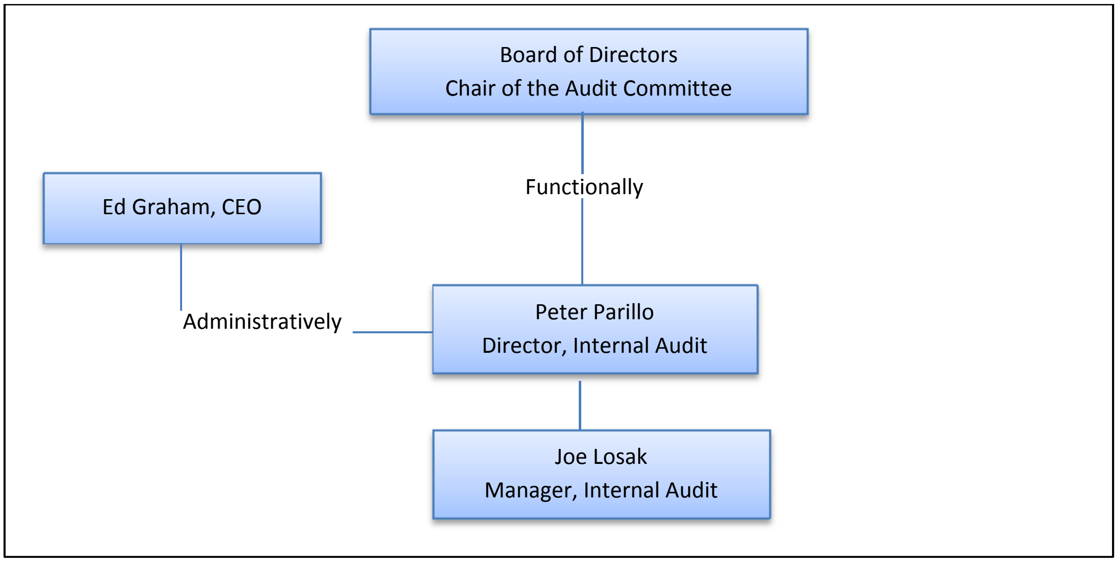
SJI's Internal Audit Department is headed by the Director of Internal Audit, who oversees all internal audit activities and formally reports directly to the Audit Committee of the Board of Directors. On an administrative basis, the Director of Internal Audit reports to the CEO. The reporting relationship between the head of internal audit and the chief executive of SJI illustrates the importance that the Company places on the internal audit function.[22]

[21] The $3.5 million impairment loss was comprised of two components: $2.4 million due to a reduction in the expected cash flows to be received from a solar generating facility; $1.1 million due to a reduction in the expected cash flows to be received from certain gas wells in the Marcellus.

[22] It should also be noted that the current CEO of SJI, Edward Graham, was previously an internal auditor with SJI.

Below is an organization chart of the Internal Audit Department.[23]

Table 10-4 – Internal Audit Organization Chart



Overview of Internal Audit Department

The design and implementation of effective internal controls are essential elements for public companies and fundamental to SJI operating as a going concern. Internal controls are the procedures put in place by a company to help ensure that the company is operating in a manner desired by management and/or required by applicable laws and regulations. This includes ensuring that its financial reporting is reliable, as well as ensuring that its operations are being conducted in an effective and efficient manner. The department most responsible for this area is the SJI Internal Audit Department.

As described in the SJI Internal Audit Policies and Procedures Guide (Internal Audit Guide), the mission of SJI's Internal Audit Department is to provide assistance to the management of SJI and its affiliates by examining the design of SJI's system of internal controls and testing the compliance of these internal controls. The Internal Audit department is meant to be an independent and objective advisor to help improve the Company's operations. To accomplish these objectives, SJI's Internal Audit Department must have cooperation from SJI management. There have been no instances during the audit period in which SJI's Internal Audit Department has been denied information from the departments that it was auditing.[24]

[23] Response to Discovery, OC-557.
[24] Response to Discovery, OC-313; November 13 interview with Peter Parillo.

In addition to the Director of Internal Audit, the Internal Audit Department is comprised of six auditors – one internal audit manager, four senior internal auditors (one specializing in information technology) and one staff IT auditor. There are no immediate plans to increase or decrease the size of the Internal Audit Department from its current level.[25]

The activities of the Internal Audit Department are driven by the internal audit plan that is developed through discussions with key members of management, the risk management committee, and SJI audit committee members. This plan is developed annually beginning at the end of November and it is refined until presented to the Board for its approval in January. The internal audit plan is comprised of tasks related to required Sarbanes-Oxley compliance testing as well as other "special projects" that are generally additional areas that management believes it is important for the Internal Audit Department to review. To avoid potential conflicts of interest, internal audit does not perform non-audit functions (such as designing, installing or operating internal controls) and, as such, the Internal Audit Department has no responsibility for the activities that it audits.

The Director of Internal Audit meets with the SJI CEO formally on a monthly basis (as well as informally when needed), and he also has a monthly phone conversation with the chair of the Audit Committee to discuss the internal audit plan and any issues related to Sarbanes-Oxley testing. In addition, the Internal Audit Department provides copies of all completed internal audits to senior management and the Audit Committee. The Internal Audit Department also has regular communications with the Company's external auditors. The external auditors are provided copies of all internal audits and are also consulted when the internal audit plan is being developed. The Internal Audit Department appears to be receptive to suggestions from the external auditors. One example of the Internal Audit Department's responsiveness to the wants/needs of its external auditors occurred when the Company documented all company controls through flowcharts. This project was initiated from discussions with the external auditors regarding the need for additional documentation. These flowcharts help illustrate the many different controls in place at SJI.

Performance Metrics of Internal Audit Department

The Internal Audit Department uses a balanced scorecard approach to assess its performance. Overland made a request in discovery for the balanced scorecards for all departments (including the Internal Audit Department) and these were not provided.[26] However, Overland was able to obtain the balanced scorecard goals for the Internal Audit Department. The balanced scorecard objectives and targets as of December 2010 and 2011 are listed in the tables below.

[25] Response to Discovery, OC-557; Interview with Peter Parillo, Director of Internal Audit.

[26] Response to Discovery, OC-364. The Company stated that departmental level scorecards were not retained by its human resources department.

Table 10-5 - 2010 Internal Audit Balanced Scorecard Targets

South Jersey Industries 2010 SJI Internal Audit Department Balanced Scorecard		
Objective	**Measure**	**Target**
Complete audits on a timely basis.	Percentage of audits performed within 20% of budgeted hours.	100%
Add value to the organization.	Percentage of audits where opportunities to increase efficiency, improve controls and reduce risk were identified and subsequently implemented.	85%
Complete entire audit plan.	Percentage of assigned annual audit plan executed.	100%
Issue audit reports in a timely manner.	Average number of days from end of fieldwork to submission of final report for review.	30 days
Improve knowledge of computer assisted audit techniques to improve efficiency and effectiveness.	Percentage of audits that included the use of computer assisted audit techniques.	75%
Improve audit skills and increase value to the organization.	Percentage achievement of training/education plan. (ACL, Access, Regulatory accounting)	100%
Source: Response to Discovery, OC-432, Major Issues Report, Support Services - Dec 2010.		

Table 10-6 -2011 Internal Audit Balanced Scorecard Targets

South Jersey Industries 2011 SJI Internal Audit Department Balanced Scorecard		
Objective	Measure	Target
Complete audits on a timely basis	Percentage of audits performed within 20% of budgeted hours. Complete fieldwork by Q4-2011.	100%
Implement SEC guidance	Update SOX testing templates to incorporate SEC guidance. Complete essential processes by end of Q2-2011.	85%
Complete entire audit plan	Percentage of assigned annual audit plan executed. Complete fieldwork by Q4-2011.	100%
Positive customer surveys	Receive customer surveys with an average score of 3.5 or higher. Complete by Q4-2011.	50%
Issue Audit reports in a timely manner.	Average number of days from end of fieldwork to submission of final report for review. Complete by end of Q1-2011.	30 days
Implement updated Internal Audit Charter and policy and procedures	Finalize Internal Audit charter and policy and procedures and present to executive management and the Audit Committee for review and approval by end of Q1-2011	50%
Improve understanding of subsidiaries	Improve understanding of subsidiaries to better understand processes and overall functions to better communicate updates to executive management and Audit Committee. Complete by Q4-2011.	75%
Implement electronic workpaper software	Implement electronic workpaper program which improves the audit process by providing continuity and consistency. Complete by end of Q1-2011	75%
Source: Response to Discovery, OC-432, Major Issues Report, Support Services - Dec 2011.		

The objectives listed above appear reasonable and provide a good balance between goals focused on efficiency (e.g. percentage of audits performed within 20% of budget), performance (e.g. positive customer surveys) and continuous improvement (e.g. implement electronic workpaper software). The department's performance related to these goals, however, could not be fully assessed because Overland never received the completed balanced scorecards for this department.

One balanced scorecard area that Overland was able to independently assess, however, was the goal related to the completion of audits performed within 20% of budgeted hours. Developing realistic time estimates for an audit is important for both planning purposes (i.e. making certain that all auditors are fully utilized) and employee morale. An audit budgeted for more hours than necessary could cause audit staff to become complacent and not strive to complete their work in the most efficient manner possible. An audit budgeted for too few hours could cause audit staff to deem the budget as unrealistic and ignore it entirely.

Overland was provided the budget to actual variance report of the Internal Audit Department for 2010 and 2011. Only 15% of the 2010 audits and only 26% of the 2011 audits were completed within +/- 20%

of budgeted hours.[27] The variances ranged significantly from an over-variance of 240% to an under-variance of 98%.[28] In some cases, the budgeted hours for an audit appeared nonsensical and vastly overstated. For example, one audit that was budgeted for 120 hours was completed in just two hours.[29] We would not expect the actual hours to equal budgeted hours in all cases, but when budgets are well developed large variances should be the exception. As such, we recommend that the Internal Audit Department make a concerted effort to improve the accuracy of its audit budgets. We also recommend that a budget to actual variance report for internal audits be included as part of the "Major Issues" report that is developed monthly for senior management.

Sarbanes-Oxley (SOX) Compliance

Enacted in 2002, the Sarbanes-Oxley Act (SOX) was a response to corporate malfeasance by several high profile companies in the late 1990s and early 2000s in which investors lost billions of dollars. While the thrust of previous federal securities regulations concerned disclosure of information to investors by public companies and the fair treatment of investors by the securities industry, SOX was directed at government oversight over public company boards of directors, corporate management, and public accounting firms. The focus of our review was on the results of SOX internal control testing performed by both internal and external auditors.

Results of Sarbanes-Oxley Testing

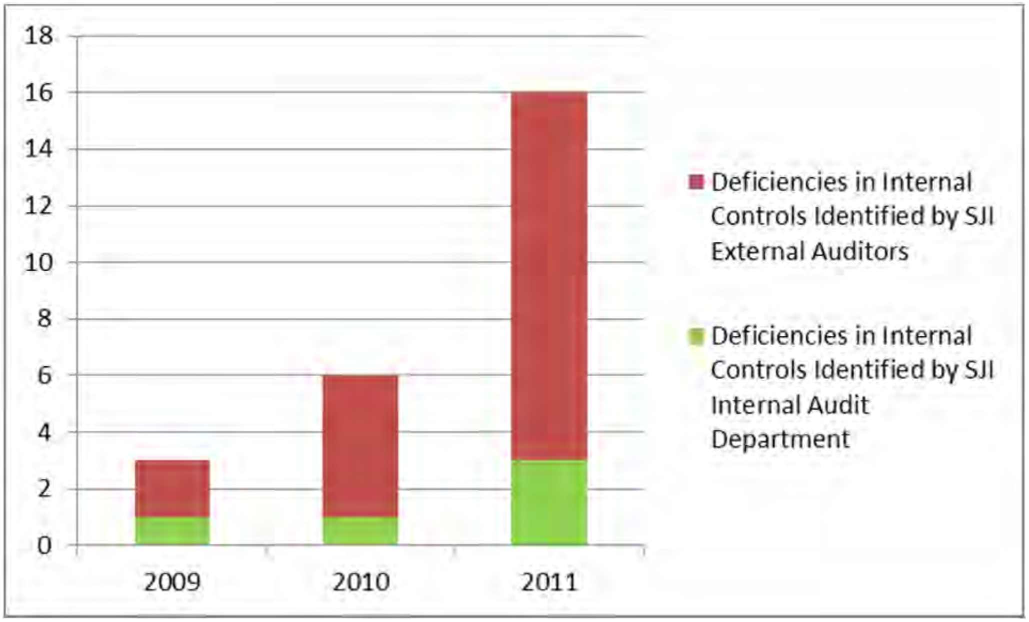
The criteria used to classify exceptions in Sarbanes-Oxley testing as material weaknesses, significant deficiencies, or control deficiencies are as follows:

- Control Deficiency – A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis.
- Significant Deficiency – A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.
- Material Weakness – A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

[27] Response to Discovery, OC-559. Of the 40 audits listed for 2010, only six were completed within +/- 20% of the budgeted hours (15%). Similarly, of the 39 audits listed for 2011, only 10 were performed within +/- 20% of budget (26%).
[28] % Variance was calculated as: (Actual Hours – Budgeted Hours) / Budgeted Hours.
[29] The Company stated this audit was not completed as described by Overland, but rather extended into the following year. This is inconsistent with other information provided in Discovery. Response to Discovery, OC-432 states that this audit was completed with the issuance of Report No. 27-2011.

The chart below shows the control deficiencies identified by the company's Internal Audit Department and external auditors during the primary audit period.[30]

Table 10-7 - 2009 to 2011 Internal Control Deficiencies



As illustrated in the chart above, the deficiencies identified during the primary audit period have increased significantly, including a dramatic increase in 2011, with the majority of these deficiencies being identified by the Company's external auditors.

In 2009 two control deficiencies were identified by SJI's external auditors. This number more than doubled in 2010 to five deficiencies (including one significant deficiency) and nearly tripled in 2011 to thirteen control deficiencies, including several that were recurring issues.

In comparison, the number of internal control deficiencies identified by the Company's auditors numbered one in 2009 and 2010 and three in 2011.

We would generally expect Company's Internal Audit Department to identify at least as many, if not more, control deficiencies as the external auditors, given the internal audit personnel's in-depth knowledge of the Company and its processes. We would also expect control deficiencies to either remain relatively constant or decline from year to year due to increased knowledge and experience

[30] Regarding Table 10-7, the Company stated that the deficiencies described in the source data for this table (Response to Discovery, OC-561) represented an incomplete listing. Specifically, the Company stated that data provided for SJI's external auditors represented deficiencies found for all SJI companies, whereas data provided for SJI's internal audit represented only those deficiencies related to SJG. Overland made multiple requests for this information. Even so, it is not clear whether Overland was ever provided a comprehensive listing of internal control deficiencies from the Company.

in complying with Sarbanes-Oxley requirements.[31] The dramatic increase in deficiencies identified by SJI's external auditors and the recurring nature of some of these control deficiencies indicates that SJI's Internal Audit department may not be effectively identifying and remediating internal control issues.

Internal Audit Quality Assurance Program

The Company's recently revised Internal Audit Guide includes a section describing the Quality Assurance (QA) program of the Internal Audit Department. The Company lists both internal and external QA mechanisms in this section. One key component of the internal QA program is the use of "Customer Satisfaction Surveys." These surveys are issued to each auditee upon completion of the audit. Among the evaluative criteria listed in these surveys are whether the audit objectives were clearly communicated and whether internal audit appropriately followed-up on corrective action. The auditees can then choose from a range of "Strongly Agree" to "Strongly Disagree."[32] These surveys provide helpful feedback to the Internal Audit department and the results of these surveys are a component of the Internal Audit Department's balanced scorecard.

Addressing quality assessments by third parties, the Company's Internal Audit Guide states the following:

> *External assessments, such as quality assurance reviews or an internal self assessment with external validation, are conducted at least once every five years by a qualified, independent review or review team from outside the organization.*

While the language from the guide is unambiguous, based on responses we received in discovery it is not clear that the Company has committed to performing these reviews on a regular basis. In one of its data request responses, the Company stated that a quality assessment from a third party has never been performed on the Internal Audit Department and that, although a quality review is recommended by the Institute of Internal Auditors it is not required, and there is no penalty for not performing these reviews.[33] Given the increasing complexity of SJI's operations, as well as the upward trend of control deficiencies identified, we believe this department would greatly benefit from an external quality review. We recommend that the SJI engage a qualified third party to perform a review of SJI's Internal Audit Department as soon as feasible and perform these reviews, at a minimum, every five years thereafter.

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[31] We would also note that the control deficiencies identified in 2009 and 2010 by the SJI Internal Audit Department were related to the same control in different locations.

[32] If a survey question is not applicable, auditees also have the option to choose "No Basis."

[33] Response to Discovery, OC-562.

Other Accounting Matters

Bad Debt Reserve **–** During the 2011 financial statement audit, SJG's external auditors expressed concerns that SJG was not adequately assessing its risk related to its bad debt reserve. SJG has since resolved this issue by revising its bad debt reserve calculation to include an additional write-off of any inactive accounts that fall in the over 24 month category. This change resulted in an incremental bad debt expense of approximately $564 thousand recorded on SJG's 2012 financial statements.[34]

Capitalization Policy **–** During the discovery process, Overland asked the Company to provide the Company's written capitalization policy. The "policy" provided by the Company was a one-page document approved in October 1987 stating the following:[35]

> *The Company policy is that equipment with a per item value of $150 or less and equipment that has a short life should be excluded from the plant equipment accounts and be charged to expense.*

This one-sentence "policy" statement is too general to provide adequate guidance to Company personnel seeking to make sometimes complex decisions regarding whether an asset should be capitalized or expensed. Furthermore, imposing a nominal dollar threshold that was approved over 25 years ago belies common sense. The Company should develop a comprehensive capitalization policy that employees could easily reference when making decisions about whether to classify a certain expenditure as an asset or an expense. We would recommend that this comprehensive capitalization policy contain at least two sections. The first section of the policy should provide references to relevant underlying accounting standards (GAAP, FERC, NJ BPU) and discuss in substantial detail the underlying logic for why certain expenditures are considered assets and capitalized, while others are considered period expenses. The second section of this policy should apply the standards described in the first section to all asset categories of the Company.

[34] Response to Discovery, OC-657.
[35] Response to Discovery, OC-596.

11. Gas Procurement and Supply

This Chapter addresses South Jersey Gas Company's (SJG's) gas procurement and supply function for the distribution of gas to customers. The principal subject areas addressed include: the organization of SJG's Gas Supply Department; SJG's 2006 Global Settlement with the NJ BPU wherein many gas supply-related issues were decided; SJG's methodology for forecasting future demand; SJG's current and future pipeline transportation capacity portfolio; the relationship of SJG with its third party marketers; SJG's procurement of the gas commodity; SJG's off-system sales and capacity release program; and a detailed review of SJG's gas procurement hedging program.

Summary of Findings

1. During the audit period, SJG engaged an outside consultant to develop an enhanced approach to demand forecasting. This forecast methodology appears sound and is an upgrade from SJG's previous methodology.
2. During the audit period, SJG routinely failed to accurately update the weather inputs used to prepare its ten-year demand forecasts.
3. The Company utilizes a widely used portfolio optimization software called SENDOUT. This software package has been employed by SJG for over a decade. Its output reports are the primary source documents for SJG's ten-year, five-year and design-day forecasts.
4. SJG's Gas Supply Department has performed reasonably well minimizing pipeline imbalance charges. With the exception of one highly volatile month in 2010, these charges have been negligible.
5. Energy efficiency programs have had a significant impact on decreasing design day demand. Without taking into account these programs, the Company's design day forecasts showed an increase from the 2012-2013 winter season to the 2020-2021 winter season of 14.6% (1.7% compounded annual growth rate). Incorporating the impacts of energy efficiency programs decreased the total growth from 14.6% to 8.5% and decreased the compounded annual growth rate from 1.7% to 1%.
6. SJG receives its natural gas supplies through direct connections to two interstate pipelines: Columbia Gas Transmission and Transcontinental Gas Pipeline. SJG maintains a number of firm transportation and storage contracts with both Columbia and Transco.
7. SJG has recently entered into an agreement with Columbia Gas Transmission to significantly increase its firm transportation capacity entitlements, beginning in 2015. This agreement increases SJG's firm transportation capacity entitlements by 50 thousand Dths/day effective September 2015, and increases by increments of five thousand Dths/day each year until reaching 70 thousand Dths/day in 2019.
8. Third party marketers are active in SJG's service territory and this activity increased during the audit period. During 2011, third party marketers provided almost 27 million dekatherms of gas supply to residential, commercial and industrial SJG customers. This was a significant increase

over the 23.7 million dekatherms provided in 2009. SJG's retail marketer affiliate is a major, though not dominant, participant in this market.

9. SJG provides considerably less information on its website regarding New Jersey's Energy Choice program than the other three New Jersey natural gas LDCs. SJG's website has only a short description of the program and does not provide guidance on how a customer could proceed to choose an alternative commodity supplier. Instead, SJG requires customers to fill out a form to request additional information.
10. SJG demonstrated a high degree of supplier diversity during the audit period. During each year of the audit period, SJG purchased gas from between twenty-one and thirty different suppliers.
11. During the audit period, SJG began utilizing an online auction to purchase its gas commodity. Suppliers interested in taking part in the auction are given access to a password-protected web portal dedicated to SJG procurement activities. These auctions allow each supplier to assess in real time if it is the low bidder, and if it is not, the supplier is allowed to bid again. With the exception of one contract that was awarded based on a single bid, the participation and bid data for these auctions indicate a strong degree of participation and competitiveness.
12. Savings resulting from the Conservation Incentive Program have been significant. With one exception, the capacity released as part of this program has been made at the maximum tariff rate.
13. In an effort to maximize the value of its capacity entitlements, SJG has begun to utilize South Jersey Resources Group (SJRG) as its asset manager to market 90 thousand Dths/day of SJG's firm transportation capacity off of Transco's pipeline. SJRG was chosen after a competitive bidding process.
14. SJG's Off-System Sales and Capacity Release transactions are large, but these programs do not have a significant impact on SJG's operating income.
15. The only affiliate that SJG conducted Off-System Sales and/or Capacity Release transactions with during the audit period was SJRG. SJG's position as a major supplier of both pipeline capacity and gas commodity to SJRG presents incentives for SJG to maintain a larger portfolio of gas supply assets than is necessary for the regulated utility.
16. In September 2010, the Company was fined $950 thousand and forced to return $120 thousand in "unjust profits" for FERC rules violations conducted by SJG and SJRG. SJG's efforts to implement enhanced controls to prevent further FERC violations appear adequate, but the effectiveness of these controls has not been tested.

Hedging-Related Findings

1. Although SJG's hedging program generally seems to be adequately designed, we found that the programs lack defined performance goals, and, in some cases, are insufficiently documented.
2. The amount of gas hedged under SJG's non-discretionary hedging strategy has fallen short of the Company's stated objective of approximately 20% of SJG's estimated annual commodity requirement. During the three completed BGSS years we reviewed, the average percentage of estimated gas supplies hedged using this strategy was only 13.8%.

3. SJG's non-discretionary hedging strategy is being executed in a discretionary manner. This has resulted in multiple instances during the audit period where the Company was non-compliant with the guidelines for this strategy.
4. Hedging decisions made by management as part of SJG's discretionary hedging strategy do not follow any formal procedures nor is the rationale for these decisions formally documented.
5. Attempts to reduce the cost of supplies previously hedged (known as "secondary transactions") were not adequately considered during the audit period.
6. The "time-averaging" method SJG currently utilizes in its non-discretionary, programmatic hedging program is superior to other possible methods.

Recommendations

1. SJG should develop, and make available on its website, a comprehensive manual that could be downloaded by third party marketers interested in providing service to customers in SJG's service territory.
2. SJG should enhance the information available to customers on its website regarding third-party supplier options. This would include consumer protection information as well as specific guidance on how a customer could switch suppliers.
3. When conducting online auctions to enter into wholesale natural gas contracts, SJG should require a minimum of two bidders before awarding the contract to an affiliate.
4. Regarding the additional controls implemented by the Company in response to the 2010 FERC investigation, SJI Internal Audit should perform a comprehensive review of these additional compliance measures implemented by the Company, and it should regularly test compliance with these controls every three years or more frequently if significant changes are implemented.
5. The Company should annually file its FERC Compliance Manual with the NJ BPU, illustrating any changes from the previous compliance manual.

Hedging-Related Recommendations

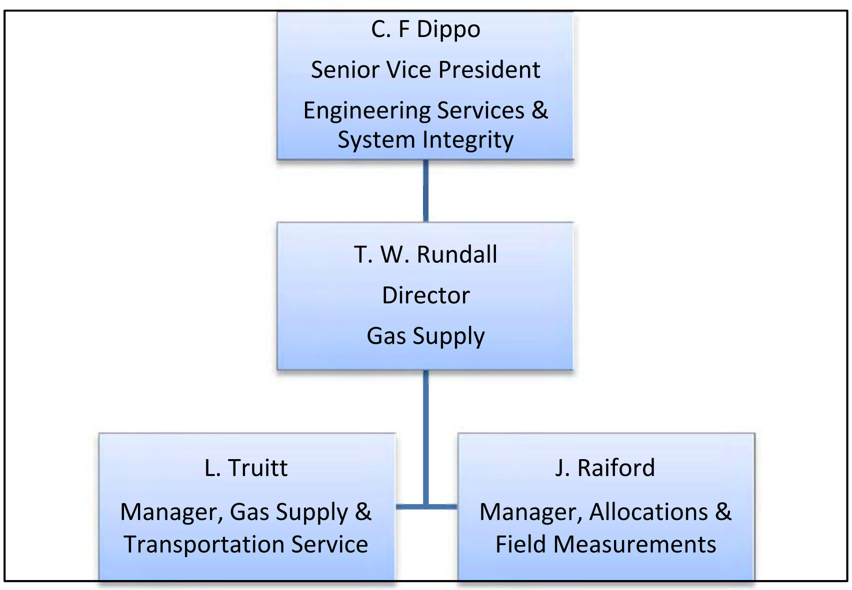
1. SJG should adhere to the established protocol of its non-discretionary hedging strategy. Specifically, SJG should remove the discretionary element of this program and it should increase the amount of supply that it hedges using this strategy so that it can hedge an amount closer to its stated goal of 20% of its supply requirements.
2. SJG should establish written performance expectations for its hedging program. These performance expectations should be compared to actual results to evaluate how well SJG's hedging strategies have performed, and they should be reviewed by SJG's Risk Management Committee on an annual basis.
3. SJG should establish documentation requirements for its discretionary hedging program. At a minimum, these documentation requirements should fully explain the Company's basis for entering into the hedge.

4. SJG should consider significantly scaling down, or potentially even de-activating, its discretionary hedging program and utilizing alternative hedging strategies to achieve an adequate level of hedged gas supply.
5. SJG management should regularly consider the criteria for secondary transactions. This consideration should be formally documented and reviewed regularly by SJG's Risk Management Committee at its quarterly meetings.
6. SJG's Risk Management Committee should perform sensitivity and benchmarking analyses to test the effectiveness of its hedging program. These analyses should determine both how well SJG's hedging program has been executed, as well as how well it has been designed.

Organization

SJG's Gas Supply Department (GSD) is located in McKee City, NJ and it is the department primarily responsible for making gas procurement decisions. The GSD is headed by the Director of Gas Supply (GSD Director) who reports to the Senior Vice President of Engineering Services and System Integrity. In addition to the GSD Director, the GSD includes two managers, two natural gas traders, two supervisors (one of which is and has been vacant), three analysts and one scheduler. An abridged organization chart of the GSD is provided below.[1]

Table 11-1 – SJG Gas Supply Organization Chart



[1] Source: Response to Discovery, OC-470.

Global Settlement

In 2006 SJG entered into a Global Settlement (GS) with the NJ BPU and the Ratepayer Advocate. This settlement decided many key gas procurement/capacity planning matters that had been brought before the BPU under various dockets. These issues included SJG's participation in a pipeline expansion project, recovery of fixed capacity costs, and it also established a storage incentive mechanism. In order to put SJG's gas procurement issues in appropriate context, we have briefly described the concerns and resolutions from this proceeding below.[2]

- Transco Central New Jersey Expansion Project
  - SJG was allowed to participate in a pipeline expansion project and recover the related demand charges.
- Allocation and Recovery of Fixed Capacity Costs
  - The GS resolved all outstanding issues related to the proper allocation and recovery of fixed capacity costs of the Company's design day resources as they existed as of the execution of the GS.
- Reduction of Monthly BGSS Threshold
  - The BGSS threshold was lowered to include additional commercial customers.
- Criteria for Capacity Planning
  - SJG was directed to include in its calculation of demand requirements the design day volumes associated with customers served under all sales rate schedules and transportation customers served under certain rate schedules. SJG was further directed to exclude any transportation customers that choose an "opt-out" provision that essentially eliminates SJG's supplier-of-last-resort obligations to these customers.
- Storage Incentive Mechanism
  - The GS established a Storage Incentive Mechanism (SIM) that allowed for storage-related gains and losses, as measured by SJG's actual storage costs incurred versus a benchmark, to be split on an 80/20 percentage basis between customers and SJG.

Demand and Supply Forecasts

Demand Forecasts

Each year, SJG's utility sendout requirement projections (and other associated and relevant data) are developed by its Financial Planning Department (FPD). This data is set apart by revenue classification, for each day of a projected ten year period. The revenue classifications are then combined, by the FPD, to produce a resultant total utility sendout, by day, for the ten year period. This total daily sendout forecast is offered under both normal and design winter weather conditions. SJG's GSD then enters these approximate 3,650 data points into its SENDOUT model along with its available gas supplies and capacity entitlements to meet same. The model is then run which yields an optimal daily use of the Company's portfolio of assets to meet the projected sendout. The GSD then summarizes the results of

[2] Response to Discovery, OC-161, Att. B.

the run in to design day, seasonal (winter / summer) and BGSS year time periods. This forecast is generally presented to the Risk Management Committee at its 3rd quarter meeting. On a semi-annual basis, a five-year forecast of requirements and capacity entitlements is developed and filed with the NJ BPU.[3]

The demand component of these forecasts is based on a methodology that was developed by an outside consultant in the 2007-08 timeframe. In developing its methodology, SJG's consultant reviewed various sources of data, including daily sales data, weather data (specifically, daily heating degree days) and daily utility sendout. Actual historical utility sendout was used to develop a multivariate linear regression analysis on SJG's firm requirements for heating and non-heating customers in the residential, commercial and industrial sectors.[4] This analysis ultimately showed that current day heating degree days and the prior day heating degree days (HDDs) were the most predictive variables for utility sendout and these two factors were used as the independent variables in the regression equation. In 2008 this methodology was refined to utilize the *change* in the current day HDDs from the prior day HDDs (instead of the prior day HDDs) as an independent variable along with the current day HDDs. This removed the multicollinearity between the current day HDDs and the prior day HDDs.[5] Ultimately, the consultant used its regression analysis, as well as growth factors developed from annual sales forecasts, to provide SJG with a ten-year demand forecast under normal and design weather conditions. Daily normal weather was constructed using the HDDs for the past 20 years. Although this normal weather data is intended to be a 20 year rolling average, from 2009 through 2011 the Company failed to update this data, and instead continued to use the same historical period (1988 through 2007) for the 2009, 2010 and 2011 ten-year forecasts.[6,7] Design year weather used the weather patterns experienced in 1969, with an assumed January 19th design day of 63 HDDs. The methodology employed by SJG's consultant appeared reasonable. Additionally, the predictive power of the regression equation (as measured through the R-Square metric) and the statistical significance of the independent variables (as measured by the t-statistic metric) were noted in the consultant report as being "very strong."[8]

SJG's Degree Days (Normal Weather) and Sendout forecasts for 2010 utilizing this methodology are illustrated in the chart below. As would be expected given the methodology described above, the forecasted sendout is heavily dependent on the projected HDDs during the month.

[3] Response to Discovery, OC-175.

[4] The consultant report noted that other model structures were considered, including exponential, polynomial and power functions, but that none of these other models provided enhanced predictive power relative to a linear regression. Through our review of a scatter plot illustrating the relationship between daily sendout and heating degree days, we concur that a strong linear relationship between these two variables is clearly evident. Response to Discovery, OC-224.

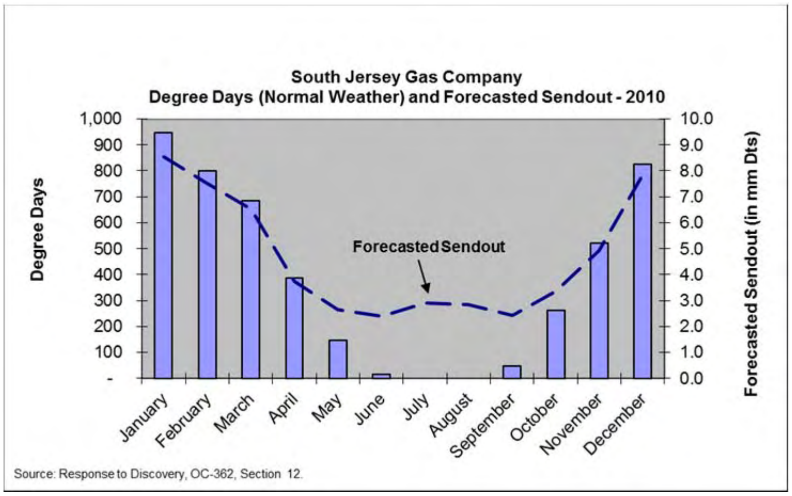
[5] "Multicollinearity" occurs when the independent variables in a regression equation are highly correlated. High correlation among the independent variables can cause the regression equation to appear more predictive than is justified.

[6] The ten-year forecast for 2012 utilized the properly updated 20-year average. Response to Discovery, OC-384.

[7] According to Response to Discovery, OC-776, the weather inputs for the 10 year forecast, which were incorrectly held constant in the 2009-2011 reports, had no gas procurement implications or cost related impact.

[8] Response to Discovery, OC-224.

Table 11-2 – SJG Degree Days (Normal Weather) and Forecasted Sendout - 2010



The most recent design day forecasts provided in discovery, estimates design day requirements increasing from 476,462 for the 2012-2013 winter season to 522,235 for the 2021-2022 winter season (a compound annual growth rate of 1.02%). As described in additional detail in the "Interstate Pipeline Transportation" section of this Chapter, SJG has entered into an agreement with Columbia to provide for substantially more capacity in the near future.

Supply Optimization

In order to determine the best use of the Company's gas supply portfolio in meeting the projected sendout, the Company utilizes a portfolio optimization software program that it has employed for over a decade called "SENDOUT." SENDOUT is used for gas supply planning purposes and its output reports are the primary source documents for SJG's ten-year, five-year and design-day forecasts.[9]

The GSD also reviews the demand forecasts on a daily basis. From Monday through Thursday a "game plan" report is produced that estimates the forecasted sendout behind SJG's city gate for the next day. Three daily game plan reports are produced on Friday for the next three days (Saturday through Monday). The GSD reviews these game plans to determine the base load volumes, delivered purchases, peaking supplies, storage withdrawals and injections.[10] The GSD arranges for delivery to customers on a daily basis through the nomination process wherein supplies are nominated from/to applicable receipt and delivery points. The GSD generally tries to minimize pipeline imbalances by communicating with counterparties and the pipelines and making necessary adjustments. When an imbalance does occur, the GSD tries to eliminate the imbalance by "paying back" the imbalance to the pipeline. In the event that imbalances are not paid back during the month, the GSD attempts to trade the imbalance through the pipeline's Electronic Bulletin Board. If this does not clear the imbalance it is cashed out in accordance with the pipeline's tariff provisions.

[9] Response to Discovery, OC-175.
[10] Response to Discovery, OC-177.

Overland reviewed the imbalance charges incurred by SJG during the audit period and these charges are summarized below.

Table 11-3 - Pipeline Imbalance Due to / (Due from) Pipeline

South Jersey Gas Pipeline Imbalance Due to / (Due from) Pipeline		
Year	Dts	Costs
2011	(23,820)	($42,822)
2010	107,406	$1,030,972
2009	(8,901)	($39,800)
Source: Response to Discovery, OC-379		

As can be seen in the above table, in two of the three years during this period (2009 and 2011) the imbalance charges were relatively insignificant amounts paid from the pipeline to SJG. In 2010, however, SJG incurred over $1 million in imbalance charges. Upon additional discussions with the Company, Overland found that almost all of these charges were incurred in February 2010. After further investigation, we determined that these charges were a function of significant price volatility in the natural gas market, not imprudence or negligence by SJG. Specifically, during January 2010 the non-New York Gas Daily price per dekatherm ranged from $6.01 to $13.55. SJG incurred the imbalance charges in an effort to avoid over buying at higher prices by drawing on available imbalances.[11]

Impact of Energy Efficiency Programs on Demand Forecasts

SJG's current energy efficiency programs have significantly reduced SJG's projected demand day forecasted requirements. In the original design day forecasts Overland was provided, SJG's forecast showed an increase between the 2012-2013 design day and the 2020-2021 design day of 14.6%, representing a 1.7% compound annual growth rate (CAGR).[12] However, Overland was provided a subsequent response in Discovery that incorporated the effects of the energy efficiency programs.

The Company's updated design day forecasts (incorporating the impact of the energy efficiency programs) shows an increase in design day requirements in the 2012-2013 winter season to the 2020-2021 winter season of only 8.5% over the period (versus 14.6% in the original analysis), representing a CAGR of just over 1% (versus a CAGR of 1.7% in the original analysis).

Interstate Pipeline Transportation

SJG receives its natural gas supplies through direct connections to two interstate pipelines: Columbia Gas Transmission (Columbia) and Transcontinental Gas Pipeline (Transco).

[11] Response to Discovery, OC-768.
[12] Response to Discovery, OC-187, Attachment A.

SJG maintains a number of firm transportation (FT) and storage contracts with both Columbia and Transco. As illustrated in the table below, SJG's FT and storage agreements with Columbia and Transco, along with the capacity available from SJG's on-system LNG facility, provide almost 70% of the Company's design day sendout of 476 thousand dekatherms.

Table 11-4 - SJG Design Day Requirements and Supplies[13]

South Jersey Gas 2012-2013 Design Day Requirements and Entitlements		
Source	**Dths**	**% of Total Design Day Requirements**
Design Day Demand		
Design Day Sales Forecast	476,462	
Firm Transportation		
Transco	110,160	
Columbia	39,308	
Total Firm Transportation	149,468	31%
Underground Storage		
Transco	72,584	
Columbia	33,862	
Total Underground Storage	106,446	22%
LNG		
Company LNG	75,000	16%
Subtotal		69%
Company Sources		
City Gate Supplies - Transco	20,000	
Peaking Service	25,000	
Total Company Sources	45,000	9%
Other	105,000	22%
Total Design Day Entitlements(1)	**480,914**	**101%**
Note1: "Design Day Entitlements" include city-gate deliveries made on a secondary basis. Source: Response to Discovery, OC-649, Attachment F.		

SJG's FT and storage arrangements with Transco and Columbia are further described below.

Transco

Transco is SJG's largest provider of gas transmission services. SJG maintains agreements with Transco to provide both main line long-haul FT services, as well as market area FT services. The long-haul FT services provide for the transportation of gas from production areas in the southwest region of the United States to SJG. Market area FT services provide for the transportation of gas from Transco's Leidy Line to SJG's service territory.[14] One long-haul FT service agreement (contract number 1005003) is seasonal and extends only for the 90 day period from December 1 through February 28.

[13] The "101%" total in Table 11-4 is calculated as follows: Design Day Entitlements / Design Day Requirements = 480,914 Dths / 476,462 Dths = 101%.

[14] Transco's "Leidy Line" is a connection between Transco's mainline and storage facilities in Leidy, PA.

Table 11-5 - SJG Firm Transportation Entitlements - Transco

South Jersey Gas SJG Firm Transportation Entitlements - Transco				
Pipeline	**Contract Nbr.**	**Rate Schedule**	**Days Available**	**MDQ Dths/Day**
Transco	1003902	FT	365	128,651
	1002231	FT	365	2,264
	1005003	PSFT	90	3,002
	1013599	FT (Leidy Line)	365	41,608
Total				**175,525**
Transco FT Capacity Released as part of CIP				**65,365**
Net FT Services Available				**110,160**
Source: Response to Discovery, OC-362, Section 4 and Section 14.				

SJG maintains multiple storage agreements with Transco, under various rate schedules described below:[15]

- GSS (General Storage Service) - Firm storage service available on a daily basis throughout the year.
- S-2 and SS-2 – Storage services with limited periods for withdrawal.
- LSS (Leidy Storage Service) –This is a firm market area storage service with limited periods for withdrawal.
- LNG – Storage service that utilizes natural gas that is liquefied and injected into storage.

In total, the Transco firm storage supply available for SJG's peak-day demand is roughly 73 thousand dekatherms. The breakdown by rate schedule is provided in the table below.

[15] All storage services listed are incremental to the FT services provided by Transco.

Table 11-6 - SJG Storage Services - Transco

South Jersey Gas SJG Storage Services - Transco				
Pipeline	**Contract Nbr.**	**Rate Schedule**	**Withdrawal Period**	**MDQ Dths/Day**
Transco	1000813	GSS	(A)	27,314
	1003971	SS-2	November 1 through March 31	16,043
	9014431	LNG	November 1 through March 31	15,670
	1000818	LSS	November 1 through March 31	12,000
	1000814	S-2	November 16 through February 16	1,557
Storage Services Available From Transco				**72,584**
NoteA: There are no seasonal restrictions for the GSS.				
Source: Response to Discovery, OC-362, Section 4 and Section 14.				

Columbia

SJG maintains both a firm transportation service (FTS) and a No-Notice Firm Transportation Service (NTS) contract with Columbia. The FTS contracts provide transportation services 365 days/year from primary receipt points in Kentucky and New York with firm delivery to SJG's city gate. Transportation capacity under the NTS contract is also available 365 days/year. The NTS contract also allows for SJG, in an emergency situation where gas supplies suddenly become unavailable, to obtain gas supplies from Columbia, up to a two-day maximum of 45 thousand Dekatherms. These supplies must be paid back to Columbia prior to the end of the next calendar month. As with its available capacity on Transco, SJG has also released a significant amount of its capacity with Columbia. SJG's available transportation capacity with Columbia is shown in the table below.

Table 11-7 - SJG Firm Transportation Entitlements - Columbia

South Jersey Gas SJG Firm Transportation Entitlements - Columbia				
Pipeline	**Contract Nbr.**	**Rate Schedule**	**Days Available**	**MDQ Dths/Day**
Columbia	39305	NTS	365	22,511
	38099	FTS	365	22,511
	28769	FTS	365	9,000
Total				**54,022**
Columbia FT Capacity Released as part of CIP				**14,714**
Net FT Services Available				**39,308**
Source: Response to Discovery, OC-362, Section 4 and Section 14.				

SJG subscribes to firm storage service from Columbia that provides a MDQ withdrawal of 52,891 Dths/day. Roughly 35% (19 thousand Dths/day) has been released as part of the CIP.

Table 11-8 - SJG Storage Services - Columbia

South Jersey Gas SJG Storage Services - Columbia				
Pipeline	**Contract Nbr.**	**Rate Schedule**	**Nbr. Of Days of Max Withdrawal**	**MDQ Dths/Day**
Columbia	53000	FSS	46	52,891
Total				**52,891**
Columbia Storage Released as part of CIP				**19,029**
Net Storage Services Available				**33,862**
Source: Response to Discovery, OC-362, Section 4 and Section 14.				

East Side Expansion Project

In October 2012 SJG entered into an agreement with Columbia as part of the East Side Expansion Project (ESEP) that provides additional firm transportation capacity. This agreement increases SJG's firm transportation capacity entitlements by 50 thousand Dths/day effective September 2015, and increases by five thousand Dths/day each year until reaching 70 thousand Dths/day in 2019.[16] In Discovery, SJG provided analysis demonstrating that the ESEP was the lowest cost alternative to acquiring additional pipeline capacity. As illustrated in the charts below, without the ESEP SJG would be forced to rely increasingly on purchasing city gate supplies in the secondary market.

[16] Response to Discovery, OC-649, Narrative Response.

Table 11-9 - Design Day Resource Projections - with ESEP[17]

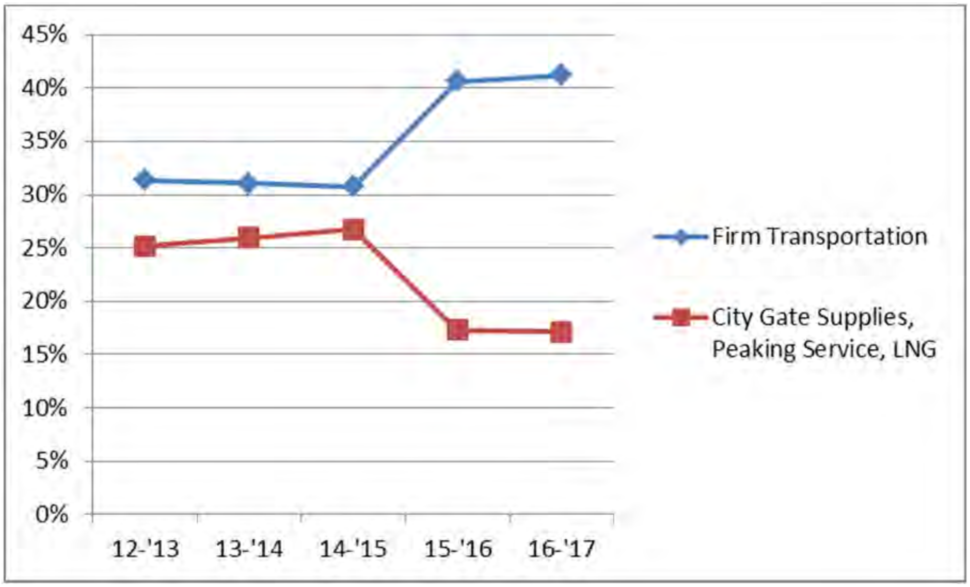
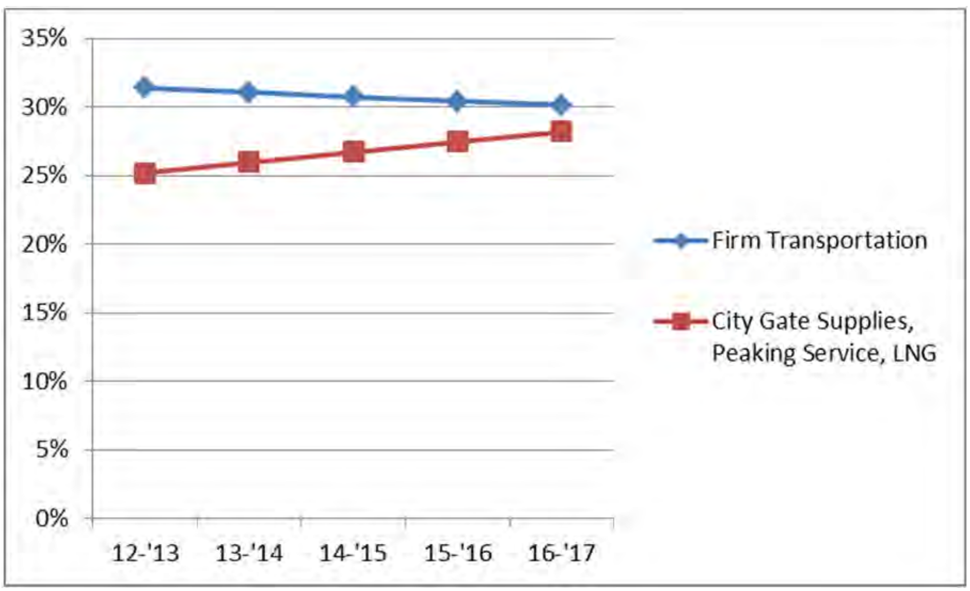


Table 11-10 - Design Day Resource Projections - without ESEP[18]



[17] Source: Response to Discovery, OC-649, Attachment H.
[18] Source: Response to Discovery, OC-649, Attachment D.

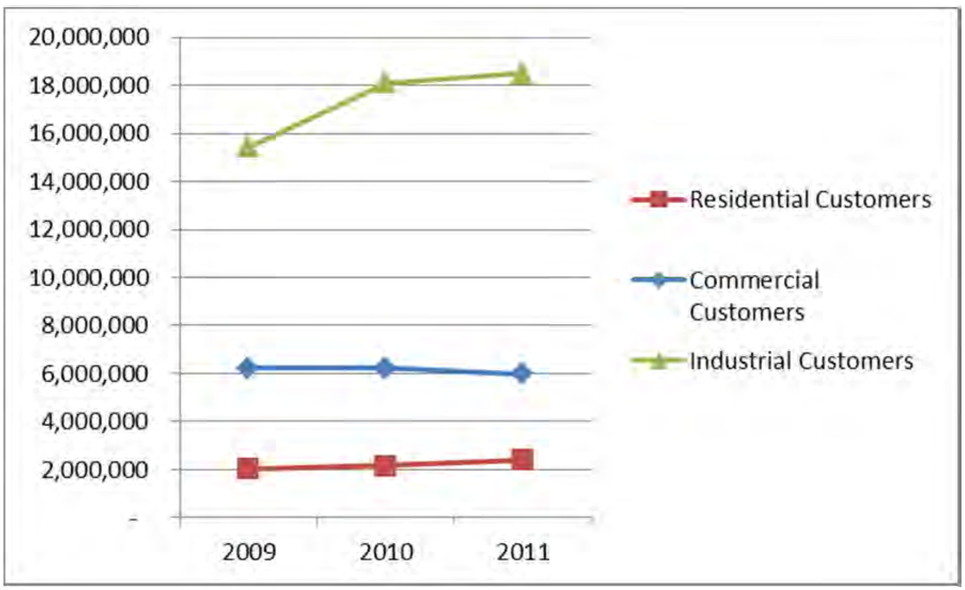
Third Party Suppliers

Competitiveness of Market

As a result of energy restructuring legislation (particularly the 1999 Electric Discount and Energy Competition Act), all classes of natural gas customers in New Jersey have the option of choosing their natural gas supplier.

Third party suppliers are active in each customer class of SJG's service territory. During 2011, third party marketers provided almost 27 million dekatherms of gas supply to residential, commercial and industrial SJG customers. This was a substantial increase over the 23.7 million dekatherms provided in 2009.[19] As seen in the chart below, commercial and residential third party marketer activity stayed relatively flat during this time period, but third party marketer activity for industrial activity increased significantly.

Table 11-11 - Supply Provided by Third Party Marketers (in Dths)[20]



South Jersey Energy (SJE), the Gas Company's gas marketer affiliate, is a major, though not dominant, participant in this market. Third party marketer activity in SJG's service territory is dispersed among a large number of marketers. In December 2011, 23 different third party suppliers provided supply to roughly 36 thousand customers in SJG's service territory. The number of customers served by each marketer ranged from a single customer to over 12 thousand.[21,22] As illustrated below, SJE's market

[19] Response to Discovery, OC-158.

[20] Source: Response to Discovery, OC-158.

[21] In terms of customers served, SJE ranked sixth out of 23 marketers active in SGJ's service territory in December 2011. Response to Discovery, OC-377, "Customer Count Report."

[22] There were no complaints or allegations made by other third party marketers regarding discriminatory or predatory practices during the audit period. Response to Discovery, OC-122.

share in terms of customers decreased in each year of the audit period, and SJE's market share in terms of quantity supplied stayed within a rather narrow range of +/10% during the audit period for all customer classes.[23,24]

Table 11-12 - Customers Served by SJE and Other Third Party Marketers in SJG's Service Territory

South Jersey Energy Customers Served By SJE and Other Third Party Marketers(1)			
2011			
Customer Class	**Total Number of Customers Served By 3rd Party Suppliers**	**Total Number of Customers Served By SJE**	**SJE Market Share**
Residential	32,210	-	0.0%
Commercial	3,820	509	13.3%
Industrial	93	29	31.2%
2010			
Customer Class	**Total Number of Customers Served By 3rd Party Suppliers**	**Total Number of Customers Served By SJE**	**SJE Market Share**
Residential	29,325	7,495	25.6%
Commercial	3,834	543	14.2%
Industrial	88	30	34.1%
2009			
Customer Class	**Total Number of Customers Served By 3rd Party Suppliers**	**Total Number of Customers Served By SJE**	**SJE Market Share**
Residential	25,210	8,987	35.6%
Commercial	3,546	575	16.2%
Industrial	92	33	35.9%
Note1: Customer Data as of year-end 2011, 2010 and 2009. Sources: SJG 2011 10-K, pg. 17; Response to Discovery, OC-158.			

[23] As noted in SJI's 2011 10-K filing, SJE exited the market for residential gas customers in October 2011. The Company stated in Discovery that SJE decided to stop serving residential gas customers because it could not provide a competitive price to residential customers. Response to Discovery, OC-259.

[24] The customer data in Table 11-12 has been provided at a point in time (i.e., customers in the residential, commercial and industrial classes as of December 31, 2011, 2010 and 2009). The customer data in Table 11-13 has been provided as activity during the year (i.e., supply provided to residential, commercial and industrial customer classes during 2011, 2010 and 2009). For example, since SJE exited the residential gas market in 2011, it had zero residential customers as of year-end 2011 (as reflected in Table 11-12). However, since SJE did not exit the residential market until October 2011, it still served residential customers until this time (as reflected in Table 11-13).

Table 11-13 - Percentage of Third Party Supply Provided by SJE and Other Third Party Marketers

South Jersey Energy Percentage of Third Party Supply Provided by SJE and Other Third Party Marketers - By Customer Class			
Residential			
	2011	**2010**	**2009**
SJE	17%	31%	29%
Other	83%	69%	71%
Total	100%	100%	100%
Commercial			
	2011	**2010**	**2009**
SJE	15%	19%	17%
Other	85%	81%	83%
Total	100%	100%	100%
Industrial			
	2011	**2010**	**2009**
SJE	32%	39%	29%
Other	68%	61%	71%
Total	100%	100%	100%
Source: Response to Discovery, OC-158			

Supplier and Customer Communications

Third Party Marketer Communications

Support for third party marketers is provided by SJG's Gas Supply and Transportation Services Department. The Gas Supply and Transportation Services Department is comprised of one manager, one supervisor and two analysts.[25] SJG maintains a "Third Party Supplier Support" section of its web page. Overland reviewed SJG's web page as well as the comparable web pages for the other three New Jersey LDCs. We found that SJG could improve its communications with gas marketers by developing a comprehensive third party supplier manual that could be downloaded from SJG's website. This type of manual is provided by other New Jersey LDCs,[26] and we believe it would help facilitate the entry of interested gas marketers by providing a comprehensive resource that includes instructions on requirements to enroll, billing options, etc.

Customer Communications

SJG's website provides considerably less information to its customers regarding New Jersey's Energy Choice program than the other three New Jersey natural gas LDCs. SJG's website has only a short description of the NJ Energy Choice program and provides very limited guidance on how a customer could proceed to choose an alternative commodity supplier. Instead, SJG requires customers to fill out a form to be provided additional information. SJG should enhance the information that it makes available on its website regarding customer choice. This should include a step-by-step guide on how a customer

[25] Response to Discovery, OC-470, Att. A.
[26] As an example, please see: http://www.njng.com/pdf/3rd%20party%20supplier%20hand%20book.pdf.

could switch suppliers. It should also include information to help protect consumers from unlawful manipulation by third-party marketers, such as slamming.[27]

Customer Billing

On May 29, 2013 the NJ BPU issued an Order that alters the procedures that SJG must follow when billing customers who choose to use third party suppliers (TPS).[28] In this Order, the Board addressed the Utility Consolidated Billing (UCB) and Purchase of Receivables (POR) mechanisms in place at New Jersey electric distribution companies and gas distribution companies. Under UCB, the gas/electric distribution company bills a customer for the charges related to distribution as well as charges related to the commodity that the customer purchased from a third party supplier. POR is a mechanism wherein the utility assumes the receivables of the third party supplier. As described on page 3 of the Order:

> *When a utility provides utility consolidated billing with POR, the utility assumes the [Third Party Supplier's] account receivables associated with the bill; that is, the utility pays the [Third Party Supplier] for the supply portion of the bill regardless of when, or how much, the customer pays."*

The Order further explains that the utility companies may cease providing consolidated billing and move the customer to dual billing under certain circumstances (such as an overdue account balance). Board Staff made several recommendations regarding the UCB/POR mechanisms that impact SJG. The Board ultimately Ordered SJG to expand its UCB/POR program to include small and mid-sized commercial customers (those under SJG's GSG and GSG-LV rate classifications). Prior to the Board Order, SJG offered UCB without POR to these customer classes. This change will likely increase the ability for third party suppliers to attract SJG's commercial customers. The Order also modified the utility's ability to refuse to offer UCB to customers not deemed to be creditworthy. Prior to the Board Order, SJG (and the other New Jersey gas and electric distribution companies) could refuse to offer UCB/POR to a customer for an entire year if that customer temporarily fell behind in his or her payments. Board Staff recommended, and the Board ultimately agreed, that this restriction was too onerous. The Board ordered that New Jersey customers who bring their accounts to the point where they are not more than 60 days in arrears should be eligible for the utilities' UCB/POR programs. In addition to these issues, the Board Order also addressed the timing of payments from utilities to third party suppliers, reporting requirements from utilities to third party suppliers and the fees that the utilities may charge third party suppliers.

Gas Commodity Procurement

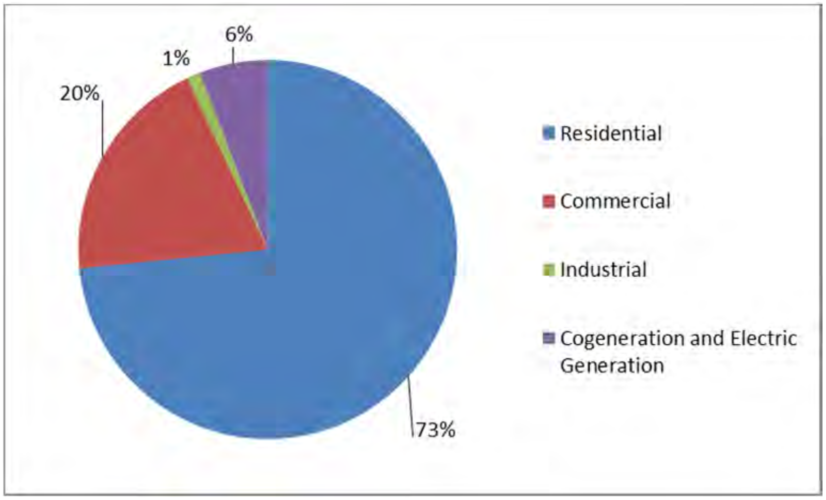
In 2011, SJG purchased and delivered approximately 37.7 million dekatherms of natural gas to its customers. Of this amount, roughly 27.7 million was for firm customers, mostly to residential and

[27] "Slamming" occurs when a natural gas customer is switched to another natural gas supplier without the customer's permission.

[28] BPU Docket Number E013030236.

commercial customers. The chart below shows the gas supplied to the different customer categories in 2011.[29]

Table 11-14 - Firm Sales by Customer Category



SJG demonstrated a high degree of supplier diversity during the audit period. In 2009, 2010 and 2011 SJG purchased natural gas from thirty, twenty-one and twenty-five suppliers, respectively. In no year did the purchases from any one supplier exceed 21%. The top five suppliers for each year of the audit period are provided below.

[29] Source: 2011 SJG 10-K, pg. 16.

Table 11-15 - Top Five Suppliers of Natural Gas Commodity to SJG[30]

South Jersey Gas Top 5 Suppliers of Natural Gas to SJG		
2009		
Name of Supplier	**Dths Sold to SJG**	**% of Total**
SJRG	6,526,141	19%
Tenasaka	3,482,024	10%
Macquarie Cook	3,266,390	9%
ConocoPhillips	2,864,319	8%
Louis Dreyfus	2,700,010	8%
2010		
Name of Supplier	**Dths Sold to SJG**	**% of Total**
ConocoPhillips	7,392,973	21%
Macquarie Energy	5,648,839	16%
Tenasaka	4,519,547	13%
VPEM	3,033,447	9%
Enterprise	2,660,815	8%
2011		
Name of Supplier	**Dths Sold to SJG**	**% of Total**
SJRG	7,086,265	19%
Chevron	4,191,439	11%
ConocoPhillips	4,114,572	11%
Shell	2,962,692	8%
Tenasaka	2,830,508	8%
Source: Table obtained from OC-124.		

In November 2009, the Company began utilizing an online auction platform administered by World Energy Solutions (World Energy) to purchase its gas commodity. This process begins with SJG providing World Energy with relevant information such as the quantity required, the term of the contract, the delivery point, etc. With this information, World Energy develops and distributes a Request for Proposals (RFP) that is then circulated to the Company's suppliers. Suppliers interested in taking part in the auction are then given access to a password-protected web portal dedicated to SJG procurement activities. The auction takes place over this web portal. This auction platform allows each supplier to assess in real time if it is the low bidder, and if not, it can bid again. The results of each of the auctions performed during the audit period are detailed below.

[30] In 2010 SJRG was the seventh largest supplier of gas commodity to SJG, providing 2.2 mm Dths (6.3% of total). Derived from Response to Discovery, OC-124, Att. B.

Table 11-16 – Energy Auction Results 2009 through 2011

[Begin Confidential]

World Energy Auction Results					
Auction Date	RFP Nbr.	Best Bidder	Volume Awarded (in Dth/d)	Nbr. of Bids	Nbr. of Bidders
		2009 Auction Results			
		2010 Auction Results			
		2011 Auction Results			

[End Confidential]

With an average of nine bidders per auction, the results of the auctions indicate that SJG has received good participation in its auctions. An average number of bids per auction of 16 correspond to roughly two bids per bidder, indicating a high degree of competitiveness amongst the bidders.

While the overall results of the World Energy auctions indicate a healthy degree of participation and competitiveness, the notable exception is the auction for RFP Number 7993 conducted on February 22, 2010 (highlighted in Table 11-16). Not only was this the only auction that had a single bidder with a single bid, but that single bid was from SJG's affiliate SJRG. This is particularly odd since on the same day SJG conducted five other auctions that received a minimum of seven bidders. When asked in Discovery what circumstances led to the auction for RFP Number 7993 only drawing one bidder, the Company stated that, "presumably" more sellers had the ability to provide delivery to the other delivery points.[31] While this is a plausible explanation, awarding a supply contract to an affiliate based on a single bid would not appear to be consistent, in fact or appearance, with the Company's desire to develop a "highly competitive environment" for suppliers through these auctions.[32] As such, we recommend that future SJG auctions conducted on the World Energy Platform require a minimum of two bidders to award a contract to an affiliate, including SJRG. Since every other auction listed included a minimum of six bidders, this should not be a major issue and it will help ensure the integrity of the auction process.

Off-System Sales and Capacity Release

Background

The stated objective of SJG's off-system sales and capacity release program (secondary market program) is to "appropriately maximize value from gas supply assets."[33] Gas supply assets include the gas commodity as well as pipeline capacity and storage capacity. The term "capacity release" refers to the surplus transportation pipeline capacity that is sold to third parties. These sales help SJG offset the demand charges SJG must pay for its firm capacity. The term "off-system sales" are sales of the gas commodity bundled with the pipeline capacity.

Conservation Incentive Program

In December 2005, SJG made filings with the NJ BPU to implement a mechanism that would separate revenue recovery from usage. In October 2006, a settlement was approved by the NJ BPU that established the Conservation Incentive Program (CIP) as a 3-year pilot program.[34] As part of the 2006 CIP settlement, SJG began a series of transactions that included transportation capacity releases and storage capacity releases. Capacity release transactions and related savings during the 2009-2011 time period are noted below.

[31] Response to Discovery, OC-770.
[32] Response to Discovery, OC-190.
[33] Response to Discovery, OC-362, Section 13.
[34] This program has since been extended to run through 2014.

Table 11-17 - CIP Release and Annualized Savings – 2009 through 2011

South Jersey Gas CIP Release and Annualized Savings				
Year	**Pipeline**	**Type of Service**	**Quantity**	**Annualized Savings (in millions)**
2010	Transco	Transportation	59,600	$2.4
2009	Transco	Storage	11,680	1.0
2009	Columbia	Transportation	14,714	1.0
2009	Columbia	Storage	19,029	1.7
2009	Columbia Gulf	Transportation	45,985	1.7
Sources: Response to Discovery, OC-362, Section 5.				

While a significant amount of capacity has been released through SJG's CIP, the Company's secondary market transactions, as discussed in more detail in the "Off-System Sales and Capacity Release Program" section below, remain substantial.[35]

Asset Management Agreement

In 2010, SJG determined that a portion of its firm transportation would benefit from being overseen by an asset manager more active in the Marcellus Shale. In November of that year SJG issued an RFP for parties interested in managing 90 thousand Dths/day of SJG's firm transportation capacity off of Transco's pipeline from December 1, 2010 through October 31, 2013. SJG received proposals from National Energy & Trade, LP and SJRG. Overland reviewed the two proposals received by SJG and found the terms to be comparable. SJG ultimately decided that SJRG's proposal had more "upside."[36] On the final day of December 2010, SJG entered into an asset management agreement with SJRG for a term extending from January 1, 2011 through November 30, 2013.

Off-System Sales and Capacity Release Program

Oversight and Procedures

The individual most directly responsible for SJG's Off-System Sales and Capacity Release program is the GSD Director. The "Essential Functions" noted in the job description for the GSD Director position includes many items related to maximizing the value of gas supply assets. The relevant responsibilities include:

- Plans, directs and supervises the activities of employees engaged in gas supply purchasing and off-system sales;
- Maximizes profits by utilizing available company pipeline capacity and gas supply or acquire additional supply;

[35] With one exception, the capacity releases have been made at the maximum tariff rate. One release of Transco long-haul capacity was released at less than the maximum tariff rate, resulting in costs in excess of bill credits of $602 thousand per year. Response to Discovery, OC-192.

[36] Response to Discovery, OC-154; Interview with Timothy Rundall, GSD Director, September 27, 2012.

- Oversees the acquisition and sale of natural gas in the interstate marketplace and pipeline capacity release.

Decisions regarding off-system sales and capacity release opportunities are determined on an annual, seasonal, monthly and daily basis. A budget for off-system sales is prepared on an annual basis by the Vice President, Engineering Services and System Integrity and the GSD Director. On a seasonal basis SJG determines the extent that the Company can make available pipeline capacity and/or bundled off-system sales. These determinations are based on normal weather and anticipated transportation volumes. Additional review of off-system sales opportunities is performed on a monthly basis by the GSD Director. On a daily basis the GSD Director as well as SJG's natural gas traders review off-system sales and capacity release opportunities.[37]

As illustrated in the table below, SJG's off-system sales and capacity release program increased significantly as a percentage of utility throughput during the audit period.

Table 11-18 - Off-System Sales and Capacity Release Activity – 2009 through 2011

South Jersey Gas Off-System Sales and Capacity Release (in Dths)					
Year	Off-System Sales	Capacity Release	Combined Capacity Release and Off-System Sales	Utility Throughput	Capacity Release and Off-System Sales as a Percentage of Throughput
2011	8,009,031	63,413,159	71,422,190	128,130,000	56%
2010	6,033,717	46,278,361	52,312,078	110,815,000	47%
2009	6,281,493	38,386,795	44,668,288	98,667,000	45%
Sources: Response to Discovery, OC-183; 2011, 2010 and 2009 SJG 10-K filing.					

The contribution of this activity to the profitability of the utility was relatively insignificant, due, in part, to the sharing mechanism which returns the majority (85%) of profits from these activities back to the customer. As shown in the table below, the gross profit attributable to secondary market transactions represented less than 1% of the total for the utility in each year of our audit.

[37] Response to Discovery, OC-149, Section 13.

Table 11-19 - Financial Impact of Off-System Sales and Capacity Release Activity - 2009 through 2011

South Jersey Gas Off-System Sales and Capacity Release Financial Impact		
Year	**Gross Profit (in thousands)**	**% of Total Utility Gross Profit**
2011	1,829	0.91%
2010	1,258	0.68%
2009	1,416	0.84%
Sources: 2011, 2010 and 2009 SJG 10-K filing.		

SJG's Off-System Sales and Capacity Release Transactions with Affiliates

[Begin Confidential]

[End Confidential]

[38] Response to Discovery, OC-207.

Table 11-20 - Percentage of SJG's Off-System Sales to SJRG - Winter Months

[Begin Confidential]

Percentage of SJG's Off-System Sales to SJRG: Winter Months			
	2009	2010	2011

[End Confidential]

Table 11-21 - Percentage of SJG's Off-System Sales to SJRG - Non-Winter Months

[Begin Confidential]

Percentage of SJG's Off-System Sales to SJRG: Non-Winter Months			
	2009	2010	2011

[End Confidential]

Table 11-22 - Percentage of SJG's Capacity Releases to SJRG - Winter Months

[Begin Confidential]

Percentage of SJG's Capacity Release to SJRG: Winter Months			
	2009	2010	2011

[End Confidential]

Table 11-23 - Percentage of SJG's Capacity Releases to SJRG - Non-Winter Months

[Begin Confidential]

Percentage of SJG's Capacity Release to SJRG: Non-Winter Months			
	2009	2010	2011

[End Confidential]

[Begin Confidential]

[End Confidential]

[39] The issues regarding SJG's excess capacity have largely been addressed through previous proceedings. For example, the settlement for BPU Docket Number GR05060496 (the "Global Settlement" discussed in the previous section) resolved "all issues related to the proper allocation and recovery of the fixed capacity costs of design day resources from customers…" as of the execution date of the settlement. Response to Discovery, OC-161, Attachment B. As such, Overland has not made any independent recommendations regarding these transactions, but we have provided the above data for the informational purposes.

FERC Penalty

In February 2008, the Office of Enforcement of the FERC (Enforcement) opened an investigation into possible violations of SJG regarding certain capacity release transactions. After Enforcement began its investigation, SJG conducted an internal review wherein it discovered and self-reported to Enforcement other violations.

Ultimately, the Enforcement's investigation culminated in a September 2010 settlement between the Company and the FERC wherein SJI agreed to pay a fine of nearly $1 million dollars and return $120 thousand in unjust profits, with roughly three-quarters of the costs of the fine being allocated to SJG and the remainder being charged to SJRG.[40] This was a significant fine, especially for a company the size of SJI. To put this penalty into perspective, applying the same penalty as a percentage of market capitalization to Microsoft would result in a fine of roughly $160 million.[41,42]

As part of the settlement SJI agreed to make semi-annual compliance reports to Enforcement for a minimum of one year, with an extension possible if Enforcement deemed it necessary. Enforcement called SJG's cooperation with the investigation "exemplary."[43]

Three types of transgressions that SJG and/or SJRG engaged in during the period were identified by Enforcement. The relevant facts related to these violations are briefly described below.

VIOLATION 1 – FLIPPING TRANSACTIONS (SJG)

Rule Description – The Code of Federal Regulations (CFR) Title 18 Section 284.8(h) generally requires that firm capacity being released at a price less than the maximum tariff rate be competitively bid and posted on the pipeline's Electronic Bulletin Board. An exception to this rule is short-term capacity release for a term of less than or equal to 31 days.[44] Although this release is exempt from the FERC's competitive bidding requirement, any such release must be posted for informational purposes within 48 hours of its release. These requirements promote transparency in the natural gas market by ensuring that all interested shippers are provided notice of available capacity. These requirements are also intended to make the markets more efficient by requiring competitive bidding, thus ensuring that the capacity will go to the shipper that values it most.

Violation Description – Under 18 CFR 284.8(h)(2) a discounted, short-term release may not be extended in any way. Enforcement ultimately concluded that SJG improperly released 36.1 Bcf of capacity at less

[40] The majority of this penalty ($950 thousand) was paid directly to the United States Treasury. The remainder ($120 thousand) was paid to energy assistance programs. Response to Discovery, OC-164, FERC Settlement.

[41] ($1 million / SJI Market Capitalization)*Microsoft Market Capitalization.

[42] SJI and Microsoft market capitalization were estimated as $1.86 billion and $292 billion, respectively, based on data obtained from Capital IQ.

[43] Response to Discovery, OC-164.

[44] Three additional exemptions are: (i) releases to asset managers; (ii) releases for more than one year at maximum rate; (iii) releases to retail marketers pursuant to state-regulated retail access programs.

than the maximum tariff rate through "flipping transactions" between January 2005 and October 2007. Flipping is the term used to describe repeated short-term releases of capacity at less than the maximum tariff rate to two or more affiliated replacement shippers.[45] In effect, these types of transactions create a long-term capacity release at a discounted rate.

Financial Impact - SJG did not earn any unjust profits from these transactions.[46]

Company Response - In its formal settlement with the FERC, the Company neither admitted nor denied that it had violated 18 CFR 284.8.[47] However, in confidential correspondence between the Company's outside legal counsel and the FERC Staff, the Company argued, among other points, that the FERC's rules and preceding Orders did not clearly prohibit flipping.[48]

VIOLATION 2 – SHIPPER-MUST-HAVE-TITLE TRANSACTIONS (SJRG)

Rule Description – The FERC's Shipper-Must-Have-Title transactions are requirements that all shippers must have the title to the natural gas that it transports on pipelines. This is meant to prevent capacity holders from shipping gas owned by third parties and, in effect, circumvent the FERC's capacity release requirements, by providing unregulated transportation services.[49]

Violation Description – SJRG used another entity's transportation capacity to transfer approximately 1.6Bcf SJRG-titled gas.

Financial Impact – SJRG earned $32,760 in unjust profits from these transactions.

Company Response – The Company self-reported this violation and agreed with the Enforcement's conclusions.

VIOLATION 3 – PROHIBITED BUY/SELL TRANSACTIONS (SJG & SJRG)

Rule Description – The holder of transportation capacity on an interstate pipeline cannot enter into an agreement to buy gas from a counterparty, transport the gas for the counterparty, and then resell the gas to the same counterparty downstream.[50]

Violation Description – Between November 2005 and December 2007, SJG violated the buy/sell transactions restrictions by entering into ninety-six short-term purchases in which SJG took gas from a

[45] The term "affiliated" is meant to imply an affiliation between the replacement shippers, not an affiliation with SJG.

[46] Enforcement determined that no illicit profits were earned by SJG because the prevailing market rates for comparable capacity were generally higher than the rates charged to SJG's replacement shippers. Response to Discovery, OC-375, Att. A.

[47] Response to Discovery, OC-164.

[48] Response to Discovery, OC-375, Att. A.

[49] Response to Discovery, OC-375, Att. D.

[50] Response to Discovery, OC-375, Att. D.

receipt point on the Transco pipeline and delivered gas in equivalent volumes to the same counterparty at a downstream delivery point. The vast majority of these ninety-six transactions were conducted with SJG's affiliate SJRG.[51] Also, in July 2005 SJG entered into an agreement with a third party whereby it bought .5Bcf of natural gas at a Transco storage facility and agreed to deliver the same volume during the 2005-2006 winter season.

Financial Impact – SJG earned roughly $8 thousand in unjust profits from its transportation-related buy/sell transactions and $80 thousand in unjust profits from its storage-related buy/sell transactions.

Company Response – The Company self-reported this violation and agreed with the Enforcement's conclusions.

Remediation Efforts

The violations noted above were largely due to the members of SJG's Gas Supply Department being ill-informed and inadequately trained regarding compliance with the FERC's regulations. In an effort to prevent the recurrence of these violations, the Company has taken the following actions:[52]

- Amended or terminated all contracts in violation;
- Issued a memorandum stating that all releases of short term capacity at less than the max rate should be bid on the appropriate pipeline website;
- Appointed the SJI/SJG General Counsel as the FERC Compliance Officer responsible for SJG's FERC compliance. The FERC Compliance Officer reviews significant transactions to confirm compliance with the FERC's policies;
- Developed a FERC Compliance Manual that describes the FERC's rules and regulations and includes an annual certificate of acknowledgement that must be signed by relevant personnel;
- Implemented FERC compliance training programs that include new employee training and mandatory semi-annual training.

The Company satisfied the Enforcement's semi-annual compliance reporting requirements to a degree that Enforcement did not deem it necessary to extend these reporting requirements for an additional year.

Overland reviewed SJG's natural gas compliance manual and found that it provided adequate guidance for GSD personnel regarding capacity release requirements that should help prevent future transgressions. In addition to providing guidance regarding specific FERC rules, SJG's compliance manual also emphasizes the expectation that the employees will adhere to "high ethical standards" and "avoid conduct that is anticompetitive or manipulative, or that otherwise is intended to circumvent or violate any policies, rules or regulations."[53]

[51] Of the ninety-six buy/sell transactions, eighty-three were between SJG and SJRG and thirteen were between SJG and non-affiliate third parties.

[52] Response to Discovery, OC-375, Att. A; OC-376, Att. C.

[53] Response to Discovery, OC-376, Att. A.

Overall, the Company has made significant progress in remediating its lack of adequate controls related to compliance with the various capacity release requirements of the FERC, but Overland has remaining concerns over this issue. There have been no internal audits to examine the effectiveness of the Company's enhanced compliance measures. Even adequately designed controls need to be regularly tested to ensure proper execution. As such, we recommend that SJI Internal Audit perform a comprehensive audit of the additional compliance measures implemented by the Company, and continue to test compliance with these controls every three years, or more frequently if existing FERC regulations are significantly altered. Overland recommends that the Company annually file its FERC Compliance Manual with the NJ BPU and provide a version illustrating any changes from the previous compliance manual.

Background and Design of Hedging Program

Origin of South Jersey's Hedging Program

Natural gas is an historically volatile commodity. New Jersey, and the rest of the United States, experienced this volatility during the winter of 2000-2001 which saw natural gas prices rise from $4.40 in November to $6.82 in January, an increase of 55%.[54] In 2001, in an effort to mitigate the impact of dramatic natural gas price changes, the NJBPU ordered SJG and the other New Jersey natural gas utilities to submit a comprehensive hedging program to the NJBPU Staff and to the Division of Ratepayer Advocate. This order was meant to prompt the utilities to develop a plan that would help smooth out price fluctuations by locking in the price of gas before that gas was needed. These hedging programs help ensure that the impact of sudden spikes in natural gas prices, such as those that occurred in the winter of 2000-2001, will be mitigated through the hedged purchases.

Governance of South Jersey's Hedging Program

SJG describes its hedging approach in its Risk Management Policy (RMP).[55] The Company stated in its RMP that its objective is to lay out a "general framework" for natural gas commodity purchasing decisions and to "add stability" to gas costs. The current hedging strategy and related procedures, for the most part, were implemented in 2006. Minor changes have been made since then. The Commodity Purchasing Guidelines (the Guidelines) provide more specific instructions regarding SJG's hedging programs that the Risk Management Committee (RMC) is responsible for monitoring. The RMC meets quarterly and is comprised of eleven members, mostly senior management.[56]

When asked how the hedging strategies are evaluated, the Company stated that they are reviewed at each RMC Meeting. However, the RMC minutes do not indicate that the RMC is evaluating the

[54] U.S. Natural Gas Wellhead prices. Energy Information Administration website, http://tonto.eia.gov/dnav/ng/hist/n9190us3m.htm.

[55] Response to Discovery, OC-149, Section 11.

[56] Interview with Timothy Rundall, GSD Director, September 27, 2012.

effectiveness of the programs or proactively reviewing potential alternatives.[57] The RMC is focused on compliance with the existing hedging program. SJG currently has no formal process for assessing the results of its hedging program or considering alternatives and refinements to the existing program.[58] The company should develop quantitative performance expectations to evaluate its hedging program. The evaluative criteria may include comparing the mitigation of price volatility provided by SJG's current hedging program to an alternative method. SJG should also develop written performance expectations for its hedging program. These performance expectations should be compared to actual results to evaluate how well SJG's hedging strategies have performed, and they should be reviewed by SJG's Risk Management Committee on an annual basis.

Description of South Jersey's Hedging Programs

South Jersey has four major categories in its hedging strategies:

1) The Non-Discretionary Strategy;
2) The Planalytics Strategy;
3) The Storage Incentive Mechanism; and
4) The Discretionary Strategy.

Currently, SJG compiles the results of its hedging activities into quarterly hedging reports. These reports are formatted to coincide with a BGSS year which begins October 1 and ends September 30. Each quarter the Company prepares two reports: one for the current BGSS year and one for the upcoming BGSS year. The quarterly reports available during the audit have been summarized in the table below.[59]

[57] Response to OC-200 (Risk Management Committee Minutes).
[58] Interview with Timothy Rundall, GSD Director, September 27, 2012.
[59] The reason why every BGSS year does not have the same number of line items is that this table is a summary of the quarterly hedging activity during the audit period (i.e. calendar year 2009 through calendar year 2011).

Table 11-24 - Summary of Quarterly Hedging Activity

[Begin Confidential]

Summary of Quarterly Hedging Activity					
"As of" Date for Hedged Positions	Total Hedged	Non-Discretionary	Planalytics	Storage Incentive Mechanism	Discretionary
HEDGING ACTIVITY FOR BGSS YEAR-Oct. 1, 2008 to Sept. 30, 2009					
HEDGING ACTIVITY FOR BGSS YEAR-Oct. 1, 2009 to Sept. 30, 2010					
HEDGING ACTIVITY BGSS YEAT-Oct. 1, 2010 to Sept. 30, 2011					
HEDGING ACTIVITY BGSS YEAR Oct. 1, 2011 to Sept. 30, 2012					
HEDGING ACTIVITY FOR BGSS YEAR – Oct. 1 2012-Sept. 30,2013					

[End Confidential]

The company begins its hedging activities roughly nine months before the applicable BGSS year begins. This can be seen in the above table in the area titled "HEDGING ACTIVITY FOR BGSS YEAR – Oct. 1, 2010 to Sept. 30, 2011." For this BGSS year, the hedging activity began sometime in the fourth quarter of calendar year 2009 resulting in a total hedged position of 26.4%. During each subsequent quarter additional hedged positions were undertaken on either a continuous or periodic basis. While some hedging activity takes place during the BGSS year, the vast majority of hedging takes place before the BGSS year begins. As seen above, the hedging activity for BGSS year 2010-2011 was largely completed by September 30, 2010. In fact, of the 57% of the gas supply that was eventually hedged, 50.1% was hedged before the BGSS year began.[60]

The four hedging strategies are described in detail in the next section. The results of these financial hedges for the audit period are summarized in the table below.

Table 11-25 - Annual Loss from Hedging Strategies

[Begin Confidential]

	2011	2010	2009	Total (per strategy)

[End Confidential]

Non-Discretionary Hedging Program

SJG's non-discretionary hedging program is a way for the Company to purchase a portion of its anticipated natural gas commodity requirements through a series of futures contracts. According to the Guidelines, under this strategy SJG purchases two futures contracts on the New York Mercantile Exchange (NYMEX) per month for 18 months beginning with the 7th month and through the 24th month with the goal of hedging approximately 20% of its gas requirements through this program.

This method is sometimes referred to as "time-averaging" because the utility hedges its gas volumes through a series of futures contracts based on a fixed schedule. In recent years the time-averaging method has come under scrutiny by some state commissions, and an alternative method sometimes referred to as "dollar-budgeting" has gained broader use.

Under dollar-budgeting a utility would develop a schedule based on quantities of gas it wished to hedge, along with a forecast of futures prices. If forecast futures prices matched the actual futures prices available for purchase, the utility would hedge the projected quantity of gas. To the extent that the futures price was lower than that projected by the utility, the utility would hedge a higher quantity of gas and vice versa. This essentially results in the utility hedging a larger quantity of gas when the forward price is lower than anticipated and hedging a lower quantity of gas when the forward price is higher than anticipated.[61] A major problem with this method is that in a period of rising gas prices the utility would hedge less gas than it originally anticipated. This would then force the Company to

[60] The stated objective in SJG's Guidelines is to hedge between 50% and 66% of SJG's annual gas supply requirements. Response to Discovery, OC-172, Att. B.

[61] This method is similar to the dollar-cost averaging approach to investing used by some stock investors.

purchase the balance of its required gas supply (i.e. that amount that was not previously hedged) in the spot market, where the gas prices would presumably be at their highest. Purchasing a large amount of gas at the spot market could cause the type of price shock that hedging programs are intended to prevent. This method also has the peculiar effect of lowering the *average* cost of hedged gas but increasing the *total* cost of purchased gas.[62, 63] As such, we believe that SJG's current time-averaging hedging strategy is superior to the dollar-budgeting method.

The Company has not fully complied with the purchasing procedures of this program. The Guidelines clearly state that, "To implement this strategy South Jersey purchases two futures contracts per month…"[64] During our review of SJG's quarterly hedging reports we found multiple instances where less than two contracts were purchased in a month, while in other instances more than two contracts were purchased during a month. The 2011 4th Quarter Hedging Report, for example, shows zero contracts were purchased in March and four were purchased in May. This hedging strategy is specifically designed to be programmatic and objective (i.e., non-discretionary). As such, SJG should conform to the established procedures of the program and make two futures contracts per month. Also, SJG has consistently fallen short of its stated objective to hedge 20% of its commodity supply through this program. During BGSS years 2009, 2010 and 2011 the average amount hedged under this program was only 13.8%. We recommend SJG begin hedging more of its gas supply using this strategy in order to better align itself with the stated goals of its hedging program.

The financial results of the non-discretionary hedging strategy are shown in the table below.

Table 11-26 - Hedging Program Results - Non-Discretionary Hedging Program

[Begin Confidential]

SJG Hedging Program Results
Non-Discretionary Program

	2011	2010	2009	Totals

[End Confidential]

Planalytics

The Planalytics software is a computer-based procurement tool that is used by a number of natural gas utilities. The Planalytics hedging strategy uses a web based hedging and risk analysis software application called "Planalytics EnergyBuyer." This software makes forecasts about natural gas prices by analyzing changing aspects that could influence natural gas prices. The variables analyzed include

[62] Total Cost of Purchased Gas = (Hedged Gas Quantity)*(Cost of Hedged Gas) + (Spot Gas Quantity)*(Cost of Gas on Spot Market).

[63] For a numeric example of this scenario see: "Hedge Timing-There's No Magic in Dollar Cost Averaging," Richard Goldberg and James Read, *Public Utilities Fortnightly*, May 2012.

[64] Response to Discovery, OC-172, Att. B.

fundamental, technical, trading and weather dynamics.[65] This Planalytics software ultimately provides a recommendation of BUY (indicating that the Planalytics software believes that natural gas is currently underpriced) or WAIT (indicating that the Planalytics software believes that natural gas is currently overpriced). SJG management always follows the recommendations of the Planalytics software.[66]

The financial results of the Planalytics hedging strategy are shown in the table below.

Table 11-27 - Hedging Program Results - Planalytics

[Begin Confidential]

SJG Hedging Program Results Planalytics				
	2011	2010	2009	Totals

[End Confidential]

Storage Incentive Mechanism

In this hedging strategy, the Company sets a benchmark for the upcoming storage injection season through the purchase of forward NYMEX contracts. The benchmark is set by the Company first establishing how much gas it plans to inject during the seven month injection period. The company then divides that total over each of the seven months during the injection season and it purchases NYMEX futures contracts to fulfill these monthly requirements. During the injection season, the Company then attempts to take advantage of market conditions in order to exceed the benchmark.

The financial results of the Storage Incentive Mechanism Program are illustrated in the table below.

Table 11-28 - Hedging Program Results - Storage Incentive Mechanism

[Begin Confidential]

SJG Hedging Program Results Storage Incentive Mechanism Program				
	2011	2010	2009	Totals

[End Confidential]

[65] In addition to the “WAIT” or “BUY” recommendations, EnergyBuyer also provides other information including a live NYMEX price feed for energy commodities including natural gas, crude oil, and heating oil. EnergyBuyer also provides daily weather forecasts, and since 2009 it has been used for purchasing futures contracts to set the benchmark for the Storage Incentive Mechanism. Response to Discovery, OC-171 and OC-497.

[66] Response to OC-497.

Discretionary Hedging

Discretionary hedges are the financial and physical hedges that management decides to put in place in response to market conditions. Discretionary hedges could be in the form of futures or options. **[Begin Confidential]**

[End Confidential]

Responsibility of determining whether, and the extent to which, SJG should enter into discretionary hedges falls largely on the GSD Director.[67] The GSD Director also typically executes these trades.[68] There are no written procedures or supporting documentation requirements for the discretionary hedging program.[69] This lack of documentation is a major shortcoming and it is inconsistent with industry best practices. A discretionary hedging program should have *more* (not less) required documentation than other hedging programs, given the unstructured nature of the decisions. An industry periodical recently discussed this issue as follows:

> *"[T]he more discretionary a program design, the more critical decisional documentation and transparent processes become. Further, there must be rigor and consistency in how hedging is adjusted in different market price environments. It will be important in the design and approval stage that the hedging program has clear triggers for when hedging decisions will be executed. During the implementation stage, it will be important for utilities to document information that was known to them at the time hedges were transacted to demonstrate that reasonable actions were taken, consistent with the program design."*[70]

We recommend that SJG implement enhanced documentation requirements regarding its discretionary hedging program. At a minimum, these documentation requirements should fully explain the Company's basis for entering into the hedge. Requiring adequate contemporaneous documentation for these transactions will allow the Company to subsequently support its rationale for entering into these hedges and will allow third-party reviewers to determine whether the Company's decisions were prudent.

In addition to the enhanced documentation requirements, we also recommend that SJG consider significantly scaling down, or potentially even de-activating, its discretionary hedging program and

[67] In addition to the GSD Director, the Company stated that the SJG RMC and/or the Company's derivatives consultant may have input into the decision. Response to Discovery, OC-493.

[68] Although the current GSD Director performs these functions for SJG, the job qualifications for the GSD Director position do not require prior experience with financial derivatives, and the current GSD Director does not consider himself a "derivatives expert." Response to Discovery, OC-71; Interview with Timothy Rundall, GSD Director, September 27, 2012.

[69] Response to OC-493.

[70] "Hedging Under Scrutiny," Julie Ryan and Julie Lieberman, Public Utilities Fortnightly, February 2012.

utilizing the other hedging strategies to achieve an adequate level of hedged gas supply.[71] While we believe that a discretionary hedging program at an LDC can be valuable under certain circumstances, the expected benefits of the program should outweigh the costs of the program. Stated another way, there should be a sufficient probability that the hedges being entered into by the LDC will benefit the LDC ratepayers through decreased commodity costs and/or decreased volatility. Given the resource limitations of a relatively small LDC such as SJG, we find it unlikely that SJG would enter into profitable hedges with counterparties that are likely more experienced with trading financial derivatives and more narrowly focused on tracking market movements.[72] Additionally, scaling down this program will simplify SJG's hedging decisions, thus allowing the GSD Director to focus on the other essential tasks of the position, such as supervising the members of the gas supply department to ensure transactional compliance.[73]

The financial results of SJG's discretionary hedging program can be seen in the table below.

Table 11-29 - Hedging Program Results - Discretionary Hedging Program

[Begin Confidential]

SJG Hedging Program Results Discretionary Program				
	2011	2010	2009	Totals

[End Confidential]

Secondary Transactions

In addition to the hedging strategies discussed above, the Guidelines discuss management's ability to utilize "secondary transactions" under certain conditions. Specifically, these secondary transactions are intended to be used when management believes there is a reasonable possibility that the price of natural gas will drop below the current price of hedged gas.[74] During the audit period, U.S. natural gas wellhead prices declined from $4.60 per MCF to $3.14 per MCF, a decline of 32%.[75] A declining price environment, such as that found during the audit period, would appear to be the ideal time to consider secondary transactions. Yet, there is no written documentation indicating that SJG ever considered secondary transactions during this time, nor are secondary transactions ever mentioned as a topic of

[71] While all New Jersey LDCs maintain a discretionary hedging program, not all are active. The 2009 consultant report regarding the hedging strategies of New Jersey LDCs noted that Elizabethtown Gas did not actively engage in discretionary hedging. Response to Discovery, OC-167, pg. 13.

[72] While the SJG GSD does not formulaically take market conditions into account, market conditions are analyzed by various members of the SJG GSD and this analysis may impact SJG's hedging decisions. Timothy Rundall, GSD Director, September 27, 2012.

[73] Response to Discovery, OC-71.

[74] The Guidelines further note that the cost from these secondary transactions (from both losses and net premiums) cannot exceed $3.0 million.

[75] U.S. Natural Gas Wellhead prices. Energy Information Administration website, http://tonto.eia.gov/dnav/ng/hist/n9190us3m.htm.

discussion in the Risk Management Committee meeting minutes.[76,77] SJG should be expected to make all reasonable efforts to protect its ratepayers from additional gas costs. The lack of any written analysis concerning secondary transactions strongly suggests that due diligence over this area was not performed during the audit period. SJG management should consider the appropriateness of secondary transactions on a regular basis and this consideration should be documented and reviewed at SJG's quarterly RMC meetings.

Benchmarking

During the audit period, there were no benchmarking studies performed over SJG's hedging program. We recommend that SJG perform sensitivity and benchmarking analyses to test the effectiveness of its hedging program. To the extent the data is available, SJG should compare how well its hedging program performed relative to utilities that utilize similar hedging strategies, to test for execution of the current strategy. SJG should also compare its hedging program to utilities that use alternative hedging strategies, to determine whether there is sufficient empirical evidence to modify SJG's current strategy.

[76] In Discovery, the Company stated the following: "While secondary transactions have been discussed at various times by members of the South Jersey Gas Risk Management Committee, there is no analysis or other documentation to reference." Response to Discovery, OC-496.

[77] Response to Discovery, OC-200.

12. Gas Delivery and Operations Management

This Chapter addresses SJG's System Operations and System Planning & Design functions.[1]

Summary of Findings

1. SJG significantly upgraded its SCADA system, which is used by SJG Gas Control to monitor the pressure throughout the system. The previous system had been in place for nearly 30 years. The new system provider is widely used by other LDCs.
2. SJG utilizes the SynerGEE Gas Model as its primary network modeling software. The results of the most recent analysis network model analysis showed no major short-term challenges in serving its customers.
3. SJG has met or exceeded all assessments of its transmission pipeline required under the Pipeline Integrity Management Program.
4. In accordance with PHMSA requirements, SJG implemented an integrity management program for its distribution system in August 2011. The top threat identified in this program was corrosion on SJG's mains.
5. Approximately one-third of the miles of main in SJG's system and one-fourth of the number of services in SJG's system were installed prior to the Federal Pipeline Safety Regulations that required buried steel pipe to be cathodically protected.
6. The non-modern materials in SJG's pipeline system are primarily comprised of unprotected steel and cast iron. In terms of miles of main, SJG's system is composed of over twice as much non-modern material as the national average. This is primarily due to SJG's distribution system having nearly two and one-half times as much unprotected steel compared to the national average. SJG also has a slightly higher percentage of non-modern materials composing its services than the national average.
7. SJG has been proactive in proposing methods to accelerate replacement of non-modern pipe, several accelerated infrastructure replacement programs have been authorized by the NJ BPU.
8. While the rate of main replacement has increased 2.3 times since the accelerated infrastructure programs were put in place, SJG's spending on these programs has increased 3.7 times.
9. SJG's safety performance in terms of significant pipeline incidents has been mediocre when compared to the other three New Jersey LDCs over the past ten years.
10. Corrosion was the primary cause of leaks on SJG's mains, ranging from 77% and 86% when viewed on an annual basis. Corrosion and excavation damage were the main causes for leaks on services.
11. During the audit period, SJG significantly reduced the amount of leaks in its backlog. SJG reduced the amount of leaks in its Grade B backlog by 42% and it reduced the amount of leaks in

[1] SJG utilizes outside contractors for all engineering design work and virtually all (98%) of construction work. For additional discussion regarding these activities, and SJG's oversight role regarding these activities, see Chapter 13 - *Contractor Performance and Damage Prevention*.

its Grade A backlog by 89%. However, some of the open leaks have been outstanding for many years and extend back to February 2003.

12. During the audit period SJG maintained adequate pressure in the system and there were no widespread gas curtailments.
13. Although SJG participates in some operations-related benchmarking studies, the results of these studies are not a focus of management.

Recommendations

1. The head of SJG's Customer Distribution and Operations Department is the primary SJG officer in charge with maintaining a safe and reliable distribution pipeline system. We recommend that safety-related goals represent a minimum of 20% of this individual's balanced scorecard.
2. SJG should institute a policy to repair Grade B Leaks within twelve months of discovery. This recommendation was originally made in SJG's previous management audit, but it was not implemented.
3. SJG should integrate industry benchmark statistics into their performance targeting and should set performance targets at a "stretch" (aspirational) levels.

Organization and Staffing

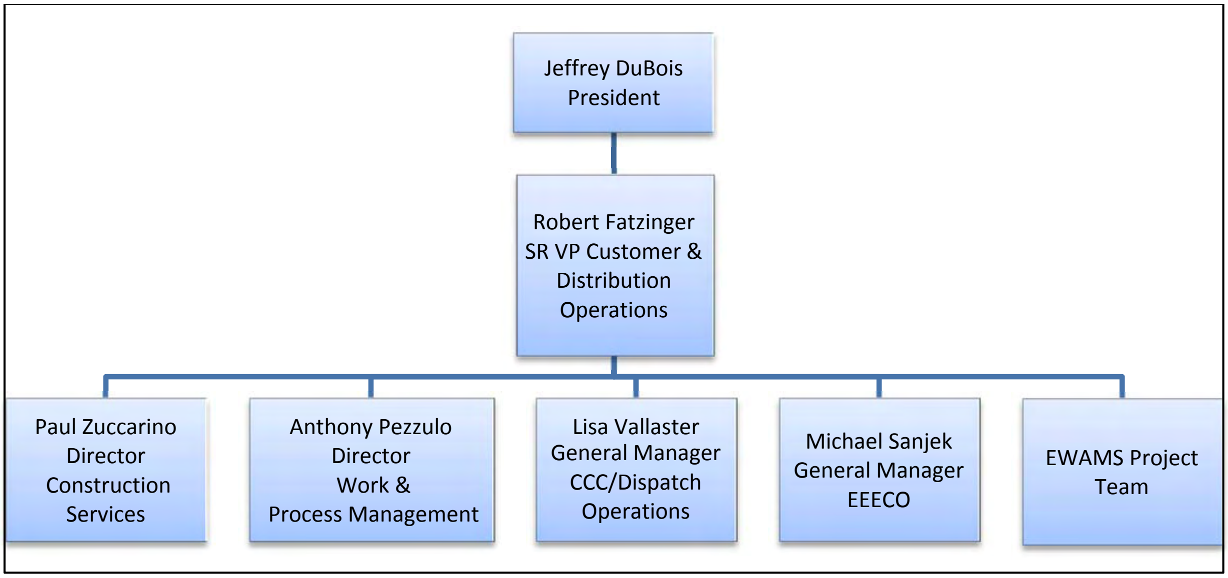
SJG's system operations, includes its Construction Services, Customer Service & Dispatch Customer and Distribution Operations (C&DO) and Engineering Services and System Integrity (ES&SI). The heads of these two groups report directly to the President of SJG.

Customer and Distribution Operations (C&DO). The C&DO organization is headed by the Senior VP of C&DO. This area is comprised of four functional areas: Construction Services, Customer Service & Dispatch Operations, Energy Efficiency Education & Consulting (EEECO), and Work & Process Management. The Company's Enterprise Work & Asset Management (EWAMS) project is also assigned to the C&DO organization and this team reports to the Senior VP of C&DO. The major goals of the C&DO organization include to maintain a safe work environment, effectively manage capital and operating expenditures, and achieve targets for customer service metrics.[2]

An abridged organizational chart of the C&DO organization is provided below.

[2] Response to Discovery, OC-356.

Table 12-1 – SJG Distribution Operations Organizational Chart

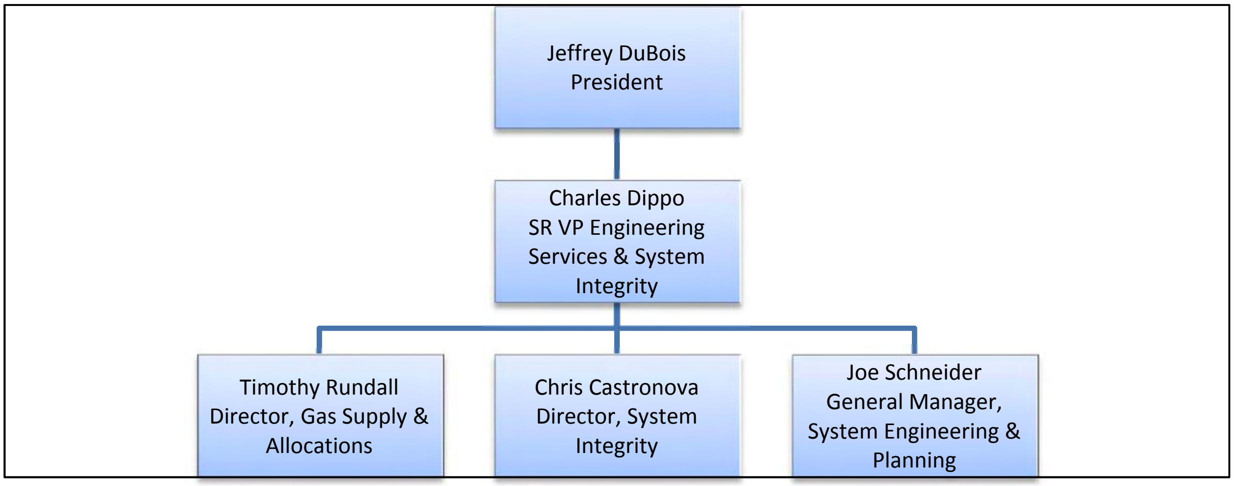


Engineering Services & System Integrity (ES&SI). The ES&SI organization is headed by the Senior VP of ES&SI. The ES&SI organization is responsible for planning and directing all engineering services involving the design and technical specifications of Company facilities. This organization's responsibilities include the oversight and management of engineering design, system planning, construction codes and standards, gas supply, gas control, system integrity, transmission pipeline operations and compliance and liquefied natural gas peak shaving activities. This organization also provides guidance on distribution operations, emergency procedures, strategic planning, infrastructure security, and regulatory affairs, when necessary.[3]

An abridged organizational chart of the ES&SI organization is provided below.

[3] Response to Discovery, OC-356.

Table 12-2 – SJG Engineering Services Organizational Chart



Technical Analysis

System Overview

SJG's service territory is approximately 2,500 square miles and covers the southern third of New Jersey. This includes all or parts of seven counties and 112 municipalities. SJG receives its natural gas supplies through direct connections to two interstate pipelines: Columbia Gas Transmission (Columbia) and Transcontinental Gas Pipeline (Transco). SJG maintains 8 gate stations that receive delivery from these pipelines. All gate stations are located in the northwest region of SJG's service area. Once gas supply is delivered to the gate stations, the gas goes into SJG's transmission and distribution piping system. SJG owns and operates 124 miles of transmission pipeline and over 6,000 miles of distribution main. SJG also has over 350,000 services. The transmission system is operated with maximum allowable operating pressures (MAOPs) ranging from 1,100 psig to 350 psig. The MAOPs on the distribution system range from 250 psig to ¼ psig.[4]

One major enhancement to SJG's System Operations that commenced during the audit period was the upgrade of SJG's Supervisory Control and Data Acquisition (SCADA) system. The primary objective of this project was to update a system that was almost 30 years old in favor of a new, more modern system. We reviewed Company presentations regarding this decision and we noted that the hardware for the outdated system was discontinued in 2007 and the manufacturer stopped supporting this hardware in 2011. The new SCADA system provider is widely used and is utilized by 75% of Northeast US LDCs. We also noted that this project was completed within 10% of its original budget.[5]

Relative to other gas-only utilities, the size of SJG's operations is relatively modest. In a 2011 AGA survey of utilities in the United States and Canada, SJG ranked 34th out of the 50 gas only utilities that

[4] Response to Discovery, OC-129.
[5] Response to Discovery, OC-651.

participated in the survey in number of customers served, and 35th and 32nd in miles of distribution main and number of services, respectively.[6]

Long-Range System Planning

System planning is performed within the ES&SI Department. The planning function staff are responsible for the following:[7]

- Providing sizing specifications for all main renewal, abandonments and new business extensions prior to detail design;
- Provide analysis of system infrastructure requirements for potential customer load additions;
- Provide analysis of system capacity deficiencies and recommend capital improvements to assure adequate system capacity to serve customer requirements under design weather conditions.

The primary network modeling tool used by SJG is SynerGEE Gas Model. This model database contains data related to all transmission and distribution mains and regulator stations.[8] The results of the most recent network model analysis showed no immediate risks to the system and sufficient capacity to meet peak day demand for the near future.[9] The Company monitors the areas with the lowest pressures in the gas distribution system throughout the winter to help anticipate if insufficient pressure may occur. As of the writing of our report, the following locations were being monitored with pressure recording devices due to having been identified as having the lowest pressures in SJG's gas distribution system: Somers Point, Linwood, Medford, Voorhees, Paulsboro, Wenonah, Millville, Bridgeton, Stone Harbor, and Delhaven.[10]

Integrity Management Programs

Pipeline Integrity Management Program

Federal Pipeline Safety Statute 49 USC 60109 (c) established requirements for pipeline integrity management programs (PIMPs) for gas transmission pipelines. The goals of SJG's PIMP are meant to ensure that SJG's transmission pipelines will continue to: operate safely in areas where a failure could impact the public, environment, or property; provide reliable transport of natural gas to SJG's distribution system; and maintain system integrity beyond the pipeline's design life.

SJG has met or exceeded all regulatory targets related to the PIMP. Specifically, SJG implemented its PIMP in December 2004 prior to the regulatory deadline. It also completed baseline assessments on all of its transmission pipelines in high consequence areas (HCAs) in 2011. The deadline for these assessments was not until 2012.[11] Further, the NJBPU has requested New Jersey's four LDCs to

[6] Response to Discovery, OC-338.
[7] Response to Discovery, OC-132.
[8] Response to Discovery, OC-132.
[9] Response to Discovery, OC-654.
[10] Response to Discovery, OC-654.
[11] Response to Discovery, OC-151.

complete baseline assessments on all transmission pipelines by the end of 2013. SJG was substantially complete with these inspections by the end of 2012.[12]

Distribution Integrity Management Program

The Pipeline and Hazardous Materials Safety Administration (PHMSA) published the final rule establishing integrity management requirements for gas distribution pipeline systems in December 2009. Under this rule, gas distribution system operators were given until August 2, 2011 to develop and implement a written Distribution Integrity Management (DIMP). SJG met this deadline by implementing its DIMP on August 1, 2011.[13] This DIMP was intended to enhance safety by identifying and reducing pipeline integrity risks and consisted of the following seven elements:[14]

- Knowledge;
- Identification of Threats;
- Evaluation and Ranking of Risks;
- Identification and Implementation of Measures to Address Risks;
- Measurement of Performance, Monitoring of Results and Evaluation of Effectiveness;
- Periodic Evaluation and Improvement; and
- Reporting of results.

The top five threats identified in SJG's distribution system based on total leak repairs were as follows:

1. Corrosion on mains (52.8% of all leak repairs);
2. Corrosion on services (12.8% of all leak repairs);
3. Excavation damage on services (7.8% of all leak repairs);
4. Other leak repairs on mains (3.8% of all leak repairs); and
5. Other leak repairs on services (3.8% of all leak repairs).

SJG's Distribution System Description

The material and age composition of pipe found in an LDC's system is a major factor of its ability to provide safe and reliable service. Cast iron and unprotected steel are generally considered "non-modern" materials because they were generally installed prior to the 1970 Federal Pipeline Regulations that, among other things, began requiring buried steel pipe to be externally coated and cathodically protected.[15] Though both non-modern materials present safety dangers as they age, the nature of the danger differs between the two materials. Cast iron has a tendency to become brittle and crack as it ages; unprotected steel begins corroding as soon as it is placed into the ground (although the degree of corrosion is based on a number of environmental factors). At the end of the audit period, non-modern material composed roughly 20% of the Company's mains and 11% of its services.[16] As discussed in more

[12] Interview with Chris Castronova, Director, System Integrity, January 9, 2013; Response to Discovery, OC-151.
[13] Response to Discovery, OC-250.
[14] Response to Discovery, OC-130.
[15] Title 49 CFR 192.455.
[16] Response to Discovery, OC-150.

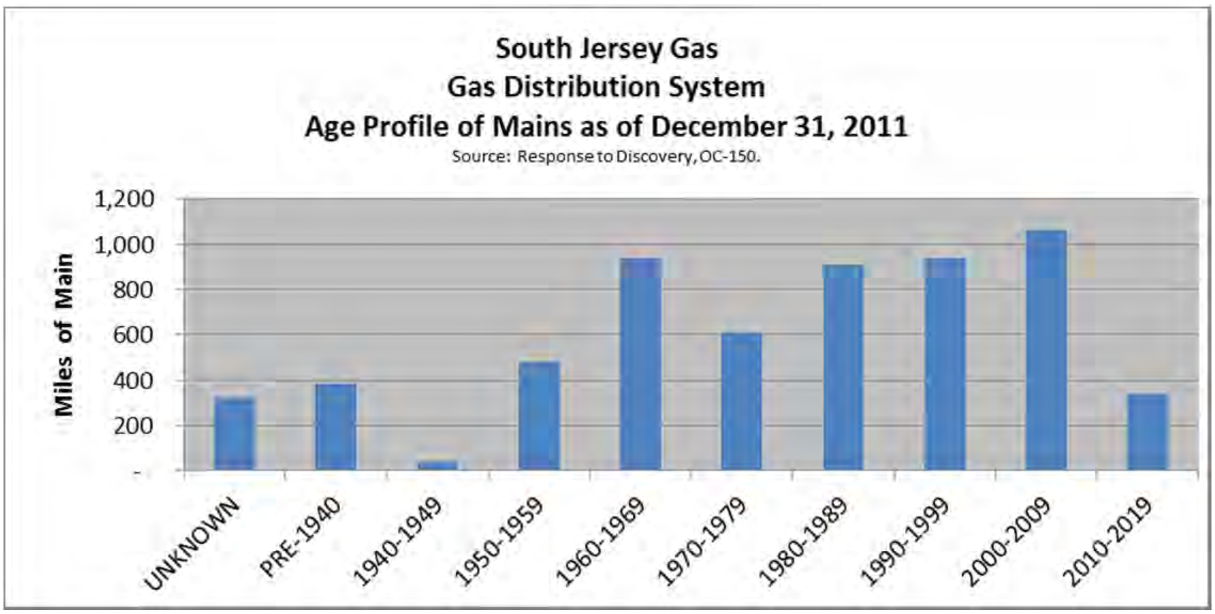
detail below, SJG has been proactive in the past few years of proposing methods to accelerate the replacement of this pipe beyond the requirements of its own internal replacement program.

The age and material composition for both SJG's mains and services are discussed in detail below.

Age Profile of Mains

Approximately one-third of the miles of main in SJG's system, including the unknown vintage, were installed prior to Federal Pipeline Safety Regulations that required steel pipelines to be cathodically protected 1970.

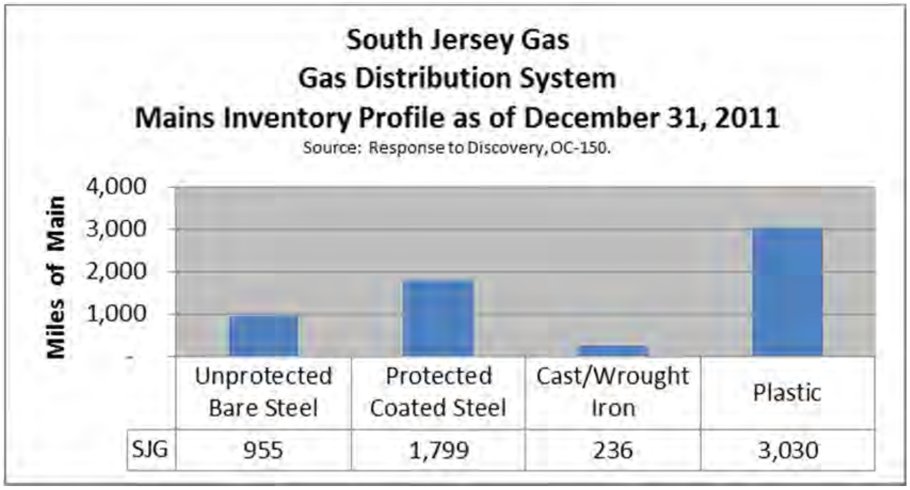
Table 12-3 – SJG Age Profile of Mains as of December 31, 2011



Material Composition of Mains

Roughly 80% of SJG's miles of main are composed of what is typically considered "modern pipe." Plastic comprises roughly 50% of the main in SJG's system with cathodically protected steel representing 30% of the main. The remaining 20% of the system is comprised of non-modern pipe: 4% cast iron; 16% unprotected bare steel.

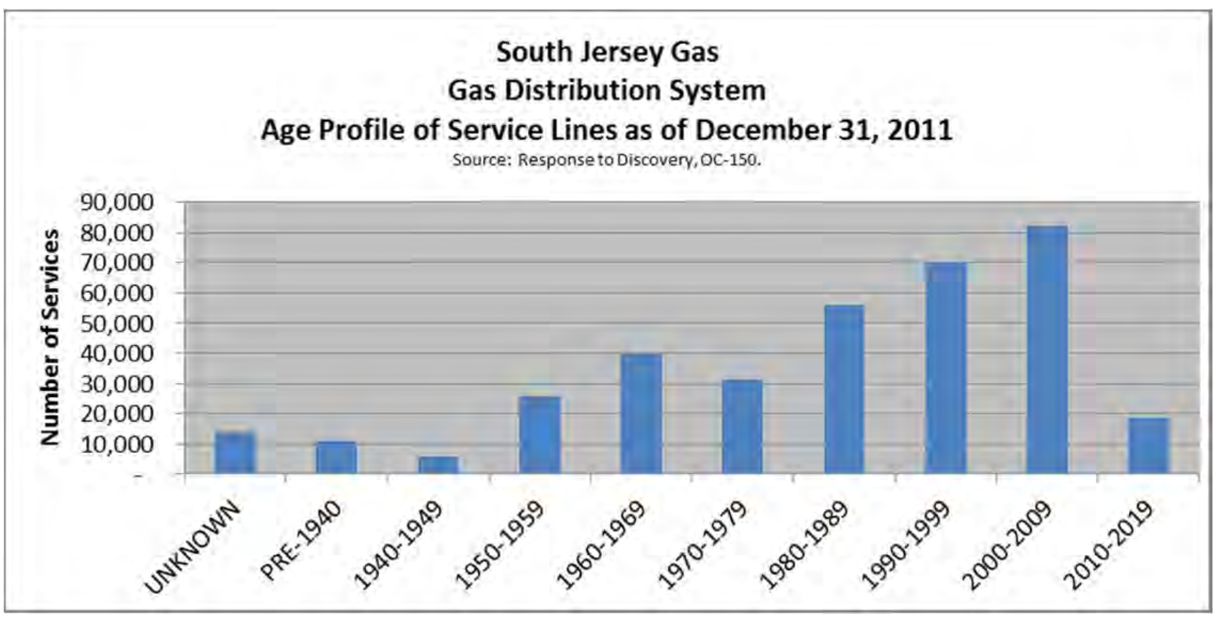
Table 12-4 - Mains Inventory Profile as of December 31, 2011



Age Profile of Services

The age profile of SJG's services is similar to that of SJG's distribution mains. Roughly one-fourth of SJG's services were installed prior to 1970.

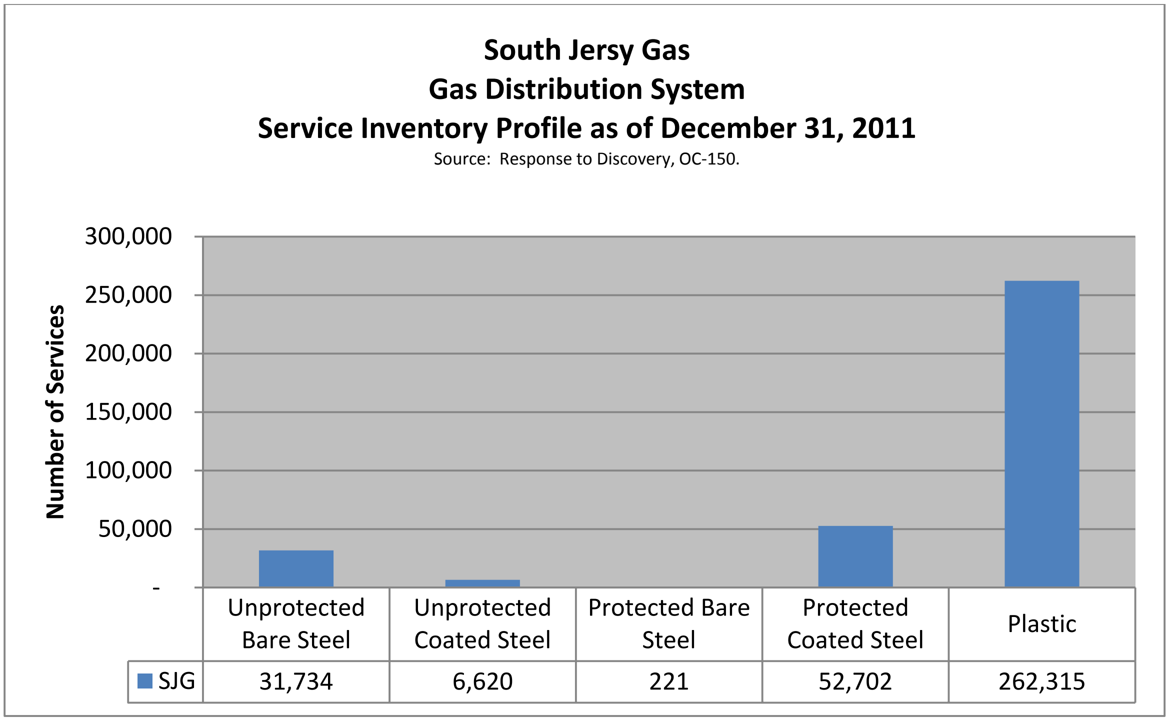
Table 12-5 - SJG Age Profile of Service Lines as of December 31, 2011



Material Composition of Services

Roughly 90% of SJG's services are composed of plastic and cathodically protected steel. Only about one-tenth of SJG's services are composed of unprotected bare steel. SJG maintains no cast iron services in its system.

Table 12-6 - SJG Service Inventory Profile as of December 31, 2011



SJG's Distribution System Compared to National Average

To put the composition of SJG's system into the appropriate context, we compared the non-modern portion of SJG's system to the national average for non-modern materials.[17] When all non-modern materials are combined and compared to the national average, the miles of main as a percentage of the distribution system composed of non-modern materials are over twice that of the national average (19.8% versus 9.2%). SJG also maintains more non-modern services in its system, but the contrast between SJG and the national average for number of services is not nearly as stark as that for miles of main. This data is illustrated in the table below.

[17] For unprotected steel, we compared both the miles of main in SJG's system and the number of services in SJG's system to the national average. Given that SJG maintains no cast iron services in its system, for this material we only compared the miles of main.

Table 12-7 - Total Non-Modern Materials as a Percentage of Distribution System

South Jersey Gas SJG Compared to National Average Total Non-Modern Materials As of December 31, 2011	
Miles of Main as a Percentage of Distribution System	
Percentage of Non-Modern Materials in SJG's System	19.8%
Percentage of Non-Modern Materials in Average System	9.2%
Difference (SJG in excess of National Average)	10.6%
Number of Services as a Percentage of Distribution System	
Percentage of Non-Modern Materials in SJG's System	10.8%
Percentage of Non-Modern Materials in Average System	8.5%
Difference (SJG in excess of National Average)	2.3%
Source: Response to Discovery, OC-150 and OC-358.	

In order to quantify what materials were comprising the difference between SJG's system and the average distribution system, we compared the individual non-modern materials found in SJG's system with the national average distribution system. The results of this analysis are discussed below.

SJG's system is composed of a much larger percentage of unprotected steel than the average distribution system. In terms of miles of main as a percentage of the distribution system, SJG's distribution system has nearly two and one-half times as much unprotected steel as the average distribution system. The percentage of unprotected steel services in SJG's distribution system is also higher than the national average. This is illustrated in the table below.

Table 12-8 - SJG Compared to National Average - Unprotected Steel

South Jersey Gas SJG Compared to National Average Unprotected Steel: Miles of Main and Number of Services As of December 31, 2011	
Miles of Main as a Percentage of Distribution System	
Unprotected Steel - SJG	15.9%
Unprotected Steel - National Average	6.4%
Difference (SJG in excess of National Average)	9.5%
Number of Services as a Percentage of Distribution System	
Unprotected Steel - SJG	10.8%
Unprotected Steel - National Average	6.9%
Difference (SJG in excess of National Average)	3.9%
Source: Response to Discovery, OC-150 and OC-358.	

Regarding miles of main as a percentage of the distribution system, SJG maintains more cast iron in its system than the national average. However, as illustrated in the table below, this difference is not nearly as significant as it is for unprotected steel.

Table 12-9 - SJG Compared to National Average - Cast Iron

South Jersey Gas SJG Compared to National Average Cast Iron: Miles of Main As of December 31, 2011	
Miles of Main as a Percentage of Distribution System	
Cast/Wrought Iron - SJG(A)	3.9%
Cast/Wrought/Ductile Iron - National Average	2.8%
Difference (SJG in excess of National Average)	1.1%
Note A: As of December 31, 2011, SJG had no Cast Iron services and no Ductile Iron in its distribution system. Source: Response to Discovery, OC-150 and OC-358.	

Description of SJG's Infrastructure Replacement Programs

SJG has an internal policy to maintain compliance with the NJ BPU and Office of Pipeline Safety regulations regarding pipeline replacement (known internally as its Compliance Replacement Program). This program provides a basis for prioritizing the replacement of sections of SJG's main, particularly those sections composed of non-modern materials discussed in the previous section. In this policy, SJG divided potential main replacements into two categories: Construction by Others and Programmed Replacement. By dividing its main replacement program in this manner, SJG is able to reduce both its construction costs and disturbance to the surrounding community by coordinating with other in-ground construction efforts.

"Construction by Others" criteria is utilized any time that construction by another party and/or for another purpose (e.g., street improvements or other utility construction) is proposed. SJG performs an evaluation of all the mains within the area of the proposed construction to determine whether SJG should replace the main in this area. The evaluation process includes performing a leak survey within 90 days prior to the planned construction and considering the cost and repair of all past, present and future leaks that may occur over the next five years.[18]

The "Programmed Replacement" criteria is focused on identifying those sections of main that are most at risk for failure. Under this program a Main Replacement Evaluation Sheet (Evaluation Sheet) is completed if certain conditions are present. The conditions that would necessitate an Evaluation Sheet include visual inspections where the pipe was found to be in "poor" condition, as well as certain instances where leaking gas has been detected and repairing the leak is not feasible. The Evaluation

[18] Response to Discovery, OC-151; SJG's Operating and Maintenance procedure 1.7.3.

Sheets contain weighted point values regarding leak history, safety and field conditions that influence the useful life of distribution mains. In SJG's Operating and Maintenance Manual, there are three ranges for the scores of these Main Replacement Evaluation Sheets: No Action, Monitor, and Replace. A score in the "No Action" range would indicate that the main was not risky enough to warrant any particular action. A score in the "Monitor" range would indicate that the main section should be monitored on a frequent basis. Based on the Company's standards, these leak surveys are conducted once each calendar year and at least every 15 months. A score in the "Replace" range would indicate that this particular section of main should be replaced within a three-year timeframe. A section of main in this score range would also be monitored for leaks twice per calendar year until the main section was replaced. Main segments identified under this program are replaced within a maximum of three years.

In 2009, the Capital Investment Recovery Tracker (CIRT) program was approved to supplement SJG's normal replacement program. In October 2010, SJG filed a petition with the NJ BPU to continue the CIRT program beyond 2010. This eventually resulted in programs that approved additional spending into 2011 and 2012.[19,20]

In addition to the programs listed above, there is also a state-mandated program to replace services that meet a certain criteria. Under this program, bare steel services are replaced in a defined geographic area when more than 20% of the services in the area have experienced leaks (known as the 20% Service Replacement Program).

Results of SJG's Infrastructure Replacement Programs

The infrastructure replacement programs described above have increased the rate of pipeline replacement. From 2009 through 2011, SJG's infrastructure replacement programs resulted in a reduction of 158 miles of unprotected steel main and 23 miles of cast iron main. This represented an average of 53 miles of unprotected steel and 8 miles of cast iron, respectively, more than double SJG's historical annual rate of replacement.[21]

The annual replacement data for the audit period is provided below.

[19] For an additional description of the CIRT, including a description of how these costs are incorporated into rates, see Chapter 13 - *Contractor Performance and Damage Prevention.*

[20] The CIRT program ended at year-end 2012, but the BPU subsequently approved the establishment of the Accelerated Infrastructure Replacement Program (AIRP) that approved spending levels for 2013 through 2016.

[21] Without the CIRT Program, SJG averages an annual replacement of its main of 23 miles of unprotected steel and 3 miles of cast iron. Response to Discovery, OC-151.

Table 12-10 - Miles of Main Replaced 2009 through 2011

South Jersey Gas SJG Reduction in Non-Modern Distribution Mains Miles of Main Replaced 2009 through 2011				
Material	2009	2010	2011	Total
Unprotected Bare Steel	26	68	29	123
Unprotected Coated Steel	-	-	35	35
Unprotected Steel Subtotal	26	68	64	158
Cast Iron	3	6	14	23
Total Miles of Main Replaced	29	74	78	181
Source: Response to Discovery, OC-151.				

While the rate of replacement has increased substantially, this has come at a significant cost. In 2008, the year prior to the CIRT being approved by the NJ BPU, SJG spent $9.3 million on its various infrastructure replacement programs. From 2009 to 2011, the spend on these programs averaged $34.8 million, about 3.7 times the amount spent in 2008.[22]

As demonstrated in the table below, material and composition of SJG's system have changed due to these programs. The percentage of unprotected steel main as a percentage of SJG's system has decreased from roughly 18.5% (17.9% + 0.6%) in 2009 to 15.9% in 2011, while the percentage of cast iron dropped from 4.4% to 3.9% during this period.

Table 12-11 – Changes in SJG's Distribution Main Profile

South Jersey Gas SJG Changes in Distribution Main Profile Percentage of Main by Material - 2009 to 2011						
Miles of Main	2009	% of Total	2010	% of Total	2011	% of Total
Unprotected Bare Steel	1,052	17.9%	984	16.6%	955	15.9%
Unprotected Coated Steel	35	0.6%	35	0.6%	-	0.0%
Protected Bare Steel	5	0.1%	5	0.1%	-	0.0%
Protected Coated Steel	1,801	30.7%	1,795	30.2%	1,799	29.9%
Plastic Pipe	2,718	46.3%	2,870	48.3%	3,030	50.3%
Cast Iron	256	4.4%	250	4.2%	236	3.9%
Total Miles of Main	5,867	100.0%	5,939	100.0%	6,020	100.0%
Source: Response to Discovery, OC-151.						

[22] Response to Discovery, OC-660.

Gas System Safety and Reliability

Pipeline Accidents

The principal goal of every LDC should be to provide safe and reliable service at a reasonable cost. One measure of an LDC's ability to maintain a safe system is the number of significant incidents that are reported to the PHMSA. The PHMSA defines Significant Incidents as those incidents reported by pipeline operators when any of the following specifically defined consequences occur: fatality or injury requiring in-patient hospitalization; $50,000 or more in total costs, measured in 1984 dollars; highly volatile liquid releases of 5 barrels or more or other liquid releases of 50 barrels or more; liquid releases resulting in an unintentional fire or explosion.[23]

Based on this criterion, SJG's performance over the past decade has been mediocre. A listing of the significant incidents reported to the PHMSA for all New Jersey LDCs are illustrated in the table below.[24]

Table 12-12 - PHMSA Significant Incidents of New Jersey Gas Local Distribution Companies

South Jersey Gas PHMSA Significant Incidents - NJ LDCs 2002 through 2011				
Operator	Incidents	Fatalities	Injuries	Property Damage
Elizabethtown Gas Co	3	1	5	$2,244,593
New Jersey Natural Gas Co	1	-	2	531,403
Public Service Electric & Gas Co	9	-	7	7,072,693
South Jersey Gas Co	3	-	1	903,875
Source: PHMSA Distribution Incident Data				

The SJG officer with the most responsibility in this area is the Senior Vice President of the C&DO Department. However, safety-related goals for this individual were not a significant component of this individual's performance evaluation.[25] In fact, in 2011 this individual had no safety-related goals at all.[26]

Given the responsibility that the head of the C&DO has for maintaining safety of the pipeline, and given the consequences, both financial and physical, that pipeline accidents can cause, we recommend that safety-related goals represent at least 20% of the individual's balanced scorecard.

[23] PHMSA website.

[24] In addition to the incidents listed above, there was also a non-injury accident in SJG's service territory in December 2012 wherein a house was destroyed. The total property damage resulting from this incident was $320,600. Source: PHMSA Distribution Incident Data.

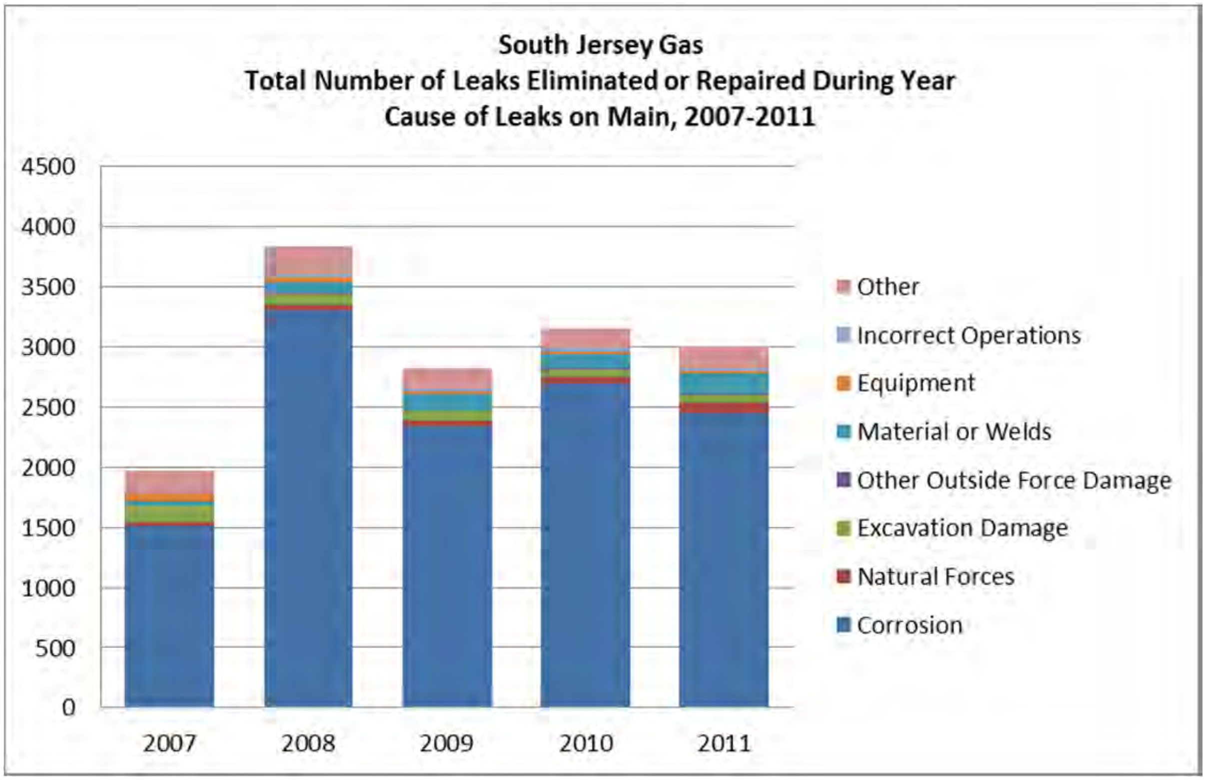
[25] Response to Discovery, OC-568.

[26] When Overland asked why this individual's safety-goals were removed, the individual stated that the SJI's CEO directed the officers that the main driving force of the balanced scorecards should be financial and not operational. Interview with Robert Fatzinger, Senior Vice President, C&DO, March 28, 2013.

Leak Profile[27]

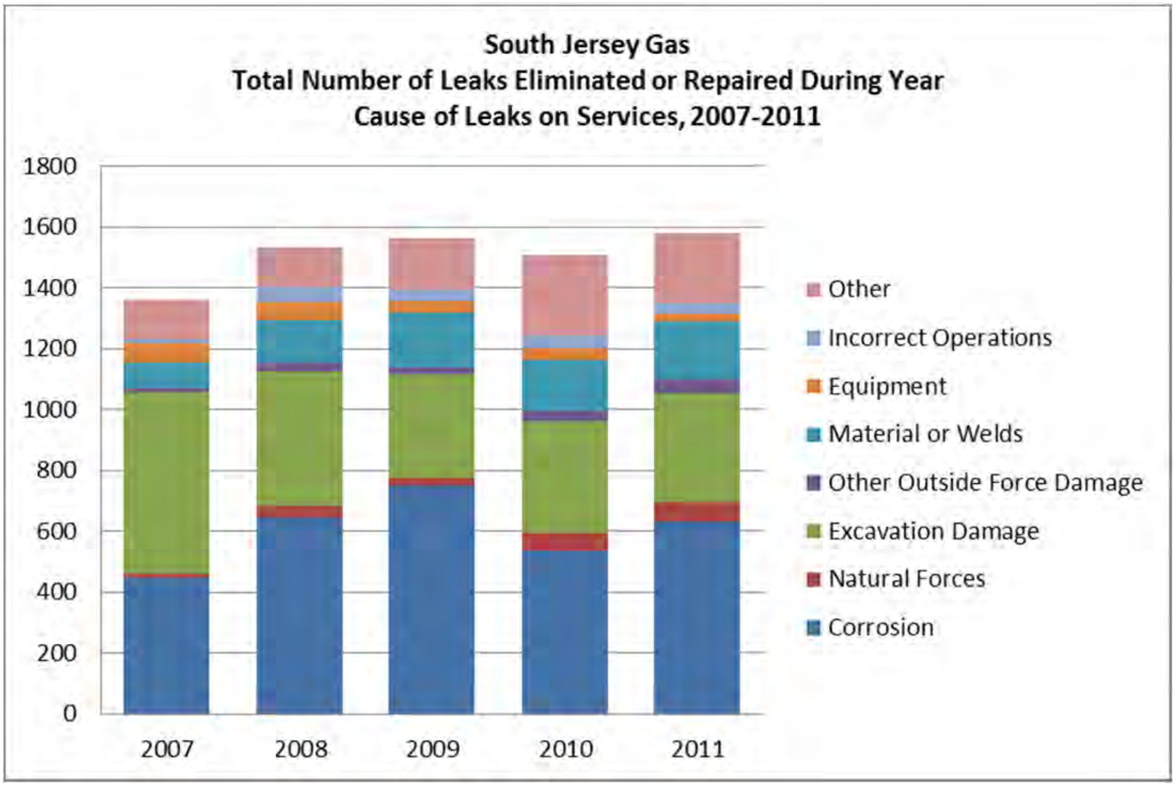
The following bar charts describe the causes of leaks on SJG's system from 2007 through 2011.[28] During this period, SJG eliminated or repaired 14,793 leaks on SJG's distribution main and 7,545 leaks on SJG services. The cause of the leaks stayed relatively consistent. As would be expected given the high proportion of unprotected steel main in SJG's system, corrosion was the predominant cause of leaks on SJG's mains, ranging from 77% of the leaks to 86%. Corrosion and excavation damage were the main factors for service leaks.

Table 12-13 - Total Number of Leaks on Main - Eliminated or Repaired



[27] For a discussion regarding Gas Leak response time metrics, see Chapter 14 – *Customer Service and Meter Reading.*
[28] Source: Response to Discovery, OC-130.

Table 12-14 - Total Number of Leaks on Services- Eliminated or Repaired



SJG classifies leaks in one of three categories:[29]

- Grade A Leaks – A leak that is nonhazardous at the time of detection and can be reasonably expected to remain nonhazardous;
- Grade B Leaks – A leak that is recognized as not being an immediate hazard at the time of detection, but justifies scheduled repair based on probable future hazard.
- Grade C Leaks – A leak that represents a hazard at the time of detection and requires immediate repair or continuous monitoring actions until a repair is possible.

As seen in the following bar charts, SJG significantly reduced the number of leaks in its backlog during the audit period for Grade A and Grade B Leaks during the audit period.[30] From December 31, 2009 to December 31, 2011, SJG reduced the amount of leaks in its Grade B backlog by 42% and it reduced the amount of leaks in its Grade A backlog by 89%.

[29] Response to Discovery, OC-130.
[30] There were no unrepaired Grade C Leaks at the end of 2009, 2010 or 2011.

Table 12-15 - SJG Grade "A" Leaks Backlog

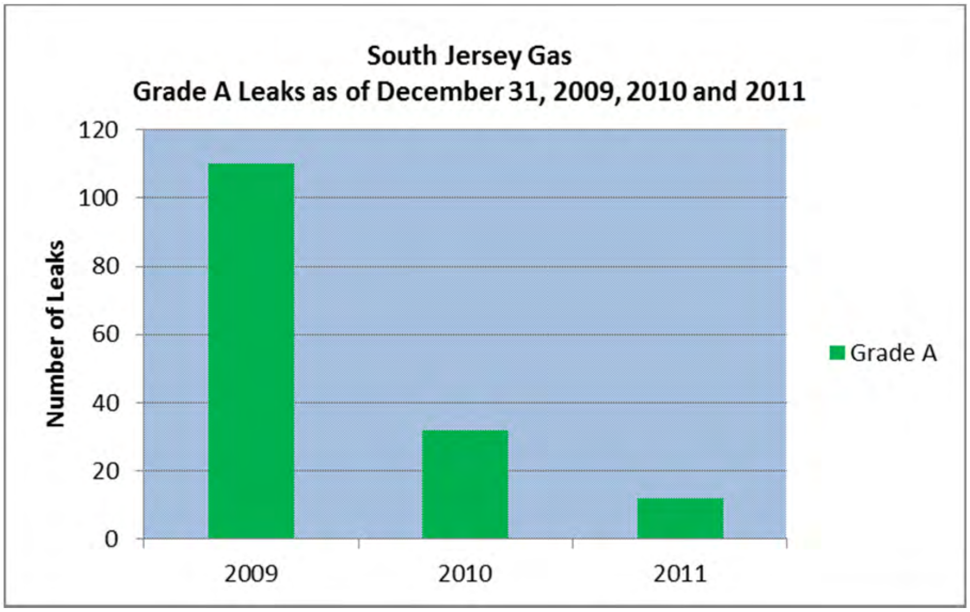
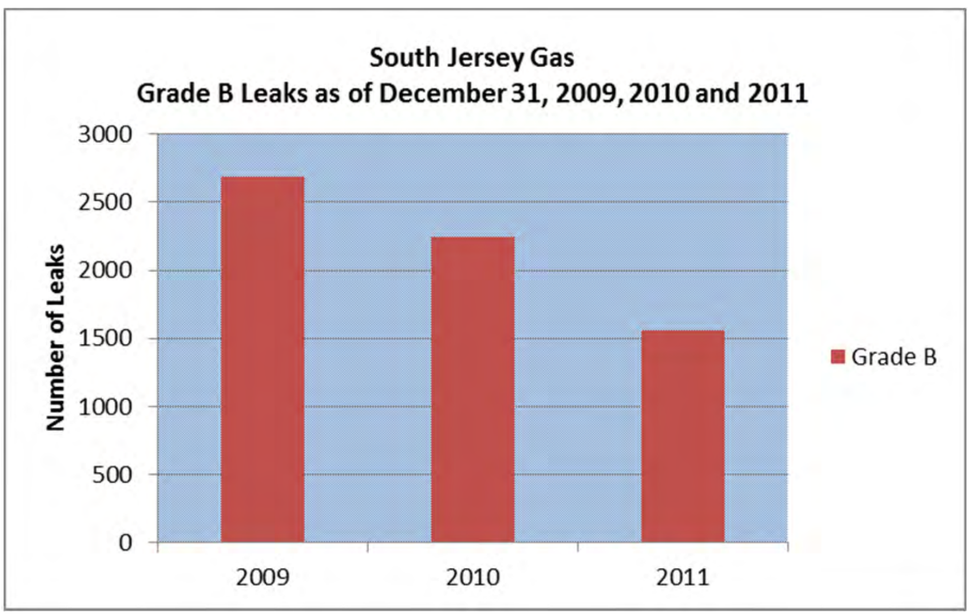


Table 12-16 - SJG Grade "B" Leaks Backlog



SJG maintains a section in its O&M Manual titled "Leak Classification and Action Criteria." Protocols regarding the most and least severe leaks are relatively standard amongst LDCs. The most severe leaks (Grade C Leaks) are made safe and repaired as soon as possible, while the least severe leaks (Grade A Leaks) are monitored on a periodic basis. Grade B Leaks are those leaks that are non-hazardous at the time of detection, but that need to be scheduled for repair.[31] Criteria regarding the repair and

[31] Response to Discovery-OC-130.

monitoring of this type of leak is arguably the most important to critically review because policy over these leaks can vary substantially between different LDCs.

During the previous management audit, a recommendation was made that SJG should adopt a timeframe (recommended as 12 months) wherein Grade B Leaks would be repaired. In the Company's response to this prior audit recommendation, SJG stated that it "agreed in concept" with the recommendation, but wanted to delay implementing the recommendation until the final DIMP rule was released noting that…. "[a]ny formal adoption of standards prior to the DIMP would be premature and potentially in conflict with Federal guidelines."[32] However, the DIMP Final Rule released on December 4, 2009 did not establish a timeframe for Grade B Leaks. Rather, the rule gave more general guidance that the DIMP should, "include an effective leak management program (unless all leaks are repaired when found)."[33] SJG has implied in filings to the NJ BPU that its goal is to reach a "find-and-fix" level of leak management, but it is not yet there. As of year-end 2011 SJG maintained a significant number of Grade B Leaks that were over one year old, the oldest of which was discovered nearly ten years ago in February 2003.[34,35] This recommendation was based on guidance from the Office of Pipeline Safety and we see no reason to revise it at this time.[36] SJG should implement the prior audit recommendation to repair Grade B Leaks within 12 months.

System Reliability

During the audit period, SJG maintained adequate system pressures and there were no widespread gas curtailments during this period.[37] To help ensure the reliability of the system, SJG performs maintenance and inspection activities designed to be in accordance with federal and state safety standards.[38] SJG's primary maintenance and inspection activities, as well as the frequency of these activities, are listed in the table below.

[32] Response to Discovery, OC-146.
[33] Response to Discovery, OC-250.
[34] Response to Discovery, OC-130.
[35] Response to Discovery, OC-336.
[36] Response to Discovery, OC-146.
[37] Response to Discovery, OC-131.
[38] Response to Discovery, OC-253.

Table 12-17 - SJG Maintenance and Inspection Activities

South Jersey Gas Maintenance and Inspection Activities	
Activity	**Frequency**
Leak Response	24/7 Call-out basis
Replacement Mains/Services	Daily
Construction Inspection	Daily
Gate Station Checks	Weekly
Transmission Patrol	Monthly
LNG Fire Protection	Monthly
Pipeline Crossings	Quarterly
Exposed Pipeline Survey	Quarterly
Elevated Pressure Patrol	Biannually
Valve Maintenance	Annually
Regulator Maintenance	Annually
Relief Valves	Annually
LNG Process Control	Annually
Mobile Leak Survey	Annually
Transmission Leak Survey	Annually
Business District Survey	Annually
Service Leak Surveys	3 year cycle
Transmission Integrity Assessments	7 to 10 year cycle
Meter Changes(A)	Based on sampling program results
Note A: The meter testing process is described in Chapter 14 - *Customer Service and Meter Reading.* Source: Response to Discovery, OC-253.	

The Company also holds biannual operations meetings to specifically discuss reliability related issues related to the Company's winter season. These are known internally as the "Pre Winter" and "Post Winter" operations meetings. The Pre Winter meeting is held in the fall of each year and brings together the operations and engineering staffs to discuss how the issues from the previous winter season have been addressed and how the Company will address anticipated issues for the upcoming winter season. Also, any low-pressure areas of the system are discussed and determinations regarding where the Company needs to place additional pressure recording equipment are made. The Post Winter meeting is held annually in the spring. This meeting is used to discuss any significant issues that occurred during the most recent winter season.[39]

Benchmarking

Benchmarking its performance against other LDCs is not something that is emphasized at SJG in general, or the operations and engineering functions in particular. SJG does participate in two benchmarking

[39] Response to Discovery, OC-654.

studies, one sponsored by PSE&G and one through the AGA, that provide performance data of other LDCs in comparison to SJG, but little emphasis is placed on the results.[40,41]

SJG should make it a regular practice to compare its performance to industry benchmarks. Performance is more likely to improve, and good performance is more likely to be maintained, when targets are set at levels that require effort to achieve. When possible, industry best in class performance levels should be used as benchmarks for setting internal performance targets.

[40] As an example of how little emphasis SJG places on these benchmarking studies, the 2009 AGA benchmarking study that was provided in discovery had the incorrect number of customers listed for SJG which drastically altered SJG's per-customer metrics. However, the Company appears to have not noticed this as no mention of this discrepancy was noted in the discovery response.

[41] Responses to Discovery, OC-338 and OC-372.

13. Contractor Performance and Damage Prevention

This chapter covers SJG's management of construction and maintenance contractors, with a focus on damage prevention activities. Topics discussed include:

- Construction and maintenance functions conducted by contractors and employees
- Contractor oversight and construction inspection
- Construction project management
- Evaluation of SJG's excavation damage prevention program
- Procedures for reviewing mark outs and inspecting contractor work
- The scope and frequency of field and contractor facilities audits
- Processes to review the performance of contractors installing gas facilities

Summary of Findings

Construction and Contractor Performance

1. SJG outsources nearly all of its construction activities, the markout (pre-excavation facilities location) process and most of the leak survey functions to contractors. Approximately 220 employees in SJG's divisional "Utility," "Street" and "Office" departments operate and perform most maintenance on the company's gas distribution system, as well as manage and administer all construction, maintenance and operations activities.
2. SJG's construction activities have increased substantially since 2009 as a result of accelerated gas service and main replacement programs. These programs, which are approved annually by the BPU, permit SJG to earn a return on accelerated infrastructure replacement costs prior to being included in base rates.
3. SJG's Construction Manual includes detailed written construction inspection procedures. The procedures include a detailed set of inspection responsibilities covering the construction process and qualifications and requirements for contractors and their employees.
4. SJG does not currently use a Project Management Office structure to manage large construction. However, SJG brings together division staff, schedulers, design supervisors, contractor management and relevant municipal, county or state officials on a bi-weekly basis to discuss project status for all construction projects, whether new business or replacement.
5. SJG is currently implementing an Enterprise Work and Asset Management System (EWAMS) which should result in a significantly enhanced ability to manage both the physical and cost aspects of construction and maintenance projects.

Excavation Damage Prevention

1. SJG is a member of the Common Ground Alliance, a national stakeholder group dedicated to the protection, safe construction and operation of underground infrastructure. SJG's Markout Coordinator is a current member of the New Jersey Common Ground Alliance Board.

2. SJG's written procedures to address pipeline damage prevention appear adequate. These include a damage prevention program operating procedure and a pipeline markout procedure. In 2011 SJG added a horizontal directional drilling procedure and a high-risk excavation procedure.
3. SJG's key damage prevention metric, damages per 1,000 markout requests, has improved steadily. After peaking at 7.4 damages per thousand in 2007, it has declined each year since. For the 10 months ended October 31, 2012, it was 4.87, a 35 percent reduction from the 2007 rate. However, SJG's damages rate appears to be worse than the industry median. For example, in 2008, the median damages rate for a group of 30 utilities that included New Jersey utility PSE&G was 3.69.[1] Although it was trending downward, SJG's damages rate in 2008 was 6.53.
4. SJG's excavation markouts are currently performed by contractor Utiliquest. SJG recently signed a five-year contract with Utiliquest that includes a termination clause in case Utiliquest fails to meet performance requirements. SJG has a procedure under which it audits approximately 1,000 Utiliquest markouts annually. The "failed audit" percentage has dropped from 15 percent in 2008 (the earliest year for which statistics were made available), to 2 percent for 2011. The number of damages attributed to locator error dropped from 262 in 2007 to 126 for the first 10 months of 2012 (representing an annualized rate of 151 for 2012).

Recommendations

1. SJG's key damage prevention metric is damages per 1,000 markout requests. We recommend that a goal to improve this statistic to "best in class" levels be reflected in the performance evaluations for employees directly responsible for damage prevention, including the Director of Work and Process Management and the Markout Coordinator.[2]
2. The division of gas system construction and maintenance functions between employees and contractors has remained constant for at least the last 12 years. Employees perform most routine maintenance while contractors perform essentially all construction. SJG has not conducted any studies of the costs and benefits of using employees vs. contractors since at least 2009. At least for the excavation location (markout) function, which is and has been handled by a contractor, the use of employees can be considered to be a best practice because it tends to provide better control over the process. Although it may be that the status quo continues to represent SJG's least-cost alternative, we recommend that SJG perform a high-level computation of the costs and benefits of each construction and maintenance function at least once every five years.
3. Objectives to achieve damage performance metrics; most importantly, damages per 1,000 locates, should be included in the Balanced Scorecards of all employees with responsibility for

[1] Overland Consulting, *Audit of Relationships and Transactions Between Public Service Electric and Gas Company and its Affiliates and a Comprehensive Management Audit of Public Service Electric and Gas Company*, Public Version, January 2012, page 21-7, Table 21-4.

[2] Although the Balanced Scorecards for the Markout Coordinator had several performance goals linked to damage prevention (which is the Markout Coordinator's primary responsibility), a goal targeting improvement in the key damage performance metric was not among them.

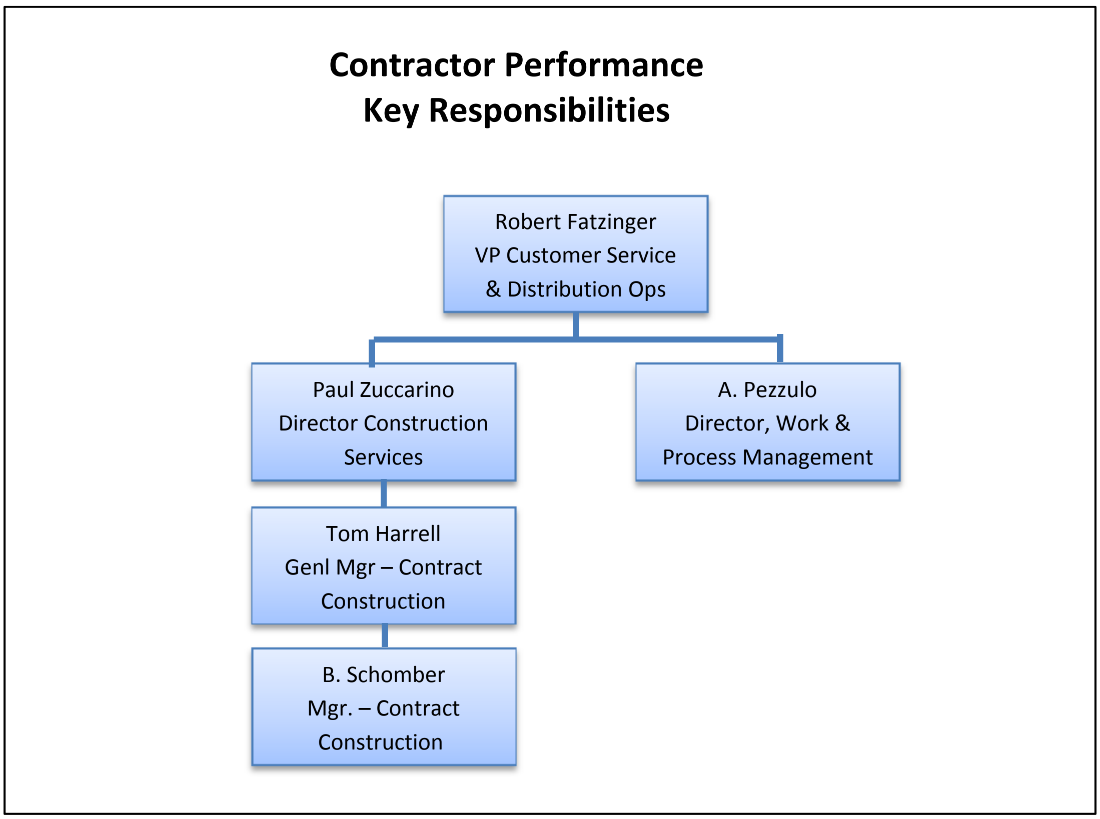
contractor safety procedures, especially employees with direct responsibility for overseeing the leak survey and damage prevention processes, including the Director, Work and Process Management (Anthony Pezzulo at the time of our audit) and the Markout Coordinator (William Tappin at the time of our audit).

Contractor Performance

Overall responsibility for contractors performing construction and maintenance work is vested in Paul Zuccarino, Director, Construction Management. Mr. Zuccarino reports to Robert Fatzinger, Vice President of Customer and Distribution Operations. Mr. Zuccarino is in charge of SJG's "Street," "Utility" and "Office" departments. These departments include approximately 222 employees responsible for both constructing and maintaining SJG's distribution main and services facilities. Employees responsible for the selection, coordination, management and supervision, and inspection of contractor work include, in addition to Mr. Zuccarino, Tom Harrell, General Manager of Contract Construction, Brent Schomber, Manager of Contract Construction, and Anthony Pezzulo, Director of Work and Process Management.

The chart below summarizes the reporting relationships among these individuals.

Table 13-1 - Contractor Performance Key Responsibilities



SJG's Use of Contractors and Employees for System Construction and Maintenance

SJG utilizes contractors for nearly all construction work, which includes, in addition to new construction, system improvement and gas main and service replacement. SJG also outsources its distribution pipeline design work. SJG employees perform distribution system maintenance and a small percentage of leak surveys. Employees also provide all oversight of design, permitting and construction and they serve as emergency responders. The division of construction and maintenance responsibilities between employees and contractors is summarized in the following table.

Table 13-2 - South Jersey Gas, Division of Field Responsibilities – Contractor vs. Employee

South Jersey Gas Division of Field Responsibilities - Contractor vs. Employee		
Area	Percentage Performed by	
	Employees	Contractors
Distribution Pipeline Design	0%	100%
Design Oversight / Permitting	100%	0%
Construction	2%	98%
Construction Oversight / Inspection	100%	0%
Leak Survey	10%	90%
Markouts	0%	100%
Gas Distribution Maintenance	100%	0%
Source: Response to Discovery, OC-514		

SJG indicated that work levels vary and the use of contractors allows SJG to match the demand for work with a flexible supply of labor. SJG stated that the decision to utilize contractors or employees is driven by economics, core competencies, workforce flexibility and minimum employee staffing levels as determined by management. SJG stated that the work performed internally vs. by contractors has remained consistent for at least the last 12 years.[3] SJG stated that it retains a sufficient number of utility workers and street crews to effectively respond to emergencies, repair leaks and complete core operations and maintenance work.[4]

SJG indicated that since 2009 it has not analyzed the costs and benefits of bringing outsourced construction or leak survey work in house.[5] Bringing work in-house that has long been performed by contractors would involve administrative difficulties and initial costs, some of which could be significant. For example, assuming SJG's crews are right-sized for current operations, in-sourcing functions currently performed by contractors would require searching for, recruiting and hiring a potentially large group of new employees. Given that utilities tend to have employee benefits programs that are more generous than those offered in the workforce in general, and given the fixed costs of vehicles, tools and insurance for employees that are billed on an "as used" basis by contractors, it is possible that the hourly cost of

[3] Response to Discovery, OC-514.
[4] Response to Discovery, OC-163.
[5] Response to Discovery, OC-255.

in-sourced work would not be lower, and might be higher, than it currently is on an outsourced basis, even when contractor overheads and profit are fully considered. More importantly, given that outsourcing is used to balance the supply of labor with SJG's need for construction work, and given SJG's relatively small size, it is likely that in-sourcing would mean less flexibility (since employees must be paid whether or not sufficient work is available to keep them busy), and therefore lower average productivity. Nevertheless, testing this hypothesis by performing a basic cost-benefit analysis at least once every five years would probably yield some useful information, including some ideas on how to make better use of contractor labor, and it might identify smaller units of work that could be economically in-sourced. This analysis is further supported in light of the significant increase in the SJG's construction program experienced in the audit period as contrasted with prior years.

Contractor Inspection Procedures

Inspection of contract construction crews is performed daily by SJG Construction Inspectors. Construction Inspection is governed by procedures set forth in Section 8.1 of SJG's Construction Manual.[6] Following is a partial list of the significant responsibilities of the Construction Inspector position:

- Check drawings, materials ordered and returned and permits.
- Review pipeline location with the Contractor and locate all underground obstructions known to exist.
- Inspect pipe loading and unloading, string operations, job site storage and ditching operations.
- Inspect qualifications records for each person joining pipe to ensure proper certifications in welding, plastic fusion or mechanical joint assembly.
- Inspect alignment and fit-up of welded, mechanical and plastic fusion joints before joining occurs.
- Visually inspect completed welds and plastic fusion joints.
- Inspect and approve all pipe bends.
- Inspect pipe surfaces for defects prior to coating joints or any field-coated pipe repairs. Inspect the surface of the pipe as it is lowered into the ditch.
- Inspect the ditch prior to pipe installation for proper clearances and adequate depth of cover.
- Check the pipe fit to the ditch prior to backfill.
- Inspect backfilling operations to prevent coating damage.
- Review and document tie-in procedures with subcontractors prior to work commencement.
- Direct or conduct special tests and inspections, including graphitization, as required and outlined in procedures.
- Inspect repairs, replacements and ordered changes before they are covered.
- Be on-site during main tie-ins.
- Make field corrections on drawings and prepare field sketches showing as-built conditions.

[6] Response to Discovery, OC-514.

In addition to these requirements, Construction Inspectors have the authority to order removal and replacement of equipment, welding and materials failing to comply with SJG specifications.

In 2011 SJG added a written procedure to cover the process of inspection of high-voltage electrical pipeline coatings. The purpose of such inspections is to test the continuity of the protective coatings and to determine, prior to installing pipe in the ground, whether there are "holidays" (discontinuities of electrical coatings) that expose the metal surface of pipe to the environment. The procedure covers the use of an "electrical holiday detector," a device for locating electrical discontinuities in pipe coatings.

In addition to the job responsibilities listed above, which concern the quality and safety of pipe installation, SJG's Construction Inspectors are required to monitor Operator Qualification (OQ) and various safety-related components of contractor work. As stated by SJG, these requirements include the following:[7]

- Contractors must provide SJG with the names and qualifications of the employees assigned to the project, including management oversight of the project. The Company decides whether resources are adequate to perform the work.
- Contractors must provide evidence they have reviewed SJG's safety, construction and O&M manuals with their employees prior to beginning work.
- Contractors must provide a quarterly spreadsheet summarizing OQ status for employees authorized to work on SJG facilities.
- SJG recently added a requirement that contractor employees who fail an OQ must wait at least 48 hours before retesting.
- SJG audits contractor OQ training and reports the information to the BPU.
- For purposes of safety on the job site, contractors are required to conduct job safety talks with their crews prior to beginning work each day.
- SJG monitors contractor drug and alcohol testing results.

Management Performance Evaluation – Contractor Performance

We reviewed the balanced scorecards for employees that SJG identified as having responsibility for contractor selection and performance. These included Paul Zuccarino, Tom Harrell, Brent Schomber and Anthony Pezzulo. Most of the performance objectives documented in the scorecards were generalized and high-level, and none dealt specifically with contractor performance.

We reviewed Mr. Pezzulo's 2012 balanced scorecard (covering his recent tenure as Director of Work and Process Management). 2012 operational goals included safety, compliance objectives and EWAMS implementation. Among the compliance objectives were leak surveys and the high-risk excavation procedure discussed in this chapter. Mr. Pezzulo was rated for acceptable performance (3 of 5) on the compliance objectives and slightly below that for safety (2.5 of 5). There were no performance objectives in Mr. Pezzulo's or any of the scorecards directly tied to damage prevention, or to SJG's most significant statistic: damages per 1,000 locates.

[7] Response to Discovery, OC-514-E & F.

Construction Project Management

SJG's construction projects can be divided roughly into two categories: Integrity-driven pipe replacements and new business system expansion projects. Construction project costs for the review period are summarized below.

Table 13-3 - South Jersey Gas – Capital Project Summaries

South Jersey Gas - Capital Project Summaries Actual vs. Budget (Amounts in $000s)								
Type	2009		2010		2011		2012 - 10 Months	
	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget
Division Blankets	43,561	39,473	45,817	43,969	52,329	49,595	53,251	45,213
Engineering Blankets	3,960	4,950	3,981	4,772	3,891	3,947	3,857	3,373
SJIS Managed Blankets	1,786	1,932	2,825	2,983	3,202	2,751	1,604	2,575
SJIS-IT Projects	-	-	-	-	527	566	219	481
Subtotal Blankets	**49,307**	**46,355**	**52,623**	**51,724**	**59,949**	**56,859**	**58,931**	**51,642**
Division Specials	2,303	3,300	1,033	1,220	10,889	8,861	(35)	3,728
Engineering Specials	656	1,215	1,587	2,521	8,064	7,106	2,417	3,466
SJIS Managed Specials	5,023	2,497	-	-	-	-	-	-
SJIS - IT Projects	-	-	6,686	6,572	8,031	7,130	12,303	10,150
SJIS - Admin Services Projects	-	-	716	843	2,113	2,233	1,067	860
Subtotal Specials	**7,982**	**7,012**	**10,022**	**11,156**	**29,097**	**25,330**	**15,752**	**18,204**
Subtotal Non-CIRT								
CIRT I Projects	57,221	68,804	37,367	39,297	-	-	170	-
CIRT II Projects	-	-	7,628	10,002	49,327	50,886	16,415	12,741
CIRT III Projects	-	-	-	-	-	-	32,822	36,359
Subtotal Cap. Inv. Recovery	**57,221**	**68,804**	**44,995**	**49,299**	**49,327**	**50,886**	**49,407**	**49,100**
Total Construction	**114,510**	**122,162**	**107,640**	**112,179**	**144,494**	**139,453**	**124,089**	**118,945**
Source: OC-515								

Accelerated Main and Service Replacements - SJG's construction activities increased after the implementation of accelerated main and service replacement programs beginning in 2009. Three programs, known as Capital Investment Recovery Trackers (CIRTs), have been approved by the BPU and implemented by SJG since 2009. At the time of our audit, SJG was in the process of seeking BPU approval for a fourth program, named the Accelerated Infrastructure Replacement Program, to be implemented in 2013. The programs are designed to improve system integrity and safety by speeding up the replacement of leak-prone bare steel and cast iron services and mains in areas with higher leak rates. SJG is permitted to earn a return on investment under the AIRP as expenditures occur. Adjustments to rates to reflect the investment return are to be made in a future rate proceeding.[8] The programs supplement, rather than replace, SJG's normal service and main replacement activities.

Construction Procedures - On approved projects, once permits are obtained, construction plans are forwarded to SJG's divisional construction supervisory employees, who are responsible for performing final reviews of project scope, design and tie-in procedures. The plans are then released to the Contract

[8] Under normal circumstances, completed construction that becomes plant in service does not earn a return on investment and is not incorporated into customer rates until reflected in rate base as part of a rate application.

Construction Services group.[9] Day-to-day construction project management is the responsibility of the divisional Construction Supervisor. This individual and staff track field construction progress, actual cost vs. budget and project schedule. They also prepare as-built documents. A separate financial analysis is run on new-business projects to determine financial viability.

SJG indicated that it does not employ a Project Management Office for the management of large construction projects.[10] However, work management meetings are held twice per week to discuss status for all new business and pipe replacement projects.[11] Attendees include division staff, schedulers, design supervisors, contractor management and government representatives as needed. As a result of these meetings, project schedules and other elements of construction may be adjusted. These meetings appear to effectively function as SJG's project management office.

SJG states that the implementation of the Enterprise Work and Asset Management System (EWAMS), scheduled for 2013, will automate many of the manual steps currently required to manage construction projects. In particular, project cost estimation and tracking should be improved. EWAMS will allow projects to be continually updated, in terms of both physical completion and actual incurred cost. SJG also expects EWAMS to improve the accuracy and flexibility of the project scheduling process.

Excavation Damage Prevention

Activities to prevent damage to SJG's existing underground gas facilities include the excavation markout process and efforts to communicate excavation safety and markout requirements to groups that conduct or initiate excavations. SJG identified the following steps it has taken to minimize damage to its facilities:[12]

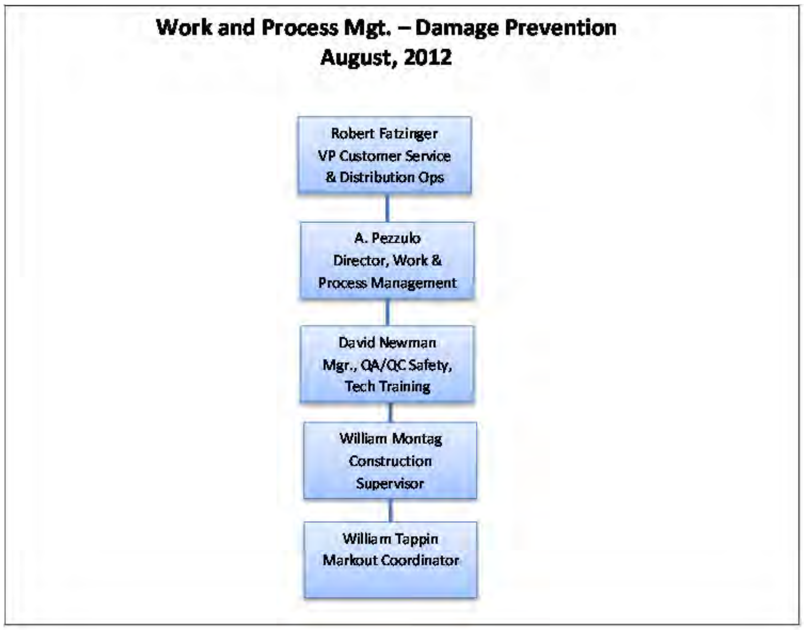
- Written damage prevention procedures, including an operating procedure addressing the One-Call system, excavation locate (markout) procedures, and customer and contractor communications, and recently added procedures addressing high risk excavation and horizontal directional drilling,
- Regular formal and informal communication with excavating contractors,
- Communication with residents in SJG's service territory,
- Participation in organizations that share damage prevention best practices, including the American Gas Association, Northeast Gas Association, Common Ground Alliance and New Jersey Common Ground Alliance, and
- Formation of a Damage Prevention Improvement Team to further improve the excavation damage prevention program.

[9] Response to Discovery, OC-515-A.
[10] Response to Discovery, OC-515-B.
[11] Response to Discovery, OC-515-A.
[12] Response to Discovery, OC-252.

Damage Prevention Responsibilities

Prevention of damage to SJG's gas facilities is currently the direct responsibility of Anthony Pezzulo, Director, Work and Process Management.[13] Mr. Pezzulo reports to Robert Fatzinger, V.P. of Customer and Distribution Operations. William Tappin, Markout Coordinator is responsible for the markout process, the key process in preventing excavation damage from occurring. The chart below summarizes Mr. Pezzulo's and Mr. Tappin's reporting relationships within the Work and Process Management function.

Table 13-4 - Work and Process Mgt. – Damage Prevention



Damage Prevention Procedures

SJG states that its Damage Prevention Program is designed to comply with Code of Federal Regulations (CFR) Title 49 and the New Jersey Underground Facility Protection Act. Sections 1.16.1 and 1.16.2 of SJG's Operations and Maintenance Manual address the procedures to comply with these regulations. SJG's Damage Prevention Program consists of the following components:[14]

- <u>One-Call System</u> – SJG participates in the One-Call Damage Prevention System for New Jersey (New Jersey One-Call). Key features include:
  - Receiving and recording notice of intent to excavate from excavators (the company, its contractors or its customers).
  - Assigning a confirmation number and maintaining a record of excavator and site information.

[13] Interview, Anthony Pezzulo, Director, Work and Process Management, November 15, 2012. Prior to 2012 the position was held by Edward Unger.

[14] Response to Discovery, OC-516, Att. 1, Operating and Maintenance Manual, Sections 1.16.1 and 1.16.2.

    - Notifying underground facilities operators (e.g. SJG) regarding the excavations, and notifying excavators of these operators.
    - Maintaining records of each notice of intent to excavate for seven years.
- Pipeline Markouts – As described in more detail below, SJG requires facilities markouts for each planned excavation.
- Line Markers – Line markers are required for mains and transmission lines.
- Underground Warning Tape – Yellow sub-surface marking tape is placed in backfill above pipelines when they installed, repaired or replaced.
- Public Notification – Contractors, customers and the public are notified about damage prevention and New Jersey One Call through a variety of means, including mailings, direct contact (with contractors), newspaper and magazine releases and articles, utility bill inserts, and other forms of communication.
- On-Site Inspections –
    - *Transmission Lines* - SJG's procedure requires the Pipeline Department to "make all reasonable efforts to provide on-site inspection oversight immediately prior to and during excavation and backfilling which exposes or potentially exposes the Company's transmission pipelines." Employees acting as "contractor guides" are required to prepare records of oversight and inspection efforts by completing a Pipeline Opening Report, Field Transmission Locate report or Pipeline Maintenance Order.
    - *Distribution Facilities* – Division Operations is required to "make a reasonable effort to provide a guide for oversight and information . . . where the Company has reason to believe its facilities could be damaged. . . The guide shall document all activities and important information on an individual work order for each location." The procedure lists a set of factors to be considered in determining the need for and extent of inspections.
- Damage Reporting – This component of the procedure defines damage and requires the completion of a Facilities Damage Report. It requires bi-weekly damage reporting to the Board of Public Utilities.

Markouts and Other Pre-Excavation Damage Prevention Procedures

Anyone planning to dig, including homeowners and contractors, as well as SJG itself, is required to request a mark out through New Jersey One Call prior to excavation. Most of SJG's markouts are performed by Utiliquest, a locator company with which SJG recently signed a five-year contract.[15] Following a request, Utiliquest generally has three business days to perform the markout, a process that SJG monitors to ensure it is done on time.[16] Utiliquest's responsibilities include receipt, recording, dispatching and closing of all excavation notices, as well as field investigation of damaged facilities.[17] Located facilities are marked using safety yellow based on information available in SJG's map / sketch records and with the use of locator equipment, including hookups to tracer wires and cross referencing

[15] Pezzulo Interview, November 15, 2012.
[16] Emergency work is marked out on a same-day basis.
[17] Response to Discovery, OC-518.

physical location data with sketches.[18] Paint, stakes or flags are used depending on the surface being marked. All facilities within a perimeter of 10 feet of a proposed excavation are marked. Photographic evidence of the markout is taken and visual and written records of the markouts are maintained for seven years. Utiliquest is required to notify SJG when it finds SJG's records to be inaccurate.

Large construction projects, defined as sewer, water, drainage or similar projects involving excavation of more than 2,000 linear feet to a depth of at least four feet, require additional procedures. According to SJG's Operating and Maintenance Manual, Section 1.16.2, large construction projects require the following steps:

- SJG schedules a pre-construction meeting with the installation contractor and the locator (currently Utiliquest) to determine the scope, extent and schedule of the project.
- The locator is provided with records needed to perform locations and is scheduled to be on site each morning during excavation to ensure all facilities with the day's scope of work are properly marked.
- When appropriate, SJG assigns a contractor's guide to remain on site during critical phases of the project.
- An SJG representative meets periodically with the contractor and locator during lengthy projects to discuss required activities and assure proper communication and coordination.

When damage occurs the Company responds to it as an emergency and repairs are made.[19] Both SJG and Utiliquest perform damage investigations. Once the responsible party is identified, they are billed for the damage through the Claims department.

Quality Control and Auditing

SJG randomly selects approximately 1,000 markout tickets each year and dispatches personnel to field locations to perform quality assessments of the markouts performed by contractors.[20] When errors are found they are discussed with Utiliquest. There is a termination clause in SJG's contract with Utiliquest that may be exercised if the locator cannot meet quality standards. The table below summarizes field audit activity since 2008.

[18] When physical location procedures identify errors, these must be noted in the sketch.
[19] Pezzulo Interview, November 15, 2012.
[20] Pezzulo Interview, November 15, 2012.

Table 13-5 - South Jersey Gas, Markout Field Audit Statistics

South Jersey Gas Markout Field Audit Statistics							
Year	# of Tickets	# of Audits	Audits per 1,000 Tickets	# of Failed Audits	Failed Audit Pct.	#of Passed Audits	Passed Audit Pct.
2011	88,290	959	10.90	22	2%	937	98%
2010	84,613	632	7.50	17	3%	615	97%
2009	86,376	1066	12.30	56	5%	1010	95%
2008	38,568	536	13.90	79	15%	457	85%
Source: OC-517							

Other Damage Prevention Metrics

SJG stated that the primary metrics it uses to assess the performance of its damage prevention program are:

- Damages per 1,000 markout tickets,
- Markout ticket backlog, and
- Locator mismarks.

The table below summarizes the damages rate as a percentage of markout statistics and the causes of damages, including those due to locator mismarks. It shows that since peaking in 2007, during a time when residential construction was still booming, damages per 1,000 markout requests has declined by approximately 35 percent. The table also shows the number of locator errors has declined significantly, from 176 in 2007 to 61 in the first 10 months of 2012. During this time the rate of locator error dropped by approximately half.

Table 13-6 - South Jersey Gas, Underground Facilities Damages and Causes

South Jersey Gas Underground Facilities Damages and Causes							
				Causes			
Year	Requests for Mark Outs	Damaged Faciliies	# of Damages per 1,000 Requests	Excavator or No Ticket	Locator Error	Excavator Error	SJG Record
2012 10 Mos.	86,010	419	4.87	126	61	193	39
2011	88,290	476	5.39	129	86	194	67
2010	84,613	475	5.61	122	90	226	37
2009	86,376	480	5.56	141	80	233	26
2008	95,498	624	6.53	185	96	343	n/a
2007	105,137	777	7.39	262	176	339	n/a
2006	115,516	727	6.29	n/a	141	586	n/a
2005	120,601	569	4.72	n/a	n/a	n/a	n/a
Source: OC-519							

Recent Specific Steps to Improve Damage Prevention

New Jersey utilities (including SJG), contractors, the One Call Center and the BPU are part of the New Jersey Common Ground Alliance. This group meets quarterly to share information and discuss best practices with regard to damage prevention.[21] SJG states that during 2012 it formed a Damage Prevention Improvement Team to further improve its damage prevention program. The team includes various subject matter experts within SJG, including Field Construction Supervisors and Communications and Government Affairs employees. It also includes Utiliquest and certain contractors who perform excavations.[22] The team holds meetings in which it brings in outside experts, conducts root cause analysis of damages and discusses potential solutions. SJG states that Utiliquest assigns a person on a full-time basis to assist contractors working on large projects.[23] SJG recently implemented two additional procedures which it states are aimed at damage prevention: a high-risk excavation procedure and a horizontal directional drilling procedure.[24]

High-Risk Excavation Procedure - This procedure establishes criteria for assessing the risk associated with specific excavation locations. In general, high-risk locations include "any location where a large amount of people are likely to congregate at the time of excavation, or any location where the excavation will create a significant risk of damage to [SJG's] facilities due to the depth and scope of excavation." High-risk locations include schools and day care facilities, hospitals and nursing homes, large shopping malls, "religious facilities," high-rise buildings and others. When a planned excavation is established to be high risk, it requires a series of steps involving communication between the excavator and the company. SJG's "Office Supervisor" or Pipeline Supervisor makes a determination as to whether a site visit or standby observer is required. The observer meets with the digging contractor, and completes a high-risk excavation safety review sheet and a high-risk observation log. Copies of all paperwork are retained for 10 years.

Horizontal Directional Drilling Procedure (HDD) – This procedure, added to SJG's Construction Manual in 2011, indicates that HDD is a method of installing pipe without digging a trench. It involves using power equipment to create a tunnel through which gas pipe can be inserted.

Management Performance Evaluation – Damage Prevention

We attempted to establish the links between damage prevention statistics and performance evaluations for the SJG employees directly responsible for damage prevention. We focused on Anthony Pezzulo, who SJG made available as the subject matter expert for our interview on damage prevention and who stated he was directly responsible for damage prevention, along with Bill Tappin, Markout Coordinator.

Mr. Tappin's performance goals for the year 2010 included the following related to damage prevention:

[21] Response to Discovery, OC-516.
[22] Pezzulo Interview, November 15, 2012.
[23] Pezzulo Interview, November 15, 2012.
[24] Response to Discovery, OC-516.

- Recommend / assist in implementing at least three process improvements to improve the productivity and / or customer satisfaction level of the Utiliquest process.
- Complete 20 markout audits monthly.
- Review information gathered from DIRT reports and suggest 3 areas of improvement that will help reduce damages.
- Bring three ideas from the National CGA meeting that can be used to improve our damage numbers.
- Suggest new ideas to promote 811 awareness.
- Meet regularly with Utiliquest management and field personnel to discuss issues that can improve their locating.

Generally, Mr. Tappin received “met expectations” ratings for these goals. There were no goals tied to specific reductions in damage rates. Mr. Pezzulo’s balanced scorecard objectives for “internal process” (operational objectives including those relating to damage prevention) are shown below. Mr. Pezzulo’s balanced scorecard also contains no objectives directly tied to damage rates.

Table 13-7 – SJG Director of Work & Process Mgmt., 2012 Balanced Scorecard “Internal Process” Objectives & Measures

SJG Director of Work and Process Management 2012 Balanced Scorecard "Internal Process" Objectives & Measures	
Objective	**Measure**
Improve SJG safety, business efficiency and productivity while meeting compliance requirements	Safety - Achievement of 2012 safety goals
	Achieve compliance objectives - Regulators, valves (incl. RE), Commercial age changes - Leak Survey - High risk excavation procedure - Main and service replacement'
	Achieve EWAMS implementation milestones
Source: Response to Data Request OC-365, "DR #365 A Pezzsulo BSC 2012 (Operations).xls	

14. Customer Service and Meter Operations

The Customer Service and Dispatch function includes call center, customer accounting, credit and collections, meter reading, billing, service dispatch and customer relations functions. Audit period actual costs incurred ranged from a low of $14.0 million in 2011 to a high of $16.5 million in 2010. Budgeted and actual costs are summarized in the table below.

Table 14-1 – Customer Services, Budgeted and Actual Expense by Cost Center

South Jersey Gas Customer Services Budgeted and Actual Expense by Cost Center						
Cost Center	2009		2010		2011	
	Actual	Budget	Actual	Budget	Actual	Budget
Dispatch (661) Total	906,458	838,843	966,911	974,631	952,080	959,361
Call Center (881) Total	3,793,290	3,908,417	4,056,073	3,953,665	3,923,672	4,162,255
Customer Accounting (882) Total	866,147	966,447	891,270	941,838	938,770	831,071
Credit & Collection (883) Total	3,829,930	3,585,302	5,307,464	3,621,562	2,970,809	3,728,077
Meter Reading (MAS) (884) Total	2,927,252	2,919,599	3,015,548	3,021,701	3,086,904	3,073,020
Billing Services (885) Total	1,870,921	1,858,800	2,041,898	1,974,541	2,090,762	1,971,800
Customer Relations (886) Total	60,400	55,602	65,003	73,785	59,268	66,494
CIS Project (901) Total	142,287	153,165	132,902	123,520	(386)	92,680
Total	14,396,685	14,286,175	16,477,070	14,685,242	14,021,878	14,884,758
Source: OC-500						

Summary of Findings

1. SJG relies on a legacy Customer Information System (CIS) developed in the 1970s to maintain its customer accounting and billing processes. The system has significant limitations in terms of flexibility, reliance on paper-driven processes and ability to interface with other SJG systems. SJG began to evaluate options to replace the legacy CIS in 2010 and management approved the acquisition of a new system in 2011. SJG is currently in the process of developing a new CIS, based on an Oracle platform, which will provide improvements such as real-time information, customer-based (rather than meter-based) financial information, web-based customer self-service, better flexibility to incorporate rate and other changes, and improved capture of performance metrics. The new system is budgeted at $22 million (about $63 per customer).
2. SJG replaced its Avaya phone system in 2010. Its new Cisco phone system includes an automatic call direction (ACD) sub-system that interfaces with the CIS through an interactive voice response (IVR) system, which was upgraded when the new phone system was installed. The new system can direct customer calls to service representatives based on skill designations. Customers can also obtain payment and other information from the system without waiting to talk with a service representative.
3. SJG uses the Automated Dispatch System (ADS) to dispatch customer service orders to the field. The ADS is a web-based system that dispatches orders and collects service order results data in the

field. It links with the legacy CIS to schedule appointments and provide Customer Service Representatives with the ability to view service call information.

4. SJG measures customer satisfaction relative to other gas utilities using surveys conducted by J.D. Power. SJG's overall customer satisfaction was above the average of its peer group (mid-sized, eastern region gas utilities) in three of the four years from 2009 through 2012.
5. Customer service performance metrics cover the areas of inbound call answering, meter reading and billing, gas leak response, service appointment, customer complaints, and customer interaction. The current set of metrics and targets were negotiated during the 2010 rate case. Most metrics reported by SJG showed improvement between 2009 and 2012.
6. Although most customer service performance metrics improved during the review period, some performance targets have not been met. SJG improved "percentage of calls answered within 30 seconds" from 43% in 2009 to 62% in 2012, but it remains below the targeted level of 80%. Other call metrics, such as the average seconds to answer, seconds to obtain a live agent and calls per representative per hour, also remained somewhat below target; however, time-to-answer statistics in general showed significant improvement, most likely as a result of the implementation of the new phone system and improvements to the IVR.
7. The number of complaints to the BPU dropped significantly, from 1,078 complaints in 2009 to an annual rate of 480 as of October, 2012. It is likely that at least some of the decline can be attributed to an improving economy. Customer-perceived levels of service representative courtesy and knowledge improved from the 70-75% range in 2009 to 91% in 2012. First call resolution improved from 69% in 2009 to 72% in 2012. However, "service appointments met" stayed about 10 points below the target level of 95% for the period for which statistics were provided (January, 2010 through October, 2012). The percentage of gas leak and odor calls responded to within one hour remained consistently around 96%, slightly below the SJG target of 97%, but above the target of 95% established in the 2010 rate case.
8. SJG's late-payment collection and disconnection activities depend on customer credit scoring. The credit scoring process is outsourced to Total Solutions, Inc., which uses a proprietary process to score customers based on criteria which include how long the customer has been with the utility, number of recent delinquencies, billed and past-due amounts, when the most recent payment was made and how often the customer has been eligible for disconnection due to non-payment. Credit scores, which can range from "Excellent" to "Unsatisfactory," are the primary driver of collection procedures and efforts. Collection activities include sending late payment and shut off notices, making outbound "last attempt to collect" phone calls, physical disconnection at the meter or curb valve, and post-disconnection attempts to collect by outside agencies.
9. SJG's bad debts, measured as a percentage of revenue, more than doubled between 2009 and 2012, from 0.41% to 0.90%. SJG attributed the increase to "the financial market crash of 2008 and its subsequent impact on the local economy." We question the causal link that SJG draws between the 2008 financial crisis and an increase in the bad debt rate between 2011 and 2012. To the extent the increase in 2012 is not simply a "catch up" of amounts that should have been expensed before 2012, it could be the product of either less-than-aggressive collection efforts or sub-par efforts to ensure that as many customers as possible who are eligible for energy assistance receive the assistance.

For example, while the bad debt rate increased in 2012, SJG's percentage of customers disconnected declined from 1.6% in October, 2010 to 1.2% in October, 2011. At 1.2%, SJG's disconnection rate was one-third the average rate of 3.6% for gas utilities in the mid-Atlantic region, according to statistics compiled by the AGA in its fall 2011 survey. Although a relatively low disconnect rate does not prove anything by itself, it could be an indicator that SJG's collection policies are somewhat less aggressive than those of its peers. While the increase in the bad debt rate over time presents a concern, it should also be noted that a rate of less than 1% of revenue does not indicate a serious collection problem.

10. Past-due accounts with balances of $25 or more are sent for external agency collection after shut-off, if active, or after 60 days, if inactive. The effectiveness of collection agencies, as measured by the average rate of recovery of amounts sent for outside collection, decreased from 8.5% in 2010 to 4.1% in 2012. During this time, the number of accounts sent for collection increased from 34,133 to 48,931. Outside agencies recovered $867,000 in 2010, but just $554,000 in 2012.
11. Meters are read by affiliate Millennium Account Services (MAS). The Joint Agreement between MAS and SJG defines acceptable performance as obtaining actual reads (by Millennium or the customer) of at least 91% of total SJG meters. With the exception of a few individual months impacted by snow events, MAS met the 91% standard throughout the review period, with an average gas meter read rate of slightly less than 95%.
12. Meter testing is outsourced to Measurement Controls, Inc., located in North Carolina. SJG tests a 5% sample of all new meters purchased and continuously conducts testing on a sample of "small" meters (under 500 c.f./ hour capacity) in accordance with BPU requirements. Meters with capacities above 500 c.f./hour are scrapped after 10 years. To pass a test, a meter must be within +0.5% and -1.0% for both "open" and "check rate" tests, with a spread of no more than 1.0% between the tests.
13. Meters found to be out-of-tolerance may be subject to billing adjustments. A Fast Meter Refund is calculated and issued if a meter is found to be registering fast by more than two percent. Billing adjustments are not processed for slow meters unless SJG finds evidence of tampering or the meter fails to register consumption. When a non-registering meter is adjusted, the customer may spread the additional amount owed over the same amount of time that the meter determined not to have been registering usage.

Recommendations

1. SJG should consider adding automated dialing and collection capability to its new phone and CIS system to enable it to initiate active collection efforts on past due amounts at an earlier stage in the account aging process. Currently available technology is capable of identifying past due accounts, dialing the associated customers automatically with payment messages, and facilitating the collection of payments from such customers over the phone, in many cases without the intervention of a live agent. This permits additional focus and effort to be applied to overdue accounts earlier in the aging process at a minimal incremental cost per collection attempt. Given that SJG is currently in the process of implementing a new CIS, we believe it is timely to consider implementing

automated dialing and collection technology. Alternatively, SJG should at least ensure that its new CIS is designed with the capability of handling automated collection in the future.

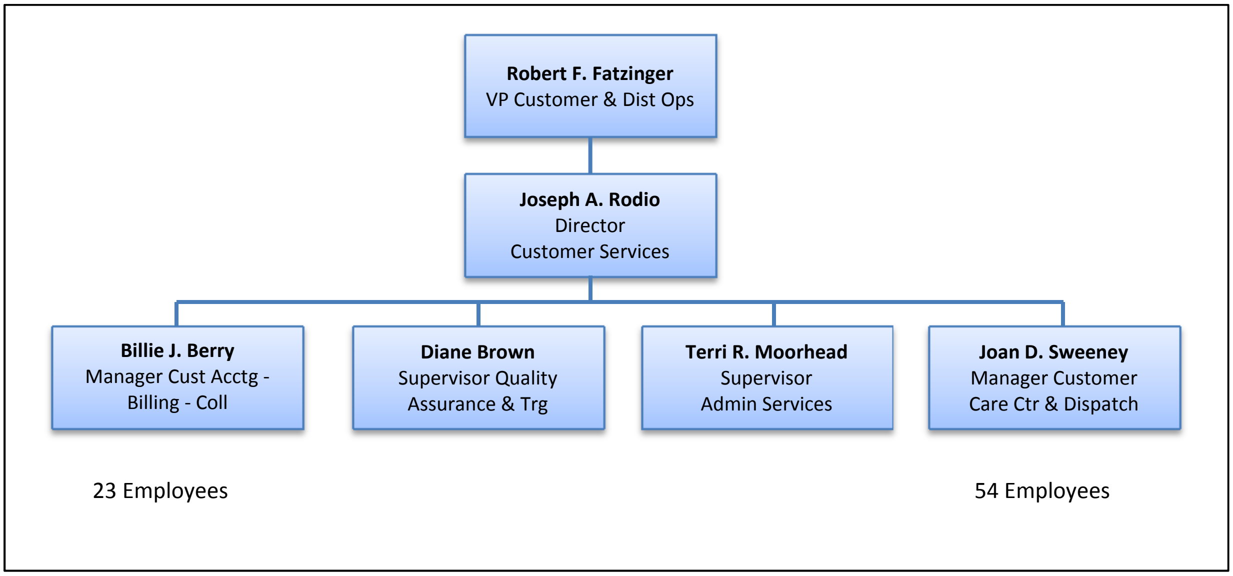
2. Overland recommends that SJG establish performance targets for the following credit and collection statistics and add them to the balanced scorecard for the Manager, Customer Accounting and Billing: 1) arrearages over 60 and 90 days; 2) bad debts as a percentage of revenue; and 3) percentage of revenue recovered for accounts turned over to outside collection agencies. To the extent statistics are available from AGA surveys of arrearages and collection activities, the AGA statistics for peer companies should be used to establish benchmarks.
3. Balanced scorecards for managers in the Customer Service function do not currently include performance targets for important department metrics. Assuming it is the responsibility of Customer Service managers to meet these targets, we recommend including them in the balanced scorecards for the Managers, Customer Service and Dispatch and Customer Accounting and Billing. Specifically, call answering, gas leak response, first call resolution, service appointments met and service representative courteousness and knowledgeable targets should be included in the balanced scorecard for the Manager, Customer Service and Dispatch. Targets for bad debts as a percentage of revenue, 60 and 90 day arrearage as a percentage of total outstanding accounts receivable, field collector productivity and percentage of revenues recovered by collection agencies should be added to the balanced scorecard for the Manager, Customer Accounting and Billing.
4. As noted above in the Summary of Findings, SJG's disconnection rate is between one-third and one-half of its AGA Mid-Atlantic region peers. SJG should investigate the reasons that its disconnection rates are lower than its peers during a time when its bad debts as a percentage of revenue have been increasing. Based on this, SJG should determine whether its procedures for identifying and disconnecting non-pay accounts are appropriately aggressive. To the extent SJG's reliance on credit scoring may be causing it to leave non-pay accounts connected beyond the age that such accounts are disconnected by peer companies, SJG should adjust its procedures and perhaps increase the aggressiveness of its shut-off activities.
5. SJG should develop a written procedure describing the activities needed to systematically ensure that, to the extent possible, all customers eligible for energy assistance programs have appropriately identified and encouraged to apply for assistance. Further, the procedure should outline the processes and employee responsibilities required to ensure that all monthly billing credits due from the State of New Jersey under the State's Lifeline program are appropriately processed and collected. SJG should ensure that to the extent permitted by law, its new CIS tracks energy assistance eligibility and participation.

Organization, Staffing and Key Functions

SJG's customer service organization had approximately 80 employees as of August 2012. It is headed by Joseph Rodio, Director of Customer Services, who reports to Robert Fatzinger, Vice President, Customer and Distribution Operations. The chart below summarizes the organization as of August 2012. Mr. Rodio oversees managers in charge of call center and dispatch operations, which had approximately 54 employees in August 2012, and customer accounting, billing and collection, which had 23 employees in

August 2012. Also reporting to Mr. Rodio are a Supervisor of Quality Assurance and a Supervisor, Administrative Services. Although Mr. Rodio is responsible for the meter reading function, and though it is one of the largest budget items, SJG has no meter reading department. As discussed elsewhere, meter reading was outsourced to Millennium Account Services, an affiliate, more than 10 years ago.

Table 14-2 – South Jersey Gas Customer Service Organization, August 2012



Groups within the customer service organization include the following.

- *Customer Care Center* – This is the largest functional group, with approximately 54 employees, including Customer Service Representatives, their supervisors, a Manager, Customer Care and Dispatch and several clerical employees. Most of the clerical positions were added to the group between 2009 and 2012. The Customer Care Center interfaces with customers who call SJG with requests for service connection or termination, have questions about their bills or accounts or otherwise need assistance.
- *Service Dispatch* – This function consists of seven Dispatchers who route customer service orders to field personnel and help monitor the orders while they are in process.
- *Billing and Collection* – This group consists of 23 employees, including a Manager, Customer Accounting and Billing, Commercial Audit Representatives, Collection Representatives, a supervisor, a Financial Analyst and clerical employees. According to the job description for the Manager position, this group is responsible for cash receipts and cash processing, customer billing, maintaining customer and meter history records, collection processes, both internal and external, preparing monthly customer accounting and collection reports, and interfacing and maintaining files relating to cash collected on behalf of others (marketers and SJESP).[1]

[1] Response to Discovery, OC-71, "DR #71 – SJG – A Job Descriptions.pdf."

In addition to these internal groups, SJG has outsourced the following components of the customer service process:

- Meter reading (Conducted by affiliate Millennium Account Services)
- Meter testing (Conducted by Measurement Controls, Inc.)
- Post-disconnect and post-write-off collection efforts (Conducted by various external collection agencies)

Customer Service Technology and Information Systems

South Jersey Gas currently relies on an internally-developed, mainframe computer-based customer information and billing system (legacy CIS) developed in the 1970s.[2] A separate system, the Automated Dispatch System (ADS), is used to dispatch service orders to the field for fulfillment.

Customer Information System (CIS)

The legacy CIS was the primary system for maintaining customer account data, including energy usage, billing and payment data during the review period. The system is significantly outdated and inflexible compared with current technology. Among its limitations are the need to navigate multiple screens to obtain information; various manual, paper-driven processes; inflexible report generation requiring hardcoding to implement or change; limitations in establishing and documenting billing arrangements; a lack of web access; and a lack of sufficient interface with other SJG systems, such as the Automated Dispatch System.

In 2010, SJG contracted with AAC Utility Partners to evaluate options to replace the legacy CIS. SJG hired AEG (Applied Energy Group) to perform a full risk assessment for the CIS. In 2011 the decision was made to replace the legacy CIS with a new system. SJI developed criteria for vendor selections and divided the selection process into two phases: one to review vendor profiles, functions, technical solutions and costs, and a second to consider innovation and flexibility, demonstrations of vendor capabilities and reference checks. During this process, SJG considered both SAP and Oracle platforms, each with their own set of implementation vendors.

A new "customer centric" CIS, based on an Oracle platform, with implementation assistance from PriceWaterhouseCoopers, EP2M and Blue Heron Consulting, was approved in November, 2011.[3] The total approved cost, consisting primarily of consulting fees, was approximately $22 million. Among the key features of the new CIS are:

- Focus on customer-level financials (as opposed to meter, customer premises or account-based financials);
- Web-based customer self-service;
- An interface with the interactive voice recognition (IVR) call system;

[2] Interview, Joseph Rodio, Manager, Customer Service, January 8, 2013.
[3] Response to Discovery, OC-271, Attachment "SJG New Customer Information System (CIS)," November 22, 2011.

- Ability to quickly absorb and translate changes in rates and rate design into bills;
- Real-time information;
- Reduction in billing errors associated with currently manual processes; and
- Improved capture of metrics such as call response time and first-call resolution, improvements in collection processes and the ability to mine customer data and use it for marketing.[4]

Telephone System

SJG replaced its existing Avaya phone system with a new Cisco phone system at the end of 2010. The new Cisco system includes an Automatic Call Direction (ACD) sub-system.[5] The ACD directs incoming calls to specific customer service representatives based on identified skill designations.
The telephone system interfaces with the CIS via an interactive voice response (IVR) system. SJG indicates that its IVR was upgraded when the Cisco system was installed in 2010. Since the upgrade, customers have been able to obtain information about payments, energy efficiency, payment assistance programs, payment center locations and mailing addresses through the phone. They can also request an energy choice packet and they can input meter readings.

Although it has upgraded the inbound side of its telephone technology, SJG has not adapted more sophisticated technology to its outbound collection efforts.[6] Such technology typically includes automated dialing and voice recognition systems which enable automation of the collection process.[7]

Automated Dispatch System (ADS)

The ADS is used to dispatch service orders to the field. SJG describes its ADS as a "web-based dispatching and field results capture tool that is based on the legacy mainframe."[8] It is used by the dispatch function to send work to field personnel. Field personnel capture time and other details related to the work. ADS links to the existing CIS to schedule customer appointments and emergency calls and to provide customer service representatives with the ability to view information associated with service calls.

Performance Metrics

SJG uses J.D. Power to conduct surveys to monitor customer satisfaction. J.D. Power's customer data is ranked with peer utilities. In addition, SJG maintains certain operational performance metrics relating to call answering, metering and billing, gas leaks, service appointments and customer complaints. SJG does not benchmark its operational statistics against other utilities.

[4] Id.
[5] Response to Discovery, OC-625.
[6] Response to Discovery, OC-626.
[7] These systems can be set up to dial delinquent accounts and take payments without human intervention.
[8] Response to Discovery, OC-645.

Customer Satisfaction Metrics

SJG monitors customer satisfaction at the corporate level using J.D. Power's Gas Utility Residential Customer Satisfaction Study to compare their performance against other natural gas utilities in the region. The survey measures overall customer satisfaction, as well as satisfaction in individual categories, including:

- ***Billing and Payment*** - Billing and payment performance through a variety of methods for customers to pay their bills, the amount of time given to pay the bill, ease of finding the exact amount, the usefulness of information provided to customers on their bills and the ease of finding the payment due date.
- ***Price Performance*** - The total monthly cost of natural gas service, fairness of pricing, the effort spent by the company to help the monthly usage, and understanding price options that meet customer's needs.
- ***Corporate Citizenship*** - Involvement in local charities and civic organizations, a variety of energy efficiency programs; actions taken towards the environment safety, and efforts to maintain a safe gas system.
- ***Communications*** - Communication about natural gas safety, usefulness of suggestions on reducing bills, and keeping overall energy costs low.
- ***Customer Service Performance*** – The survey utilizes customer service management metrics to evaluate customer service performance. The metrics focus on calls placed on hold, report hold time (minutes), estimated hold time, hold time longer than estimated, number of website clicks required, first call resolution and website resolution.
- ***Field Service Performance*** - This evaluates SJG's quality of work performed, attention to safety, and appearance of the workforce.

SJG's overall customer satisfaction index is summarized below in comparison to the peer company high, low and average.

Table 14-3 – Overall Customer Satisfaction Index, East Mid-Size Segment

J.D. Powers Customer Satisfaction Survey Overall Customer Satisfaction Index, East Mid-Size Segment	2009	2010	2011	2012
Highest Peer Company	625	649	635	646
South Jersey Gas	615	634	-	632
Peer Average	595	614	613	622
South Jersey Gas	-	-	601	
Lowest Peer Company	555	571	581	599
Source: OC-80, OC-722, J.D. Powers Gas Utility Residential Customer Satisfaction Survey, East Mid-Size Segment Overall CSI Results, 2009-2012				

The drop in SJG's CSI between 2010 and 2011 was the most significant among the eight peer companies in J.D. Power's "east midsize segment." We asked SJG to describe the reasons for the decrease in the index from 2010 to 2011, when it dropped from above to below the peer group average. Following is an excerpt from SJG's response:[9]

> *During [a presentation to SJG's management team in November 2011], Chris Oberle, Senior Director of J.D. Power . . . reported that SJG's customer satisfaction scores between 2010 and 2011 were negatively impacted by economic conditions in SJG's service area as 45% of customers responding to the survey reported they were worse off economically in 2011 than they were in 2010. Oberle reported that customers of other utilities in the east midsize region did not indicate that they were as negatively impacted by the economy as did SJG's customers. His belief is that as economic conditions improve so would SJG's scores.*

SJG notes that Mr. Oberle also made the following suggestions which he stated should help improve SJG's CSI:

- More aggressively promote the Equal Payment Plan, online bill payment and auto-debit payments;
- Promote the use of the Aclara tool on SJG's website so customers can view their account information and analyze their energy usage to save money; and
- Increase communication about rate decreases, safety messages and community involvement activities.

SJG stated that in response to these suggestions it went live with a new website in 2012 that is easier to navigate and expands the information available about billing, payment, financial assistance programs, energy efficiency, safety and more aggressively promotes EPP and the Aclara tool. It also stated that it implemented a "12 month communications plan that uses social media, advertising, IVR messages, Call Center Representative talking points, on-hold messages, news releases and bill inserts to increase messaging [about various matters]."

As shown in the table above, SJG's overall CSI climbed back above the peer average in 2012 to a level comparable to what was achieved in 2010.

Operational Performance Metrics

SJG's current set of operational performance metrics were negotiated during the 2010 rate case. In addition to metrics relating to call center and meter operations, most of SJG's operational customer service metrics showed improvement between 2009 and 2012. The table below summarizes the metrics for the review period.

[9] Response to Discovery, OC-281.

Table 14-4 – Operational Performance Metrics

South Jersey Gas Customer Service Operational Performance Metrics								
	2009		2010		2011		2012	
Measure	Target	Actual	Target	Actual	Target	Actual	Target	Actual
Call Answering:								
Pct. answered less than 30 secs.	Not Provided	42.5% (1)	80% (2)	55.70%	80% (2)	47.50%	80% (2)	61 50%
Live Agent (average seconds)	70	231	70	187	70	100	70	85
Overall (average seconds)	48	153	48	122	48	71	48	60
Calls per Rep per Hour	>=10	9.4	>=10	9.1	10	8.7	10	8.1
Abandoned Call Percentage	5.0%	8.60%	5.0%	9.0%	5.0%	3.3%	3.5%	2.4%
Meters and Billing								
Residential Meters Read on Cycle	Not Provided	94.2%	95%	94.3%	95%	94.3%	95%	95.0%
Re-bills per 1,000 Customers	Not Provided	Not Provided	<=20	10.2	<=20	10.9	<=12	9.7
Billing Memos & Hi-Lo Failures - Review, correct & mail w/in 2 days of receipt	95%	100%	95%	100%	Not tracked	Not tracked	Not tracked	Not tracked
Gas Leaks								
Gas Leak / Odor Response Time Within 60 Minutes	97%	95.50%	95.0%	95.10%	95%	95.7%	97.0%	96 3%
Service Appointments								
Pct. of Service Appointments Met	Not Provided	Not Provided	95%	85.8	95%	85.40%	Not Provided	86.9% (3)
Customer Complaints								
BPU Complaints		1078		837		788		400 (4)
Complaints Per 1,000 customers, without shut-offs	1.75	2.3 (5)	< 1per 1000 customers	2.37	< 1per 1000 customers	2.26	Not Provided	0.7 (4)
JD Powers Quarterly Customer Survey:								
First Call Resolution	>67%	68.7%	> 69.5%	69.8%	None	68.1%	70.0%	72.0%
Rep. Was Courteous	>73%	75.9%	> 76.5%	75.6%	None	91.2%	None	91.7%
Rep. Was Knowledgeable	>69%	70.9%	> 71.5%	70.3%	None	89.6%	None	90.8%

Sources: OC-81, OC-247, OC-523A & G and OC-637
(1) July through December. (2) Rate Case Goal. Internal goals may be different. (3) Through October. (4) Annualized through October. (5) This rate, from OC-247, is inconsistent with 1,078 complaints as shown in OC-81.

Call Answering - In mid-2009 SJG began measuring the percentage of calls answered within 30 seconds. In the rate case that concluded in 2010, SJG stipulated to a set of customer service metrics which are included in the table above. The rate case stipulation set a target of 80% for calls answered within 30 seconds. While SJG has made improvements in the statistic since 2009, it still cannot answer more than about 60% of incoming calls within 30 seconds. However, according to the company's statistics, SJG made a more significant improvement in the average time it takes for a live agent to pick up a call, reducing it from an average of around 3.5 minutes in the 2009-2010 timeframe to about 90 seconds in 2012.

As the average wait time improved, the abandoned call percentage also declined. SJG attributes call answering improvements to "additional CSRs . . . added to help in improving [the percentage answered within 30 seconds] metric."[10] It also appears likely that the call answering improvements are attributable to changes in work procedures and to the installation of the Cisco Automatic Call Distribution system at the end of 2010.

[10] Response to Discovery, OC-279.

- Meter Reading – According to statistics provided in response to requests for customer service metrics, the percentage of meters read on cycle was steady at approximately 95% during the period 2009 through 2012.[11] Re-bill statistics were not provided for 2009. For the period 2010 through 2012 they have remained stable at around 1%.
- Gas Leaks - The percentage of gas leak calls with response times under one hour remained steady at around 96% throughout the period 2009 through 2012. SJG did not achieve its 2009 or 2012 targets of 97%. It is unclear why targets were 95%, instead of 97%, in 2010 and 2011.
- Service Appointments - The percentage of service appointments met remained steady at an annual average of approximately 86% for the period 2010 through 2012. SJG has not been able to approach its service appointments met target of 95%.
- Customer Complaints - The number of customer complaints to the BPU declined significantly between 2011 and 2012. The 2012 statistic was annualized data based on the 12 months ending October 2012, rather than on calendar year 2012. One of the complaint statistics provided for 2009 (either the number of complaints or the rate per 1000 customers) is incorrect.
- J.D. Power Customer Representative Statistics - SJG slightly exceeded its first call resolution targets of 67% to 70% for the years 2009 through 2012. According to the reported statistics, SJG made significant improvements in customer-perceived levels of Customer Service Representative courteousness and knowledge, increasing them from percentages in the low 70s in 2009 to over 90% in 2012. Virtually all of this change occurred between 2010 and 2011.[12]

Credit and Collection

Oversight of credit and collection is the responsibility of the Manager, Customer Accounting and Billing. Credit and collection activities include telephone and final bill collections, negotiation of payment arrangements, account write offs, oversight of outside collection agencies, and credit risk evaluation and approval.

Credit and Collection Policies

Credit Scoring - Customer credit is scored on a scale ranging from "Excellent" to "Non-Satisfactory."[13] Scoring determines how customers are treated with respect to collection of amounts in arrears. The process is outsourced to Total Solutions Inc. (TSI). SJG sends TSI a customer information file at the end of each billing cycle, which TSI uses to develop the scores, which are input into the legacy CIS. TSI's credit scores are based on the following criteria:[14]

- How long the customer has been with the utility;

[11] However, these statistics vary slightly from data provided in response to read vs. estimated consumption provided in Response to Discovery OC-277, which shows meter read rates of 94.6%, 93.7% and 94.9% for 2009, 2010 and 2011, respectively.

[12] Since the J.D. Power statistics are based on customer surveys, it is important to note that it is possible for a change in the way a survey question is framed to produce a change in the resulting statistic.

[13] The scale includes "Excellent," "Very Good," "Good," "Satisfactory" and "Non-Satisfactory."

[14] Response to Discovery, OC-731.

- How many times the customer was delinquent within the prior 8 months;
- The amount in arrears;
- The number of times the customer was eligible for disconnection or actually disconnected within the prior 24 months;
- When the last payment was made; and
- Amount of the most recent bill.

Deposit Policy – SJG's written deposit policy provides that deposits are "required from any customer who has not established credit or where credit has become impaired."[15] "Impaired credit" includes credit rated as "Satisfactory" or "Unsatisfactory," the two lowest ratings on SJG's five-level credit scale. SJG may waive deposits if customers without established credit provide acceptable references. Deposits for new customers are added to the customer's first bill.

The initial deposit is an amount equal to twice the monthly Equal Payment Plan amount, if available. If an Equal Payment Plan amount is not available, the deposit is based on double the average monthly consumption, provided at least 10 months of history is available. When Equal Payment Plan amounts and sufficient consumption history data are both lacking, deposit amounts are $87 for residential non-heating customers and $257 for residential heating customers.

Collection Activities

We asked SJG to provide the collection actions, events and a timeline that occurs when accounts become overdue, and as the accounts age. SJG provided the following list of collection steps:[16]

1. Late payment or shut off notices are generated by the billing system based on credit scoring and arrearage balance using the following criteria:[17]

    - Active customers with a credit scoring of "Good" receive late notices on their bill if arrearage is $25.00 or more;
    - Active customers with a credit scoring of "Satisfactory" receive a shut off notice on bill if arrearage is at least $25.00, if the arrearage is under $25.00 a collection letter is sent; and
    - Active customers with a credit rating of "N" Non-Satisfactory Customer Rating receive a Shut off notice on bill if arrearage is at least $25.00; if the arrearage is under $25.00 a collection letter is sent.
2. SJG Collection Representatives make a "last attempt to collect" phone call. Payment arrangements are offered to all customers in arrears as long as the customer has not already broken 3 prior payment arrangements.
3. Shut off orders to disconnect are issued to the field collectors.

[15] Response to Discovery, OC-629, "DR #629 Deposit Policy.pdf."
[16] Response to Discovery, OC-731.
[17] No mention is made of customers with "Very Good" or "Excellent" credit scores. We interpret this to mean that no late payment or shut off notices are sent to these customers. SJG did not provide information to indicate when (at what age) late payment or shut off notices are sent to other customers.

4. Shut offs are performed by field collectors when all attempts to work with the customer have been exhausted, the customer has been given the required 10 day notice of service discontinuance and they are not protected under a moratorium. The collectors make one final attempt to collect the customer payment prior to shutting off service.
5. Following shut-off, *active* customer accounts with a credit rating of Satisfactory or Non-Satisfactory rating are handled as follows:[18]
   - Heat customers with balances of $300 or more and non-heat customers with balances of $150 or more are sent to an agency that performs outbound collection calls; and
   - Collection letters are sent to active customers below these dollar thresholds, unless balances are below $25.
6. Inactive accounts are sent to an outside agency for collection "at 60 days."
7. When accounts are written off (SJG does not indicate when this occurs), accounts are sent to a primary collection agency immediately, and to a secondary agency six months after write off.

SJG did not provide a timeline for the activities listed above, but instead stated the following:[19]

> *Our collection process is driven by a customer's credit score, incorporating the tariff, account status and amount of arrearages. There are collection events triggered at billing time and at collection time. No collection events are triggered for residential customers with Excellent or Very Good scores or on a payment arrangement.*

Credit and Collection Metrics

During our interview with the Manager of Customer Accounting and Billing, we determined that SJG maintains certain statistics relating to credit and collections that are not among the operational performance metrics negotiated during the last rate case (as discussed above).[20] Among the statistics noted in the interview were the following:

- Delinquencies by "status" and "revenue class;"
- Number of customers on payment arrangements;
- Bad debts as a percentage of revenue; and
- Field Collector productivity metrics (accounts worked and productive hours).

Bad Debt Expense

SJG's bad debt expense accounting for the years 2009-2011 is summarized in the following table. SJG attributes the 2011 decline in net actual charge offs to a $20 million BGSS (Basic Gas Supply Service) billing credit; the result of declining gas prices.

[18] SJG does not explain what happens to customers with credit scores above "Satisfactory." This may be because credit scores cannot be above "Satisfactory" after shut-off has occurred.

[19] Response to Discovery, OC-731.

[20] Interview, Billie-Jo Berry, Manager, Customer Accounting and Billing (during the 2009-2011 review period), March 14, 2013.

Table 14-5 – Charge Offs to Uncollectibles

South Jersey Gas			
Charge Offs to Uncollectibles			
Item	2009	2010	2011
Gross Charge Offs	2,914,655	3,204,522	3,633,485
Reserve Adjustments	160,324	530,820	(1,587,538)
Credits	558,013	(566,996)	(538,922)
Adjustments	(377,167)	415,389	(264,266)
Net Charge Off Actual	2,139,799	3,583,735	1,242,759
Net Charge Off Budget	2,064,000	1,990,600	1,997,818
Budget Variance	75,799	1,593,135	(755,059)
Source: OC-629			

We also requested SJG effective bad debt rate, as a percentage of revenue. SJG provided the following information, which shows that bad debts as a percentage of revenue more than doubled between 2009 and 2012.

Table 14-6 – Bad Debts as a Percentage of Revenue

South Jersey Gas				
Bad Debts as a Percentage of Revenue				
Item	2009	2010	2011	2012
Budgeted	0.40%	0.42%	0.49%	0.50%
Actual	0.41%	0.64%	0.62%	0.90%
Source: OC-733				

SJG stated that the bad debt rate “has been significantly impacted by the financial market crash in 2008 and its subsequent impact on the local economy.”[21] However, Overland notes that the bad debt rate continued to increase significantly, in percentage terms, in 2012, four years after the financial market disruption. It is also curious that as the bad debt rate increased over a four year period, SJG continued to budget lower bad debts than it incurred. Although a detailed study of the causes of SJG’s bad debts is beyond the scope of our audit, it seems unlikely that the financial crash of 2008 had much to do with a 50% increase in the bad debt rate between 2011 and 2012.

We also asked SJG to provide data reflecting the benchmarking of overdue accounts and disconnection statistics with those of other utilities. This was data that SJG had indicated was available during an interview with the Manager of Customer Accounting and Billing. Although the data SJG summarized in a spreadsheet was limited, it contained the following disconnection statistics:

[21] Response to Discovery, OC-733-A.

Table 14-7 – Percentage of Customers Disconnected

South Jersey Gas Percentage of Customers Disconnected		
Item	Oct. 2010	Oct. 2011
SJG	1.64%	1.19%
Middle Atlantic Region Gas Utilities (per AGA)	3.20%	3.60%
Source: OC-729		

The data show that SJG's disconnection rate was declining even as its bad debt percentage was increasing, and that the percentage of customers SJG had in disconnected status was one-half to one-third the percentage disconnected in the average Mid-Atlantic gas utility. Finally, we noted that as bad debts have increased, the effectiveness of the post-write-off collection process has decreased, as shown by the statistics below.

Table 14-8 – Statistics for Accounts Sent for Collection

South Jersey Gas Statistics for Accounts Sent for Collection			
Item	2010	2011	2012
Accounts sent for Collection	34,133	54,759	48,931
Amount Sent for Collection	$10,247,550	$13,000,548	$13,588,079
Amounts Collected	$867,292	$744,595	$554,044
Average Rate of Recovery	8.46%	5.73%	4.08%
Source: OC-732			

Impact of the New CIS System on Credit and Collections

SJG noted a number of improvements in credit and collection activities that will be facilitated by the new CIS that are not possible under the legacy CIS currently in use. As of March, 2013, plans call for the following enhanced capabilities:[22]

1. The New CIS system will offer the following credit & collections capabilities that are not currently in the "legacy" system:
   - Payment arrangements will display on the customer's gas bill.
   - Different collection paths based on the customers SJG (internal) credit score. (Good Credit vs Bad Credit) This will enhance the ability to prioritize collection efforts and improve the timing of credit agency referrals.
   - The ability to offer a delinquent customer a payment arrangement on their arrearage while also putting them on a budget (Equal Payment Plan EPP).

[22] Response to Discovery, OC-730.

- A field activity dispatching functionality that will be used to prioritize and route Field Collection activities and report on those activities.
- Real-time payment application for payments taken in the field or SJG payment locations.
- Budgets (EPPs) will be offered to customers regardless of the time of year. The current system only enrolls customers on the budget in the September time frame due to the timing of the budget true-up.
- Ability to determine where a customer is in the collection process.

2. The new CIS system will provide Business Intelligence Dashboards that provide real-time analytics specifically related to Credit & Collections such as:
   - Arrears Compared to Revenue (Arrears as a Percentage of Billed Revenue).
   - Collection Process Effectiveness (Collection Process Volume; Collectible Amount; Collection Duration, Number of Field Shutoffs).
   - Write Off Process Effectiveness (Number of Write Off Processes; Write Off Amount; Write Off Duration).

Meter Operations

Meter operations consist of meter reading, testing and repair.

Meter Reading

Meter reading has been outsourced to affiliate Millennium Account Services (MAS) since 1999. MAS's affiliate relationship and transactions with SJG are discussed in Chapter 2. The Joint Meter Reading Services Agreement among MAS, Atlantic City Electric (ACE) and SJG includes a Statement of Work (SOW) under which ACE and SJG request meter reading to be performed.[23] The SOW includes performance requirements for both ACE and SJG. For ACE, MAS is required to meet an aggregate read rate of at least 98%. For SJG the minimum acceptable read rate is 91%.[24] We reviewed contract amendments and extensions in effect during the review period to ensure that the read performance rate for SJG had not changed.[25] Below are the actual performance statistics, in terms of meters read and estimated, during the review period.

[23] ACE Response to Discovery in Overland's 2009 audit of ACE, OC-81, "OC 81 Millennium Joint Agreement SOW – 2007.pdf."
[24] SJG's required performance is significantly lower because of gas meters installed inside homes that often cannot be accessed by the meter reader.
[25] Response to Discovery, OC-488.

Table 14-9 – Estimated vs. Actual Meter Reads

South Jersey Gas Estimated vs. Actual Meter Reads			
Item	2009	2010	2011
Actual Meter Reads	4,123,272	4,169,624	4,215,678
Estimated Meters	234,767	280,535	224,320
Percentage Read	94.6%	93.7%	94.9%
Percentage Estimated	5.4%	6.3%	5.1%
Source: OC-277			

MAS exceeded the minimum read performance requirement in the SOW for all three years in the review period. We found a month in each of the three years in which MAS did not achieve a 91% read rate. In each case, SJG attributed the lower read performance to "snowfall impacting meter reading operations." February, 2010 was the month most impacted by snowfall. During February, 2010 the percentage of meters read dropped to 70.5%. This explains the relatively low read rate of 93.7% for the year 2010 compared with 2009 and 2011.

Customer Read Procedures - Customers with indoor meters often read their own meters. To provide a read, customers may fill out a meter card or call the read in through a toll-free number. There is no limit to the number of consecutive months an SJG customer can provide their own reading. Customer reads are subject to the same exception process as a meter read by MAS.[26] If a customer read fails the exception process (either high or low), a request is sent to MAS to obtain a verified read. SJG stated that this is programmed into the legacy CIS and occurs automatically.[27]

Estimated Read Procedures – SJG's legacy CIS begins an "access letter" routine after two consecutive estimated reads.[28] When a third estimated billing occurs, the system generates a letter informing the customer of the read status. The letter requests access to the premises and informs the customer that they may also provide their own reading through a toll-free number or by filling out a meter reading card, which, together with a return envelope, is included with the access letter.

A second letter is sent if a response or access is not obtained after 60 days. The second letter informs the customer that service may be disconnected if access cannot be obtained. It also provides the customer a second opportunity to provide a read, and includes a second card and return envelope. After an additional 60 days (during which consumption continues to be estimated), a third letter informs the customer that service may be disconnected if arrangements for a read are not made within 10 days. In addition to these steps, MAS pursues a reading by contacting the customer by telephone, letter and certified mail.

[26] Response to Discovery, OC-275.
[27] Id.
[28] Response to Discovery, OC-276.

Automated Meter Reading – In the past decade, some utilities have installed an automated meter reading infrastructure (AMI). Implementation of automated reading can result in a significant reduction in meter reading labor, often cutting the staffing needed to conduct meter reading by as much as 80% or more. SJG stated that it had no "filed plans with regulators concerning automated reading," but that it had discussed the potential for a joint AMI with ACE.[29] SJG cited a delay in ACE being able to obtain approval to move forward with their own plan as a reason that the discussions have not reached a planning or implementation stage. SJI stated that should it decide to pursue AMI, it will need to conduct an evaluation "to determine the best and most efficient means to carry out the project, including the ownership of the infrastructure, the impact on the current contract with MAS for meter reading operations and the potential impact on utility customer costs."[30]

Meter Testing and Repair

Like meter reading, the meter testing process is outsourced. SJG's meter testing is performed by Measurement Controls, Inc., located in Charlotte, NC. [31]

New Meters - SJG tests a 5% sample of all purchased meters. In order to pass, test results must be within +0.5% and -1.0% for both "open" and "check rate" tests, with a spread of no more than 1.0% between the tests. If 5% or more of sample meters fail the test, an additional 5% sample may be tested, or the entire batch may be returned to the manufacturer.[32] Tested meters determined to be out of tolerance are adjusted.

In-Service Meters – SJG conducts an annual small meter testing program, under which it removes and tests a sample of "small" (under 500 c.f./hour) meters that have been in service for 10 years or more. SJG stated that it conducts sampling, testing and reporting in accordance with BPU requirements and provided a copy of the BPU requirements in support of this statement.[33] All "large" (over 500 c.f./hour) meters are removed from service when they pass 10 years of service.[34]

In addition to its meter sampling process, meters may be removed for "various reasons." SJG stated that when meters are removed from service they are tested for current operating characteristics and a decision is made to scrap or repair the meter.[35] If the meter is rated at 200 c.f./hour or *less*, it is scrapped automatically. If it is rated at more than 200 c.f./hour is may be repaired. SJG stated that during the approximate period 2009 through 2011, it had removed 24,864 meters, of which it scrapped 19,422 (78%) and repaired 5,422 (22%).

[29] Response to Discovery, OC-77.
[30] SJG comments in response to Overland's draft report, July 19, 2013.
[31] Response to Discovery, OC-76, "Meter Tolerance and Repair.doc."
[32] Id.
[33] Id.
[34] Id.
[35] Id.

Procedures for Out-of-Tolerance Meters and Related Billing Adjustments

As discussed above, meters removed are subject to testing by Measurement Controls, Inc. A Fast Meter Refund billing adjustment is processed for meters found in to be registering fast by more than two percent.[36] No billing adjustment is processed for slow meters unless there is either evidence of tampering or the meter fails to register consumption.

Fast Meter Refunds appear on bills in the month after the fast meter conduction is detected. Customers found to have non-registering meters are billed for estimated usage and are allowed to spread their payments of the same period of time that the meter is found to have been non-registering. SJG provided the following procedure for issuing a Fast Meter Refund: [37]

- A refund is given for any meter testing 2.1% or more fast.
- If the date at which the meter began registering fast can be determined, then the calculation is based on that date through the remove date. However, in most cases the date at which the meter became fast cannot be determined.
- If the actual date when the meter began registering fast cannot be determined, then the set date (or turn on date, whichever is most recent) is subtracted from the remove date. Half of this period is used to calculate the refund. The maximum refund period is 6 years.
- Twelve months of consumption is averaged to determine the normal amount of CCF per month. This normal average monthly consumption is multiplied by the number of months in the allowance period and by the allowance factor. (The allowance factor is based on the percentage the meter is fast.) The outcome of the above calculation is then divided by the number of months in the allowance period to get the average CCF to be allowed per month. This figure is entered into the Fast Meter Program model to calculate the refund dollar amount using the appropriate billing rates.
- A line item on the next billing after the allowance is made appears as “Fast Meter Refund Credit.”

[36] Response to Discovery, OC-83.
[37] Id.

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15. Human Resources

The SJI Human Resources department is responsible for compensation policy including salaries, wages, benefits and incentive pay. They handle labor relations between management and the unions representing SJI employees. They are responsible for employee staffing, training, development and policy evaluation. This function originally resided within the utility. However, when SJI Services LLC was created, the human resources function was moved into that service company.[1]

Summary of Findings

Organization and Staffing

1. SJI hired a new VP of Human Resources, Kathleen A. McEndy on March 22, 2013 to replace Sharon Pennington as the head of Human Resources. Ms. Pennington is currently the AVP of Labor and Business Relations. This position did not previously exist and has not otherwise been identified as an open position.[2]
2. SJI created the Organizational Development group in 2009 to increase the role of employee development from an ad-hoc activity to a consistent program of activities which includes succession planning, talent management, individual development, planning, performance management, and training.
3. Actual spending in the four HR cost centers increased by $430,020, or almost 40% from 2010 to 2011. This is attributed to the addition of new positions and some promotions within the department.
4. SJI has shown a more concerted effort to hire from within for SJI positions. Internal hires at SJI have gone from 33% in 2009 to 51% in 2011. There was a slight drop off to 47% in 2012.
5. SJI has made changes to revamp its onboarding process for newly hired employees. The changes include:
    a. New employee resource guide and new employee orientation
    b. Linking each new hire with an Onboarding Partner
    c. A presentation to each new hire with all the necessary SJI information
6. SJI has in place an adequate and effective on-boarding process for assimilating new hires into the company.
7. HR should also consider the staffing levels of their peers relative to specific measures to determine whether the staffing levels at SJI are in line with industry norms.
8. There were several instances in the discovery process and during interviews where HR was said to be making use of benchmarking studies and other tools to compare certain HR metrics to peer companies. However, no up-to-date benchmark data was provided to Overland for its independent review.

[1] Interview with Sharon Pennington, 11/13/12.
[2] Based on the Response to Discovery, OC-587.

9. When Overland requested benchmarking reports in the area of Human Resources, the HR function of SJI originally stated that no documentation of benchmarking reports were available.[3] Ultimately, SJI updated their response, by saying that the company looks at best practices, but not specific benchmarking data.

Workforce Management

1. SJI Human Resources stated that 99% of all of the positions in SJI had job descriptions.[4] However, when Overland compared the number of job positions for August 2012[5] to the number of job descriptions,[6] only approximately 75% of the positions had matching job descriptions.
2. The ratio of customers to employees has decreased each year from 2009 to 2011, indicating a decline in productivity, at least with respect to this metric.

Compensation

1. The executive compensation program at SJI has a good balance of salary, incentive plan and equity awards that drive executives to achieve the long and short-term goals of the company.
2. SJI named executives in the 2012 Proxy achieved 19 out of 20 of their balanced scorecard performance targets.
3. SJI's peer group for executive compensation is comprised of companies that place SJI in the lowest quartile of the size measures in every instance, except for market capitalization.
4. Although SJI's goal is to provide compensation to executives within 20% of the market median, the overall average of total direct executive compensation for 2011 falls outside of SJI's goal of compensating its executives within 20% of the median based on both proxy data and market survey data provided by the compensation consultants.
5. SJI has a strong methodology for determining base salary for new positions that is based on market data. Furthermore, base salary increases that are based on market surveys for the entire base salary structure as well as an individual's performance with respect to organizational competencies provides SJI employees with a reasonable and understandable process for adjusting base compensation.

Benefits

1. HR provided very limited benchmark data relating to employee benefits.

[3] Response to Discovery, OC-588.
[4] Interview with Kathy Casella, 11/15/12.
[5] Response to Discovery, OC-5.
[6] Response to Discovery, OC-71.

Training and Development

1. SJI has used balanced scorecards to assess the performance of individual employees since 2005. Some departmental scorecards are completed, but they are not retained as they typically mirror the balanced scorecard of the individual who leads the department.
2. In 2012, SJI focused its employee training in the areas of: leadership development, LEAN Six Sigma, written communications, and advanced Excel training.
3. Access to the Lawson HRIS appears to be appropriately restricted. Only HR and Payroll employees have access to the Lawson system.
4. SJI has spent a significant amount of time and resources in the area of succession planning. This is due to approximately 45% of SJI's employees being eligible to retire by 2016.
5. SJI has a detailed plan and action steps in place for choosing an interim or emergency CEO.
6. SJI has performed a talent assessment of its executives and high level employees to determine potential successors to key positions within SJI.
7. The company has a very thorough process in place with respect to non-officer succession planning. SJI utilizes a risk assessment tool that evaluates both the employee's retirement risk and the position's importance to the company to identify which positions should be targeted for not only succession planning, but also recruiting and hiring efforts.

Labor Relations

1. SJI has contracts with two unions. The Local 1293 IBEW union has a collective bargaining agreement with SJI that expired February 28, 2013. During our field work, SJI signed a new agreement with the Local 1293 that is effective March 1, 2013 and expires February 28, 2017. The Local 76 IAMAW union has a collective bargaining agreement that expires August 31, 2014. Both of the agreements commenced in 2009.
2. SJI was able to successfully negotiate some cost saving measures into the most recent round of contract negotiations with its labor unions. These included:
    a. Workplace flexibility among job class.
    b. Capping medical expenses, saving the company $16 million in the first year of implementation.
    c. Obtaining additional employee contributions for health care premiums.
3. SJI has had a contentious relationship in the past few years with the Local 76 IAMAW union. This has been evidenced in two separate litigation matters that were brought before the National Labor Relations Board. The arbitrator in these two cases found on behalf of the Company when it charged the union with utilizing unfair labor practices, once in 2009 and again in 2012.
4. Grievances at SJI are not a major issue. As of February 13, 2012, there were only 11 open grievances and none were in arbitration.

Diversity, EEO, and Affirmative Action

1. The diversity of employees at SJG is not reflective of the diversity in the service area of the utility, which the utility is trying to emulate. This is particularly true in the category of females and Hispanic employees.
2. The Office of Federal Contract Compliance Programs in 2011, found two violations of their regulations in the SJESP affiliate with respect to hiring policies directed towards minorities and veterans.

Recommendations

Organization and Staffing

1. When Overland requested benchmarking data from SJI in the area of Human Resources recruiting, SJI's response contained two benchmarking reports that were from October 2003 and April 2006. Assuming that the reports provided by SJI are used as benchmarks for Human Resources, then these reports should be updated on a yearly basis.

Workforce Management

1. SJI should ensure that each position in the company from the CEO to full-time entry level employees has an up-to-date job description documented and retained by Human Resources.

Compensation

1. SJI executives should incorporate more challenging base and stretch goals into their balanced scorecards in the future. This recommendation is based on the fact that SJI named executives in the 2012 Proxy achieved 95% of their performance targets.
2. SJI should review the executive compensation peer group and choose companies that are relatively closer to SJI in size as well as other factors such as: utility vs. non-utility business, location, etc.

Training and Development

1. Overland found that some balanced scorecards from 2009 – 2011 were not filled out completely and the results of the scorecards were discussed informally between the employee and the supervisor. We recommend that all exempt employees have balanced scorecards filled out in their entirety and retained electronically in the employee's file for future reference.
2. Overland recommends that mid-year reviews of employee performance be completed in their entirety, and formally documented, and retained electronically.

Benchmarking

1. In general, SJI Human Resources should obtain, and more extensively utilize, benchmarking data in order to improve the effectiveness and efficiency of the HR function.

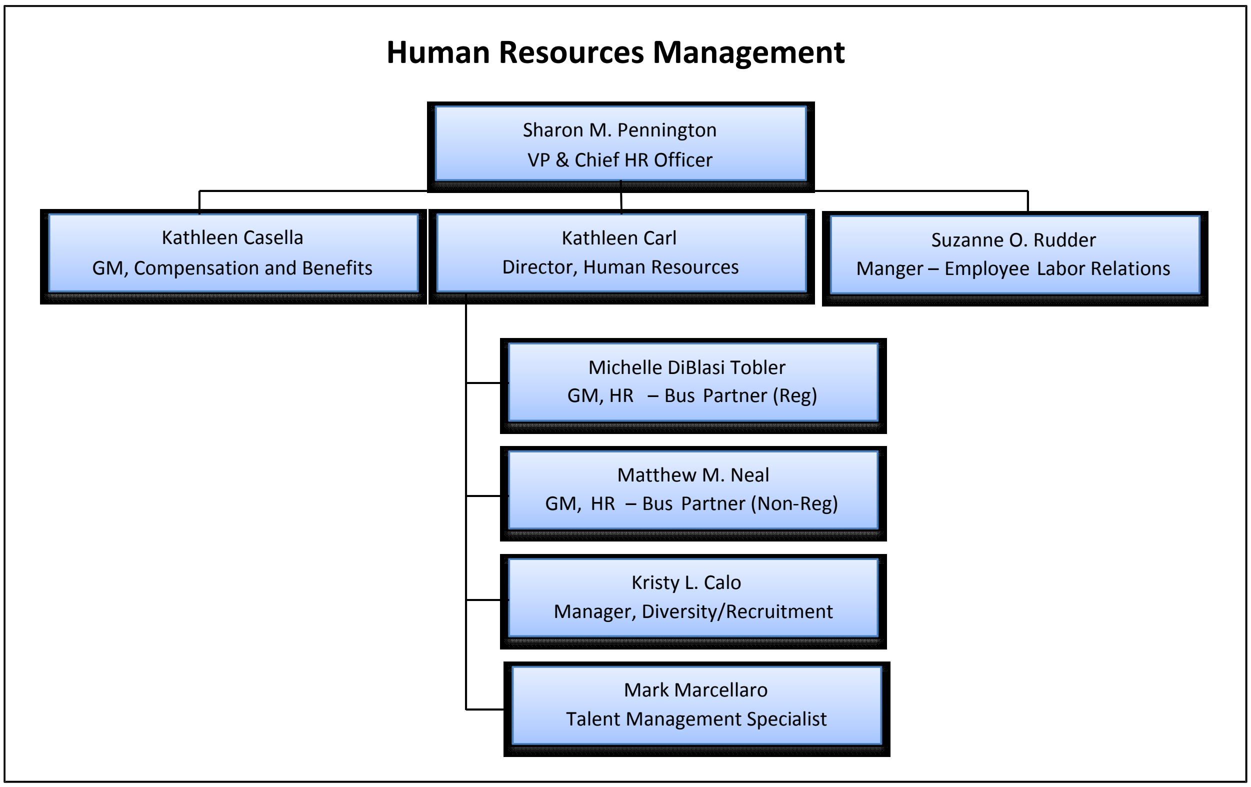
Labor Relations

1. SJI should strive to improve its relationship with the Local 76. Improving the relationship with the Local 76 might be achieved through consistent monthly meetings with the union as well as soliciting the help of outside facilitators to conduct relationship building workshops with the Company and the union.

HR Organization and Staffing

Organization

Table 15-1 - Human Resources Management Organization Chart



Source: Derived from the Response to Discovery, OC-5 and Human Resources Interviews.

The South Jersey Human Resources function has approximately 15 employees. During the audit period, the function was headed by Sharon Pennington, VP & Chief HR Officer who reported to the CEO.[7] Under Ms. Pennington was a Director of Human Resources and managers in the areas of: Compensation and Benefits, Diversity and Recruitment and Employee Labor Relations. When the Human Resources function was moved to SJIS, two positions were created, General Manager, Human Resources – Business

[7] Overland learned that on March 22, 2013, a new VP of Human Resources, Kathleen A. McEndy, was hired by SJI. Ms. Pennington's position changed to AVP, Labor & Business Relations (per Response to Discovery OC-737) and she was not available for a follow up Human Resources interview in January 2013.

Partner, to act as liaisons between HR and SJI affiliates (regulated and non-regulated) in order to meet the various needs of those entities.[8] The Human Resources function does not include payroll processing. Payroll is part of the accounting function.

Human Resources Strategy

SJI has an overall vision for the company that includes being "…the Energy Company of First Choice for…Employees". The vision also mentions being an industry leader in entrepreneurial leadership, having an empowered employee base, and having a demonstrated green energy expertise.[9] To bring this vision into reality, SJI created an Organizational Development group in 2009. Kathleen Carl is the leader of this group. The group was created to increase the role of employee development from an ad-hoc activity to a consistent program of activities which includes succession planning, talent management, individual development, planning, performance management, and training.[10] The group's goal is "to ensure that the right people with the right skills are in the right place at the right time". The goal is accomplished by working with the various SJI business lines to ensure that HR decisions are rooted in SJI's mission, strategic plan, budgetary resources and workforce competencies. Some of the initiatives to help accomplish this goal are listed below.

- Identify Leadership Development Competencies and other skills/competencies that are necessary to have for the SJI to succeed.
- Create cross-functional teams with knowledge in Green Initiatives, Technology, and Leadership Development.
- Develop a more robust Succession Management Plan.
- Expand the coaching program to include lower level employees.
- Continue and expand the POWER management development program.

In the near future, the Organizational Development group will concentrate on providing a detailed workforce analysis which will aid in workforce planning, link budgetary expenditures to SJI's talent needs, focus on succession planning, help managers develop a high achieving workforce, and provide competitive compensation and recognition programs that will retain the talent that SJI requires.[11]

[8] Ibid.
[9] Response to Discovery, OC-4.
[10] Response to Discovery, OC-539.
[11] Response to Discovery, OC-4 Part 5: 2011-2015 Strategic Plan Board Letter 1-12-11.

Budgeted and Actual Expenses

Table 15-2 - SJIS Human Resources Budget vs. Actual Expenditures

SJIS Human Resources Budget vs. Actual Expenditures						
	2010			2011		
Cost Centers	Actual	Budget	Variance to Budget	Actual	Budget	Variance to Budget
Benefits (921)	270,208	335,699	65,491	404,227	342,900	(61,327)
Labor relations (922)	303,959	371,621	67,662	370,970	390,618	19,648
Recruiting (923)	288,610	311,901	23,291	320,973	303,252	(17,721)
Organizational Development (924)	231,521	269,697	38,176	428,148	448,999	20,851
Total	**1,094,298**	**1,288,918**	**194,620**	**1,524,318**	**1,485,769**	**(38,549)**
Source: Derived from Response to Discovery, OC-500.						

As the table represents above, the HR function is divided into four cost centers: Benefits, Labor Relations, Recruiting, and Organizational Development. In 2010, all of the HR cost centers were under budget. However, in 2011, Recruiting and Benefits spent more than their budgeted amounts. Overall, actual spending in these four HR cost centers increased by $430,020, almost 40% in 2011. This can be attributed to the following reasons:

- Cost Center 921 – Two HR analysts were hired at the end of 2010 and in June of 2011, which led to increases in payroll and benefits expenses.[12]
- Cost Center 922 – A labor relations specialist was hired in June 2010. The specialist had a full year of salary and benefits in 2011. This is what drove the increase in costs for this cost center.[13]
- Cost Center 923 - There was an increase in payroll and benefits for this cost center due to the promotion of the Recruiting Coordinator to Recruiter and the promotion of the Recruiter to General Manager, Business Partner in 2011. Other increases in this cost center in 2011 were due to supplies purchased to aid in the distribution of the revised Human Resources manuals.[14]
- Cost Center 924 – In this cost center, most of the increased cost was observed in payroll and employee benefits costs due to the hiring of two Power Employees in August 2010 and another Power Employee in August 2011.[15]

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[12] Response to Discovery, OC-582.
[13] Response to Discovery, OC-583.
[14] Response to Discovery, OC-584.
[15] Response to Discovery, OC-585. In an email response from Chris Moschella on 2/15/13, SJI noted that the lease expense attributable to this cost center increased in 2011 due to a correction of an Organizational Development employee's lease expense that were incorrectly allocated to SJI in 2010 and was not corrected until the beginning of 2011.

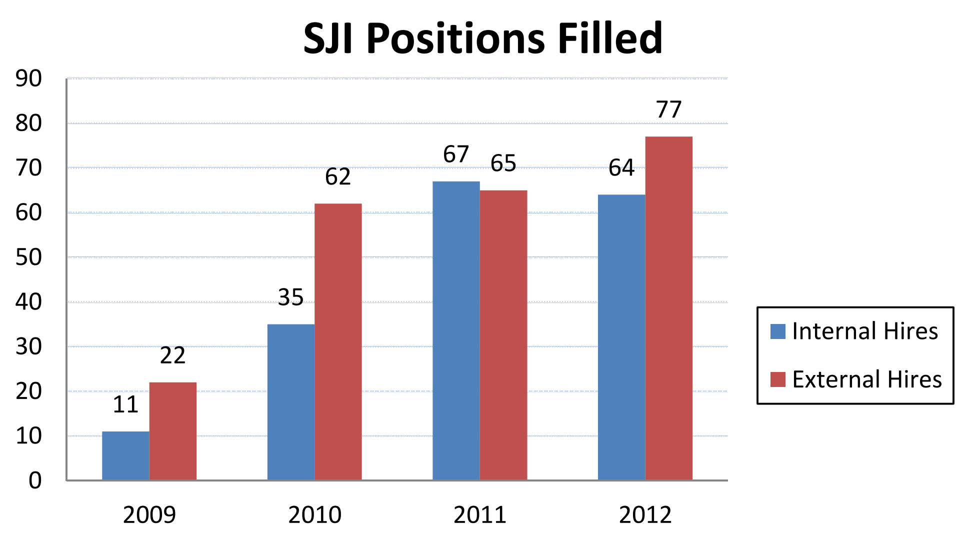
Staffing

The staffing process includes recruitment, screening, hiring, transfer and transition of employees and potential employees of SJI. This function is led by Kristy Calo, Manager of Diversity and Recruitment. Ms. Calo has two recruiters that report to her, one for the regulated businesses and another for the non-regulated businesses.

SJI performs substantially all of the staffing functions in-house. There are various sources from which SJI draws candidates for potential employment at SJI. HR uses popular job search websites such as Career Builder and Monster. It also uses SJI's Career Opportunities webpage to post open job positions. HR also uses job specific boards (e.g. job boards for HVAC technicians) as well.[16]

When there is an open position to be filled, it is SJI's policy to hire the best candidate for the job. That being said, the Company posts job offerings for five days internally before posting it externally to give qualified SJI employees an opportunity to grow in the organization.[17] Below is a graph showing how many job vacancies were filled internally versus externally from 2009 to 2011.

Table 15-3 - SJI Positions Filled



Source: Derived from the Response to Discovery, OC-522

While it is SJI's position that it selects the best person for the job, the trend shows that a more concerted effort has been made in 2011 and 2012 to hire and promote from within over the past three years.

[16] Interview with Kristy Calo, 11/16/12.
[17] Ibid.

During the recruiting and hiring process, SJI relies on information systems to track applicants for job vacancies. The Human Resources Information System (Lawson) has an applicant tracking system powered by My Staffing Pro. This application tracks a job candidate through various steps in the recruiting and hiring process to ensure that all of the necessary steps are completed. The State of New Jersey requires SJI to enter its new hires into the state's database. Additionally, SJI uses the information systems of CSS (Comprehensive Screening Solutions) to perform background checks on job candidates; Inc. for employment authorizations; and Qwest Diagnostics for drug testing.[18]

SJI has a formal on-boarding process for the job candidate that accepts the Company's offer of employment. The on-boarding process is managed by the HR talent specialist. The candidate, to whom SJI extends an offer, receives a welcome packet with forms that should be completed by their first day of employment. These forms include a background check application as well as documentation to complete a drug test. The welcome packet also includes an employee benefits overview and an employee resource guide. When the new employee arrives on the first day of employment, he or she turns in the completed forms from the welcome packet into HR. The new employee is provided an employee badge. The talent management specialist performs a new hire orientation for the employees and sends them information to complete their compliance training within 60 days of beginning his or her employment. New employees are also expected to take a tour of the Folsom facility.[19]

SJI notes that the on-boarding process that was in place during the audit period was not as structured as it could be. A proposal to revamp the on-boarding process was presented to management in July 2012 and approved. Some of the changes to the on-boarding process include:

- A new employee resource guide for new hires and new employee orientation and on-boarding guide for managers and supervisors.
- Linking each new hire with an SJI Onboarding Partner who will provide support, guidance, encouragement and answer any questions the new hire may have.
- Conducting a presentation with the new hires that includes SJI's mission, vision, values, history, structure, affinity groups, and promotion of health and wellness.

Implementation of these changes in the proposal was scheduled to take place in the 2nd half of 2012.[20] With the implementation of the on-boarding initiatives above, SJI appears to have in place an adequate and effective process for assimilating new hires into the company.

There are a few initiatives that HR has implemented or is in the process of implementing to improve the recruiting process at SJI. The largest initiative surrounds using social media as an important tool in the recruiting process. During the audit period, the recruiters in Human Resources used their personal LinkedIn profiles to post SJI job openings. HR is attempting to centralize the use of social media as a

[18] Interview with Kristy Calo, 11/16/12.
[19] Interview with Kristy Calo, 11/16/12 and Kristy Calo's BSC for 2012 (provided via email by C. Moschella)
[20] Response to Discovery, OC-540.

recruiting tool by working with a 3rd party vendor to display job postings via Facebook, Twitter, and LinkedIn. SJI also plans to use social media to expand the company's access to talent by posting on Facebook, Twitter and LinkedIn which job fairs and career expos the company will be attending. Other initiatives that have been implemented through 2012 are: formal documentation of key recruitment processes, use of behavior-based interviewing for all positions, an updated method of pre-employment testing for technical positions, and a decrease in the use of paper forms in the onboarding process. [21]

Overland obtained the balanced scorecard for 2012 for Ms. Calo, the manager in charge of recruiting for SJI. The metric that was considered the most important on her scorecard was "Turn Around Time" (TAT). This metric is defined as the number of days it takes to fill an open position from the time a requisition is approved to the time that a new employee signs the job offer. This metric was given a weight of 25 out of 100, while no other metric on Ms. Calo's scorecard received a weight greater than 10. The target for this metric for 2012 was 45 days.[22] In our interview with Ms. Calo, she described the target as a stretch goal based on historical data. The HR department was able to achieve a 38 day TAT statistic for 2012.[23]

When Overland asked SJI to provide benchmarking data that was used to determine objective for this metric, HR provided a document from April 2006 stating that the average time to fill was 37 days, and that the benchmark was taken from a 2005 Society of Human Resources Management Survey. It is unclear why HR cannot obtain more recent benchmarking data to assess the performance of the hiring process at SJI.[24]

Staffing Levels

Staffing levels are determined by operational and line managers throughout the SJI organization. Managers are responsible for making a request for additional personnel for their department and justifying the need. Several situations could trigger a request for additional personnel including: additional responsibilities added to a position, new business, and the need to ensure a consistent level of work across the Company. HR acts as a neutral party that reviews the logic of the staffing of the Company. The department's oversight helps to ensure that there is not unnecessary duplication of personnel.[25] Although the HR department consults with the company's managers to determine the appropriate level of staffing, HR should also consider the staffing levels of their peers relative to specific measures to determine whether the staffing levels at SJI are in line with industry norms.

[21] Interview with Kristy Calo, 11/16/12 and Kristy Calo's BSC for 2012 (provided via email by C. Moschella).
[22] Interview with Kristy Calo, 11/16/12 and Kristy Calo's BSC for 2012 (provided via email by C. Moschella).
[23] Follow up HR Interview with Kristy Calo, Kathy Carl, and Kathy Casella, 1/22/13.
[24] Overland notes that the response to OC-588 provided Overland with the benchmarking documents that we requested. However, two of these documents were from October 2003 and April 2006. It appears that HR is using benchmarking data that is obsolete and should be updated.
[25] Interview with Kathy Carl, 11/15/12.

Workforce Management and Productivity

Workforce Management

It is important that a company document what it expects its employees to accomplish for each position within the Company. This documentation will avoid redundant job duties and responsibilities, create or set the expectations of the employee in that position to determine how to compensate that employee, and also to ensure that the employee's work aligns with the Company's overall business objectives. SJI uses job description forms to document the duties and responsibilities of each position within the company. The supervisors or managers of a department put together a general job description and forward it to HR. The supervisors and managers work with the Business Partners in HR to put the general job description into a formalized document that is used company-wide. Overland noted that the job descriptions were reviewed approximately every 3 years, with one-third of them reviewed each year. At the time of our interview, the General Manager of Compensation and Benefits estimated that 90% of the SJI job positions had up-to-date job descriptions, 9.9% of the positions had job descriptions that were outdated, and 0.1% of the SJI job positions had no job description at all.[26] [27]

Productivity Analysis

A broad measure of overall utility productivity is the number of customers per employee. As shown in the table below, it appears that, while both utility customers and utility employees have increased over the last three years, the rate of growth for employees has exceeded that of customers. By this measure, productivity of the utility has declined over the past three years.[28]

Table 15-4 - SJG Productivity Measured by Customers per Employee

South Jersey Gas SJG Productivity Measured by Customers per Employee			
End of Year	SJG		
	# of Customers	# of Employees	Customers per Employee
2009	343,566	399	861.1
2010	347,725	411	846.0
2011	351,304	446	787.7
Source: 2011 SJI 10-K and response to OC-5			

[26] Interview with Kathy Casella, General Manager, Compensation and Benefits, 11/15/12.

[27] Overland received job descriptions through the response to OC-71. In the response, there were 235 job descriptions. Overland decided to compare this number to the number of unique positions from the employee list for August 2012 provided in the response to OC-5. Overland found there are 310 unique positions according to the August 2012 employee list. This means that Overland only received just over 75% of the job descriptions for the positions within SJI. Our calculation is different than the information provided in our HR interviews.

[28] Overland reviewed the AGA Best Practices Benchmarking Data for August 2009, 2010, and 2011 provided in the response to OC-338 and found that SJG's customer's per employee metric was 45.81, 897, and 561, respectively. This data is difficult to rely on and analyze due to the report having the wrong number of SJG customers in 2009. Also, SJI notes (in response to OC-736) that they don't place much value on this metric as different utilities outsource different functions and SJG's data includes non-SJG employees that perform tasks for the utility.

Compensation

This section addresses the various types of monetary and non-monetary compensation that is available to employees at SJI. Compensation for the Board of Directors is discussed in Chapter 6 - Corporate Governance.

Executive Compensation

The goal of SJI's Executive Compensation Programs is "to advance the Company's strategic plan and corporate mission, which are rooted in shareholder value, while attracting and retaining highly qualified executive management to carry out the Company's work and goals."[29] The objectives of the programs are listed below.

- Executive compensation should be directly and measurably linked to business and individual performance with a significant portion of the compensation designed to create incentives for superior performance and meaningful consequences for below-target performance.
- An executive's total compensation should be competitive with peer companies to attract, retain and motivate high performing business leaders.
- Executive compensation should align the interests of executives with shareholders so that compensation levels are commensurate with relative shareholder returns and financial performance through the use of performance-based restricted stock.
- Executive compensation incentive plans should balance short-term and long-term financial and strategic objectives whereby executives are rewarded for the businesses for which they are responsible and for overall Company performance.
- The process for designing, determining and monitoring executive compensation should be independent of management and use the assistance of independent compensation consultants reporting directly to the Committee.[30]

The Executive Compensation Programs are administered by the Compensation Committee of the SJI Board of Directors. The Compensation Committee is also responsible for reviewing and evaluating the performance of the CEO, CFO and the other Named Executives. The current executive compensation programs have existed at SJI since 1998. At the annual shareholders meeting on April 20, 2012, the shareholders approved the overall executive compensation structure to be used in 2012.[31]

SJI targets executive compensation to fall at the 50th percentile (median) of the market and plans to manage executive compensation to within +/- 20% of the median.[32] Total compensation figures for 2009-2011 for the top five executives of SJI along with their positions are presented in the table below.

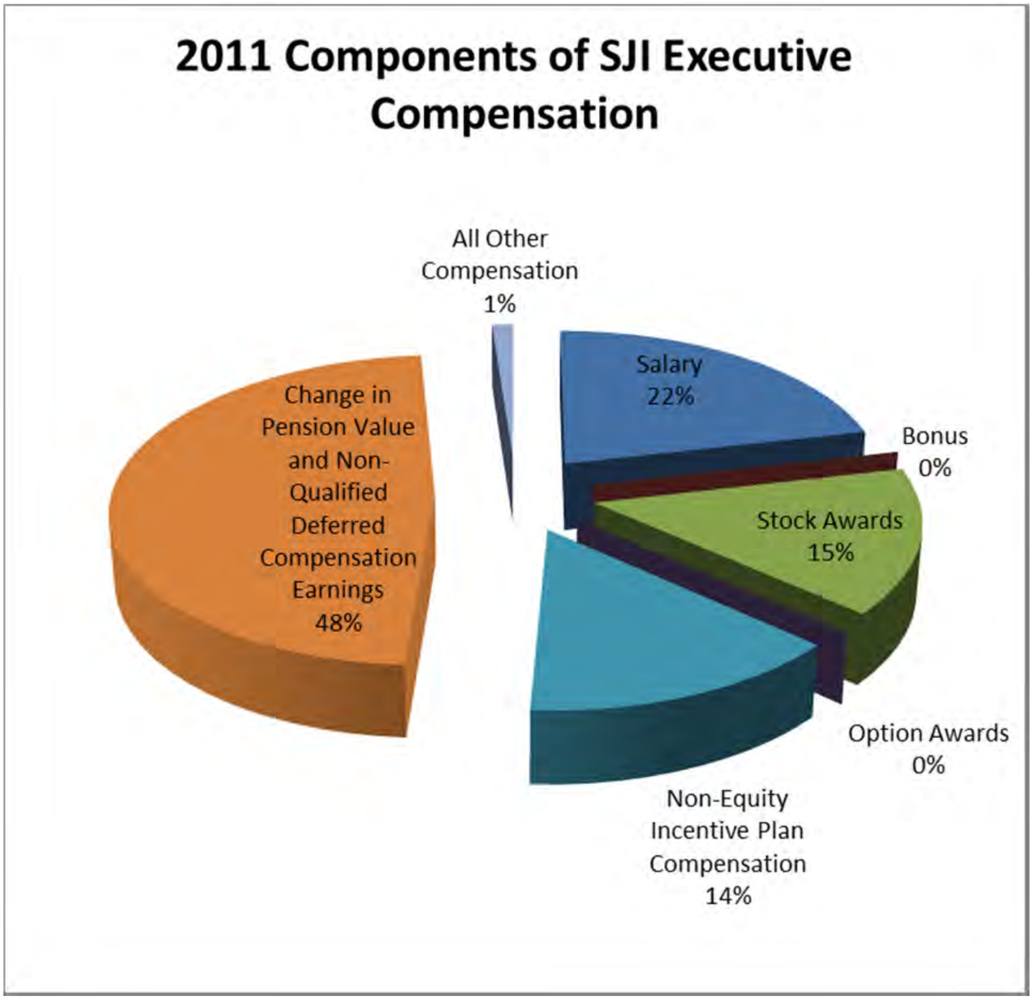
[29] SJI 2012 Proxy Statement.
[30] Ibid.
[31] Ibid.
[32] Response to Discovery, OC-31 (restricted) Executive Compensation Review 9/23/11.

Table 15-5 - Summary Compensation Table

South Jersey Industries									
Summary Compensation Table									
Name and Principal Position	Year	Salary	Bonus	Stock Awards	Option Awards	Non-Equity Incentive Plan Compensation	Change in Pension Value and Non-Qualified Deferred Compensation Earnings	All Other Compensation	Totals
		($)	($)	($)	($)	($)	($)	($)	($)
Edward J. Graham Chairman, President andChief Executive Officer	2011	659,327	-	620,857	-	554,400	2,304,000	36,959	4,175,543
	2010	624,231	-	638,757	-	624,023	1,616,000	32,888	3,535,899
	2009	574,999	-	425,846	-	300,438	694,000	34,508	2,029,791
David A. Kindlick, Vice President and Chief Financial Officer	2011	283,341	-	164,027	-	158,760	672,000	16,369	1,294,497
	2010	269,822	-	165,562	-	184,275	650,000	16,160	1,285,819
	2009	258,440	-	127,612	-	107,851	360,000	16,844	870,747
Michael J. Renna President and ChiefOperating Officer of SouthJersey Energy Solutions	2011	278,458	-	163,721	-	176,153	72,000	12,041	702,373
	2010	244,637	-	150,227	-	167,937	44,000	11,631	618,432
	2009	221,420	-	109,314	-	115,936	23,000	11,261	480,931
Jeffrey E. DuBois Vice President and Senior Vice President Operations & Chief Operating Officer of South Jersey Gas Company	2011	257,014	-	148,847	-	143,578	653,000	11,903	1,214,342
	2010	244,712	-	150,227	-	165,375	338,000	11,730	910,044
	2009	222,535	-	106,402	-	112,063	799,000	12,340	1,252,340
Kevin D. Patrick Vice President, Research &Corporate Development	2011	236,034	-	113,902	-	114,818	132,000	17,140	613,894
	2010	224,769	-	114,992	-	125,423	274,000	15,122	754,306
	2009	210,000	-	103,687	-	88,154	-	12,302	414,143
Source: SJI 2012 Proxy Statement									

Using the 2011 compensation year, the graph below shows each component's percentage of total compensation for the five named executive officers including the CEO.

Table 15-6 - 2011 Components of SJI Executive Compensation



Disregarding the change in pension value and deferred compensation, the executive compensation program has a good balance of salary, incentive plan and equity awards that drive executives to achieve both the long-term and short-term goals of SJI.

The Compensation Committee uses peer groups and salary survey data to determine the appropriateness of executive compensation. Compensation is targeted at the median (50th percentile) of the peer group or the survey data. SJI incorporates a working range of +/- 20% from the median to account for factors such as tenure, previous experience and individual and company performance.[33] For the CEO, the Committee has developed (with the help of The Hay Group, its previous compensation consultant) a peer group of 14 similar sized energy companies to compare the CEO's amounts for base salary, total cash compensation, and total direct compensation. The Committee developed a separate peer group of 39 energy companies to benchmark it long-term incentive program performance and equity awards. For the other named executives disclosed in the proxy, the Committee used industry

[33] SJI 2012 Proxy Statement.

databases provided by The Hay Group and the American Gas Association.[34] The Committee receives input and suggestions on the peer groups that it will use from its compensation consultants, but the Committee gives the final approval for the peer groups to be used for benchmarking purposes.[35]

The following narrative contains a description of the components of executive compensation and how they are measured for each executive.

Base Salary

Like the target for total executive compensation, salary is targeted at the 50th percentile of the peer group and/or competitive market. The peer group data was assembled by The Hay Group as mentioned above.[36] A review of the market for base salary is performed on a yearly basis.[37]

Annual Cash Awards

These awards are based on a percentage of the executive's base salary and are developed based on the peer group data and industry compensation studies mentioned above. The target cash incentive award for executives in 2011 ranged from 45% to 75% of the executive's base salary.[38] The executives of SJI have either two or three components on which their annual cash incentive payout is based. These components are: SJI's economic earnings per share, financial performance of the relevant subsidiary company, and their BSC. The components have different weights for each level of executive. See the table below.

[34] Ibid.
[35] Interview with a member of the SJI Board of Directors.
[36] SJI 2012 Proxy Statement.
[37] Response to Discovery, OC-115.
[38] Response to Discovery, OC-31 (restricted) Executive Compensation Review 9/23/11.

Table 15-7 - 2011 Metric Percentages for Annual Cash Incentive Awards

South Jersey Industries 2011 Metric Percentages for Annual Cash Incentive Awards			
	SJI Economic Earnings per Share	Finanicial Performance of Relevant subsidiary	Balance Scorecard Objectives
CEO	75%		25%
CFO	75%		25%
COO (for operating subsidiaries)	25%	50%	25%
Direct Report to CEO (not a head of an operating subsidiary)	50%		50%
VP		50%	50%
Director		50%	50%
Source: Response to Discovery, OC-115			

In order for there to be any payout for the economic EPS component of the cash incentive program, SJI must meet its threshold EPS. The threshold EPS for 2011 was set at the 2010 economic EPS. At that level, the cash payout for each executive would be 50% of their targeted payout. At the target economic EPS (which was $2.84 in 2011) the cash payout would be 100%. SJI determined that the target economic EPS should represent a 5% growth from the 2010 economic EPS ($2.70)[39]. The 5% is characterized as a stretch goal, as overall historic relative performance of the utility sector is 3%.[40] [41]

The cash payout is capped at 150% of the target payout when economic EPS reaches $3.00. The economic earnings per share for 2011 were $2.89, resulting in a cash payout of 116% of the targeted award.[42]

The second component, the relevant subsidiary's financial performance, is based on the net income target for the subsidiary. For instance, Michael Renna – President of SJES, has a cash payout for this component based on the net income for SJES. The net income metrics have a threshold, target, and maximum amount that correspond to a 50%, 100% and 150% payout, respectively, for this particular component of the annual cash incentive award.[43]

The third component of the annual cash incentive program is based on the individual's performance against his or her goals set in the balanced scorecard. As discussed in further detail later in this chapter, the balanced scorecard consists of both broad and specific goals and measureable targets in the areas of: finance, customers, process and learning, and growth. The overall rating on the BSC achievements ranges from 0 to 5. A rating of 3 attains the target performance and is awarded 100% of the cash

[39] Response to Discovery, OC-31 (restricted) Executive Compensation Review 9/23/11.
[40] Ibid.
[41] Overland obtained the SJG's cost of capital testimony from their most recent rate case (2010). In the cost of capital direct and rebuttal testimony 6% was used as the growth rate for the DCF calculations in those testimonies.
[42] SJI 2012 Proxy Statement.
[43] Ibid.

payout for this component. The payout for this component can range from 50% to 150% of the targeted payout based on the overall BSC score.[44]

Each one of the Named Executives in the SJI 2012 Proxy received an annual cash incentive payout that was higher than the targeted amount for the payouts in 2011. Refer to the table below.

Table 15-8 - 2011 Potential Cash Incentive Award Payout

South Jersey Industries 2011 Potential Cash Incentive Award Payout						
Name	**Title**	**Threshold**	**Target**	**Maximum**	**Actual**	**Percentage of Target**
Edward J. Graham	CEO	$ -	$ 495,000	$ 742,500	$ 554,400	112%
David A. Kindlick	CFO	$ -	$ 141,750	$ 212,625	$ 158,760	112%
Michael J. Renna	President -	$ -	$ 141,488	$ 212,232	$ 176,153	125%
Jeffrey E. DuBois	COO - SJG	$ -	$ 128,625	$ 192,938	$ 143,578	112%
Kevin D. Patrick	VP - R & D	$ -	$ 106,313	$ 159,470	$ 114,818	108%
Source: Derived from the 2012 SJI Proxy Statement						

__Long-Term Incentive Plan__

SJI's long-term incentive plan for its executives is based on the use of performance based restricted stock grants.[45] The target long-term incentive award for executives in 2011 ranged from 50% to 100% of the executive's base salary.[46] In 2011, SJI relied solely upon relative total shareholder return (TSR) over a three year performance cycle to determine the payout of the long-term incentive plan (i.e. the long-term incentives that were awarded in 2012 covered the performance cycle for 2009-2011). The table below outlines the various payout levels of the long-term incentive plan based on the performance of SJI's TSR compared to its peers over a three year period.

Table 15-9 - 2011 SJI Long-Term Incentive Payout Range

South Jersey Industries 2011 SJI Long-Term Incentive Payout Range	
Three Year TSR vs. Peers	**% of Target Shares Earned**
Below 35th Percentile	0%
35th Percentile	50%
50th Percentile	100%
80th Percentile and higher	150%
Source: Response to Discovery, OC-31 (restricted) Executive Compensation Review 9/23/11. Amounts between 35th and 80th percentiles are interpolated.	

[44] Ibid.
[45] Ibid.
[46] Response to Discovery, OC-31 (restricted) Executive Compensation Review 9/23/11.

SJI's long-term incentive plan payout for the three year performance cycles ending 12/31/09, 12/31/10, and 12/31/11, were 145.2%, 150%, and 80.7%, respectively.[47]

Other Compensation and Benefits

Other benefits that are included in the executive compensation package are: a defined benefit pension for those executives hired before 7/1/03, a 401(k) Plan that includes reimbursement for company contributions that exceed IRS limits including a gross-up for taxes, and a Supplemental Executive Retirement Plan.[48] Executives are also allowed to participate in SJI's Deferred Compensation Program.

Each of the executives named in the 2012 Proxy had signed an employment agreement with SJI.[49] The terms of these employment agreements were not negotiated by the employees. The agreements were developed after conducting a market study based on information provided by The Hay Group.[50] The term of the employment agreements was three years, expiring December 31, 2011. The employment agreements contain confidentiality and non-compete clauses for one year after termination. These agreements also outline the severance packages that an executive is entitled to following a change in control or a termination without cause. For an involuntary termination without cause and without a change in control, an executive is entitled to 150% of his or her base salary for 18 months. If a change in control occurs, and an executive either resigns or is involuntarily terminated without cause, the executive is entitled to 300% of their base salary paid in lump sum.[51]

SJI's Executive Compensation Consultant

During our audit period (2009-2011), SJI Executive Compensation was reviewed by the Frederick W. Cook & Co., Inc. (Cook) in 2011. Cook reviewed all direct and indirect components of SJI executive compensation. Cook presented its findings and recommendations to the Board in September and November 2011.

Cook first presented their findings on the peer group that SJI was using to compare certain components of its executive compensation programs. Cook proposed removing two companies from the 15 gas and multi-utility companies that SJI had been using from the 2008 executive compensation analysis conducted by The Hay Group. The peer group that Cook proposed is shown in the following table along with the peer companies' size measures that were taken into account in developing the peer group.

This peer group is the primary data source used for Cook's review of SJI executive compensation.[52]

[47] SJI 2012 Proxy Statement.
[48] Response to Discovery, OC-115.
[49] Response to Discovery, OC-531.
[50] SJI 2012 Proxy Statement.
[51] Ibid.
[52] Response to Discovery, OC-31 (restricted) Executive Compensation Review 9/23/11.

Table 15-10 - Peer Group Size Measures ($ millions)

South Jersey Industries Peer Group Size Measures						
	2010 Peer Group Size Measures ($ millions)					
Company	Revenue	Operating Income	Net Income	Total Assets	Market Cap[1]	Employees
Atmos Energy	$4,790	$482	$206	$6,764	$3,003	4,913
Nicor	2,710	240	138	4,497	2,493	3,800
WGL Holdings	2,709	224	111	3,644	1,972	1,399
New Jersey Resources	2,639	188	117	2,563	1,846	887
AGL Resources	2,373	506	234	7,518	3,186	2,621
Vectren	2,130	317	134	4,764	2,277	3,800
Southwest Gas	1,830	232	104	3,984	1,770	4,802
Laclede Group	1,735	105	54	1,840	848	1,697
Energen	1,579	533	291	4,364	4,072	1,530
Piedmont natural Gas	1,552	200	142	3,053	2,178	1,788
Black Hills	1,307	185	69	3,712	1,186	2,124
CH Energy Group	972	100	39	1,729	828	856
Northwest Natural Gas	812	152	73	2,617	1,204	1,028
75th Percentile	$2,639	$317	$142	$4,497	$2,493	3,800
Median	1,830	224	117	3,712	1,972	1,788
25th Percentile	1,552	185	73	2,617	1,204	1,399
SJI	$925	$116	$67	$2,077	$1,627	650

[1] As of 6/30/11

Note: Nicor was acquired by AGL Resources, so the peer group will have 12 members in 2012

Source: Response to Discovery, OC-31 (restricted) Executive Compensation Review 9/23/11.

Overland observed in the table above that SJI's peer group was comprised of companies that placed SJI in the lowest quartile of the size measures in every instance, except for market capitalization. SJI is comparing its executive compensation packages to energy companies that are significantly larger in size.

Overland discussed this with the SJI Board and the Chief HR officer. They pointed out that these are the companies that SJI competes against for executive talent.[53] They also mentioned that these companies are similar to SJI in that most of them have significant non-utility operations.[54] Cook proposed that SJI use this peer group for executive compensation analysis and the SJI Board Compensation Committee accepted the proposal. Cook further states that the peer group "is a reasonable frame of reference against which to benchmark SJI executive compensation."[55]

[53] In the Response to Discovery, OC-758, SJI stated that no SJI officer came from or was subsequently employed by any of the companies listed in the peer group above.

[54] Interviews with Sharon Pennington, Chief HR Officer 11/13/12 and the SJI Board of Directors.

[55] Response to Discovery, OC-31 (restricted) Executive Compensation Review 9/23/11.

Below is a summary table that compares the compensation for SJI executives to the peer group companies used in the 2011 Proxy Statement, in the table above, and the survey data compiled by Cook.

In the summary table below, target annual compensation (TAC) is defined as the sum of base salary and annual cash awards and target direct compensation (TDC) is TAC plus long-term incentive awards.

Table 15-11 - Summary of SJI Executive Compensation Analysis

[Begin Confidential]

		SJI			SJI			SJI		
		($000)	Proxy	Survey	($000)	Proxy	Survey	($000)	Proxy	Survey

[End Confidential] Given that SJI's peer group in their proxy statement consists mostly of companies that are larger in size in several different measures, the comparison in compensation for SJI executives is not totally disproportionate to the market. Overland notes that using even the most favorable size metric for SJI's peer group in their Proxy Statement, market capitalization, SJI is more than 11% under the median.[56] In all of the other size metrics in Table 15-10, SJI doesn't even reach the 25th percentile. Therefore, an analysis of SJI's executive compensation versus its peer group in its Proxy Statement is generally aligned with its peers when size is taken into consideration.

While Cook concluded that the SJI executive compensation programs were "well-designed", the consultant recommended some changes that the Company could make to: strengthen its alignment between pay and performance, align the Company with good governance practices and growing compensation trends, and enhance financial efficiency.[57] Below is a summary list of the

[56] Overland used the "FORECAST" function in Excel to interpolate what percentile SJI's market capitalization would be if the 25th percentile and the median was used for that metric in Table 15-10. The formula yielded a result of 0.387695313, which is more than 11% from 0.5, which would be considered the median.

[57] Response to Discovery, OC-31 (restricted) Executive Compensation Review 9/23/11.

recommendations that Cook made to the direct executive compensation programs for SJI and the steps SJI took to implement them.[58]

- Cook recommended that SJI's peer group for executive compensation analysis be reduced from 15 companies to 13. Cook recommended that Chesapeake Utilities be removed because of its smaller size and Southern Union be removed because of its incompatible business model. SJI implemented these recommendations for 2012.[59]
- Increases to senior executive base salary levels and/or annual bonus and LTI opportunities could be considered for consistency with the Company's targeted competitive positioning. Overland reviewed the 2012 proposed total direct compensation for the CEO and his direct reports and found that the six direct reports were listed in the proposal to receive an average increase in TDC of 7.33% in order to close the gap between the market median TDC and actual SJI TDC. With the proposed increase, two of the six would be within 20% of the 2011 median proxy peer group TDC; and likely one will be within 20% of the 2012 median proxy peer group TDC. The CEO's proposed 2012 TDC remains unchanged from 2011 as his base salary and TCC were already at the 2011 median for the proxy peer group. SJI also chose to hold the CEO's 2012 LTIP target the same as 2011.[60]
- In the future consider whether the maximum payout opportunity should be increased for the annual cash incentive plan. SJI's maximum payout is currently 150%, while the median in the Cook executive compensation review was 165%. SJI chose not to increase the payout potential in 2012, and to revisit the topic in 2013.[61]
- Consider delinking annual bonus goals from the budgeting process and setting those goals based on industry growth rates. In 2011, SJI's economic EPS growth increased approximately 7% from 2010, putting them well above the median growth of their industry peers. However, the 2011 annual bonus payouts for the CEO and his direct reports were well below the median based on the data in Table 15-11. Cook noted that SJI's budget goals for company growth were not aligned with industry growth rates. SJI chose to delink the annual bonus goals from the budgeting process and set the economic EPS goals based on industry rates, but retain the discretion to modify the potential payout based on these industry rates to take into consideration extraordinary events.[62]
- Use a combination of relative TSR and 3 year average economic EPS as the performance metric for the long-term incentive plan. Cook proposed this change to link the SJI executive equity awards to longer-term operating performance and to financial goals that are directly controllable by the executives. SJI approved and implemented this recommendation.[63]
- Use the same peer group for LTIP as is used for other components of executive compensation. Cook recommended this to ensure alignment between pay and performance. Overland believes

[58] Ibid.
[59] See the Note under Table 15-10 where the peer group was eventually decreased to 12 companies.
[60] Response to Discovery, OC-31 (restricted). 2012 Compensation Analysis for Direct Reports to CEO and for the CEO.
[61] Notes for the 9/23/11 meeting of the SJI Compensation Committee.
[62] Response to Discovery, OC-32 and Notes for the 11/18/11 SJI Board of Directors meeting.
[63] Ibid.

this would simplify and make more efficient the benchmarking process for executive compensation. SJI approved and implemented this recommendation.[64]

- Use a multi-day average for the stock price used for the TSR Calculation. Cook recommended this to mitigate the volatility of the stock price on the LTIP payout. SJI approved and implemented this recommendation.[65]
- Seek shareholder approval of both the annual bonus and stock-based (LTIP) compensation plans. Cook recommended this to become compliant with Section 162(m) to reduce tax exposure for excess compensation. Shareholders approved both the annual bonus and stock-based compensation plans during the shareholders meeting in April 2012.[66]
- Review the direct compensation programs annually and the indirect compensation programs triennially. Cook recommended this to provide timely information that would mitigate the need for large adjustments in compensation to align with the market and ensure that SJI compensation strategies and objectives are fulfilled. SJI approved and plans to implement this schedule going forward.[67]

Cook also reviewed the indirect executive compensation programs. These programs include: stock ownership guidelines, employment agreements, and severance plans. Cook made the following recommendations regarding these programs.[68]

- Stock ownership guidelines should be increased to 5 or 6 times salary for CEO, 2 or 3 times salary for other executive officers and 1 or 2 times salary for non-executive officers. Cook made this recommendation based on the peer group comparisons. SJI has not adopted this recommendation, keeping the stock ownership guidelines for the CEO, other executive officers, and non-executive officers at 3 times, 1.5 times, and 1 times, respectively.
- Remove the compliance deadline for stock ownership and replace it with a retention ratio. Cook recommended this as a best practice and a way for SJI executives to avoid making stock purchases, specifically to meet the ownership deadline. SJI has not adopted this recommendation, keeping the compliance deadline at six years.
- Add a one year non-solicitation of employees and customers to non-change in control employee agreement for executives. Cook made this recommendation to protect SJI's company resources and customer relations. SJI adopted and implemented this recommendation for 2012.[69]
- Use "double trigger" vesting for outstanding stock awards following a change in control instead of "single trigger" vesting. This change would involve the accelerated vesting of LTIP award only after a change in control and a qualifying termination (demotion, position

[64] Ibid.
[65] Response to Discovery, OC-738.
[66] SJI Board of Director minutes "Voting Results – 2012 Annual Shareholder Meeting" dated 5/3/12.
[67] Response to Discovery, OC-738.
[68] Response to Discovery, OC-31 "Executive Compensation Review: Indirect Compensation Elements" by Frederick W. Cook & Co., Inc.
[69] Notes from the 11/18/11 SJI Board of Directors meeting.

eliminated, change in benefits, etc.)[70] beginning in 2012, instead of the accelerated vesting occurring after any change in control. Cook made this recommendation to aid in the retention of executives and to avoid the need for additional awards upon acquisition. SJI adopted and implemented this recommendation for 2012.[71]

SJI is in the process of transitioning the employment agreements applicable to their executives. In the past, the agreements have had two parts: one for change in control and another for non-change in control. The length of the employment agreements had been three years with the most recent agreements expiring on December 31, 2011. For 2012, SJI decided to implement the recommendations from Cook that are mentioned above (double trigger vesting and non-solicitation of employees and customers) in one year employment agreements for its executives. In 2013, the employment agreements are to be replaced with a severance policy for the officers of SJI.[72]

SJI executives are also entitled to unique benefits as part of their compensation package. SJI has a supplemental executive retirement program that enables executives to receive a minimum retirement benefit when aggregated with the employer retirement contributions to the Pension Plan or the 401(k) Plan (for those executives hired after 7/1/03).[73] SJI executives are also reimbursed for company contributions that are not made due to IRS limitation on contributions to the Company's 401(k) Plan. SJI's named executives in the 2012 Proxy Statement are also eligible to participate in the Company's deferred compensation program.[74]

Non-Executive Compensation

Similar to executive compensation, SJI targets non-executive compensation to fall at the 50th percentile (median) of the market.[75] The components of regular compensation include: base salary, annual (cash) incentive awards, 401(k) and pension. Sales and retail employees can also earn commissions.

Base Salary

SJI has developed a salary structure for all non-executive and non-union employees that include a goal for base salary at the 50th percentile with a tolerance of +/- 20%.[76] This structure currently has 10 distinct grades. The salary structure that was in place for 2009 through 2011 is shown in the table below.

[70] Interview with Sharon Pennington, 11/13/12.
[71] Notes from the 11/18/11 SJI Board of Directors meeting.
[72] Interviews with Sharon Pennington, Chief HR Officer 11/13/12.
[73] Response to Discovery, OC-115.
[74] SJI 2012 Proxy Statement.
[75] Interview with Kathy Casella, General Manager, Compensation and Benefits 11/15/12.
[76] Response to Discovery, OC-115.

Table 15-12 - Salary Structure for 2009 through 2011

South Jersey Industries Salary Structure for 2009 through 2011									
	2006-2009 Salary Structure with 2.6% Increase in 2006 for ALL GRADES			2010 Salary Structure with 1.9% Increase in 2010 for ALL GRADES			2011-2012 Salary Structure with 2.6% Increase in 2011 for ALL GRADES		
GRADE	MIN	MID	MAX	MIN	MID	MAX	MIN	MID	MAX
1	29,614.62	42,310.32	50,769.68	30,177.30	43,114.22	51,734.30	30,931.68	44,192.10	53,027.73
2	32,907.47	47,009.46	56,414.38	33,532.71	47,902.64	57,486.26	34,370.96	49,100.27	58,923.49
3	36,563.28	52,231.71	62,677.89	37,257.98	53,224.11	63,868.77	38,189.42	54,554.66	65,465.50
4	40,223.04	57,457.92	68,945.76	40,987.28	58,549.62	70,255.73	42,012.05	60,013.41	72,012.10
5	44,239.52	63,200.80	75,843.04	45,080.07	64,401.62	77,284.06	46,206.99	66,011.71	79,216.18
6	48,667.63	69,524.00	83,427.55	49,592.32	70,844.96	85,012.68	50,832.08	72,616.13	87,138.06
7	53,531.30	76,474.74	91,769.81	54,548.39	77,927.76	93,513.43	55,912.06	79,875.95	95,851.18
8	57,116.59	81,594.45	97,913.71	58,201.81	83,144.74	99,774.07	59,656.90	85,223.42	102,268.40
9	62,827.23	89,755.12	107,702.82	64,020.95	91,460.47	109,749.17	65,621.50	93,747.06	112,492.85
10	64,641.20	92,345.97	110,812.00	65,869.38	94,100.54	112,917.43	67,516.11	96,453.05	115,740.37
Source: Response to Discovery, OC-589									

The salary structure presented above shows a minimum salary in each grade of 30% lower than the midpoint and a maximum salary of 20% above the midpoint.

Base salary increases for represented employees are governed by their collective bargaining agreements. For the Local 1293 IBEW union, its scheduled base salary increases were 3%, 3.25%, 3%, and 3.5% on the date of February 19 in the years 2010, 2011, 2012, and 2013, respectively. For the Local 76 IAMAW union, its scheduled base salary increases were, or are scheduled to be 3.25%, 3%, 3.25%, 3%, and 3.5% on September 1, 2009; June 1, 2010; June 1, 2011; September 1, 2012; and September 1, 2013, respectively.

When a new position is requested by a business line manager, HR will consult market surveys (from Towers Watson, Compdata, American Gas Association, and Watson Wyatt) to determine the median salary for the position, given the duties and responsibilities of the position. HR then takes the median salary from the market surveys and finds the salary grade with the closest midpoint to the market median salary and slots the new position in that particular salary grade.[77]

The salary structure is reviewed annually by the Internal Compensation Committee. Based on the Committee's review of merit increases shown in the salary surveys performed by Towers Watson and Mercer, it determines what percentage increase will be given to the entire salary structure. Individual employees can earn base salary increases based on his or her performance against organizational

[77] Interview with Kathy Casella, General Manager, Compensation and Benefits 11/15/12.

competencies. The new competencies were identified in 2010 and communicated throughout the company in 2011 and now include:[78]

- Leadership
- Teamwork
- Encouraging Innovation
- Decision Making
- Planning
- Communication
- Conflict Resolution
- Coaching and Motivating
- Appraising Performance

SJI has a strong methodology for determining base salary for new positions that is based on market data. Furthermore, base salary increases that are based on market surveys for the entire base salary structure as well as an individual's performance with respect to organizational competencies provides SJI employees with a reasonable and understandable process for adjusting base compensation.

Annual Cash Incentive Award

For non-executives, an employee's annual cash bonus is dependent on his or her individual performance and how that is evaluated in his or her balanced scorecard. The annual cash bonus available to these employees is capped at 3% of base salary for non-union, non-supervisory employees, 6% of base salary for all administrative, professional and supervisory employees; and 8% of base salary for managers. The scores on the balanced scorecard and their corresponding percentage of targeted payouts are shown in the table below.[79]

Table 15-13 - Cash Incentive Award Payouts

South Jersey Industries Cash Incentive Award Payouts	
Score	**% of Target Payout**
2	50%
3	100%
4	125%
5	150%

Annual cash incentive awards for represented employees are based on their collective bargaining agreements. Union employees earn up to a maximum percentage of their base salary based on the bargaining unit's performance against targets and metrics established by SJI. For the members of the Local 1293 IBEW union, they were eligible to earn up to 2% of their base salary in 2010 and 2011 and up

[78] Response to Discovery, OC-544 and OC-4 (restricted).
[79] Response to Discovery, OC-115.

to 3% in 2012, and 2013. Members of the Local 76 IAMAW union were eligible to earn up to 2% of their base salary in 2010 and 2011 and up to 3% in 2012, 2013, and 2014.[80]

Other Types of Compensation

The SJI affiliates compensate employees and their supervisors who are involved in selling products and services by providing a commission based on those sales. These commissions programs vary depending on the affiliate. Furthermore, some affiliates have implemented retention bonuses to individuals in key positions. These retentions bonuses are generally paid three years after they are earned.[81]

Benefits Programs

SJI has a broad range of benefits that it provides for its employees. Below is a summarized list of benefit programs that are offered:[82]

- Medical and Dental Plans
  - Horizons Blue Cross Blue Shield Point of Service Plans
  - Horizons Blue Cross Blue Shield Direct Access Plans
  - Horizons Dental Option Plan
  - Horizons Dental Option Plan (Enhanced Plan)
  - CVS/Caremark Prescription Drug Program
  - National Vision Administrators Vision Plan
- Life Insurance and Accidental Death & Dismemberment
- Northwestern Mutual Life Insurance (Officers and Directors)
- Short-term disability (Aetna)
- Long-term disability (Aetna)
- 401K Plan (Bank of America/Merrill Lynch)
- College Savings 529 Plan (BlackRock)
- Union Pension Plan (Aetna)
- Salaried Pension Plan (Aetna)
- Employee Assistance Program (Cigna)
- Retired Employee Benefits (Aetna)
- Flexible Spending Account (CBIZ Flex)

Overland requested benchmark data comparing SJI benefit programs to industry standards. The only data SJI provided was the percentage of monthly employee's health care premiums paid by the employee compared to other transportation, communication, and utility companies. Companies in these industries had employees contribute 19% towards the total cost of health care premiums, while SJI employees contributed 17.35% towards their health care premiums in 2011. This data was compiled

[80] Response to Discovery, OC-139.
[81] Ibid.
[82] Response to Discovery, OC-133 and OC-537.

for single coverage health care premiums.[83] More benchmarking data is necessary to compare the overall level of benefits that SJI employees receive relate to their peers.

Pension Plans and Post-Retirement Benefits

Only SJI represented and non-represented employees hired before July 1, 2003 are eligible to participate in SJI's pension plans. SJI provided to Overland the actuarial valuations that were received in 2009, 2010, and 2011 for all of its defined benefit plans. Overland reviewed the valuations of each of the defined benefit plans for the fiscal year 2011, which disclosed the following information (measurement date 1/1/12).[84]

- Retirement Plan for (Non-represented) Employees of SJI
  - Accumulated Benefit Obligation (ABO) - $68,969,796
  - Projected Benefit Obligation (PBO) - $75,313,575
  - Percentage of ABO funded – 81.2%
  - Percentage of PBO funded – 74.4%
- Retirement Plan for (Represented) Employees of SJI
  - Accumulated Benefit Obligation (ABO) - $79,633,558
  - Projected Benefit Obligation (PBO) - $88,805,145
  - Percentage of ABO funded – 76.4%
  - Percentage of PBO funded – 68.5%
- Supplemental Executive Retirement Program (SERP)
  - Accumulated Benefit Obligation (ABO) - $29,501,367
  - Projected Benefit Obligation (PBO) - $31,532,742
  - Percentage of ABO funded – 0%
  - Percentage of PBO funded – 0%
- Postretirement Benefit Plan
  - Accumulated Benefit Obligation (ABO) - $63,138,844
  - Percentage of ABO funded – 50.52%

No contributions were made to the pension plans during 2011. However, SJI did contribute $25 million to the pension plans in January 2012. The Company expects to contribute $1.3 million in payments to the SERP plan in 2012. SJG has a regulatory obligation to contribute $3.6 million per year to its other postretirement plan trusts.[85] The SERP is an unfunded defined benefit plan that is not subject to the Pension Benefit Guaranty Corporation (PBGC) funding requirements.[86] SJI pays benefits for the SERP from corporate assets. There is no ratepayer impact in providing benefits under the SERP as the costs and working capital requirements for the plan are disallowed in SJG rate cases.[87] The pension plans at SJI are at a funding level that may expose the company to the assessment of PBGC premiums. These

[83] Response to Discovery, OC-714.
[84] Response to Discovery, OC-546.
[85] SJI's 2011 10-K.
[86] Response to Discovery, OC-713.
[87] Response to Discovery, OC-735.

premiums are assessed based on PBGC rules that calculate funding percentages in a different manner than generally accepted accounting principles.

Employees of SJI are generally positive about the benefits package currently offered by SJI. The Benefits/Disability Coordinator reviews the benefits package with SJI employees when they are initially hired. The Coordinator also reviews the benefits package with each operational group each year.[88] The Patient Protection and Affordable Care Act was enacted in 2011 and could potentially affect the benefits packages offered by SJI. The Company and its benefits administrator (Blue Cross Blue Shield of New Jersey) believe that SJI healthcare plan is a "grandfathered health plan" as described in the health care legislation.[89] However, SJI is considering other health care plans for its employees in order to avoid paying the "Cadillac tax", an excise tax for those healthcare plans with the cost of coverage exceeding $10,200 for individuals and $27,500 for families. However, this provision of the act is not effective until 2018.[90]

Training and Development

Performance Evaluation

SJI calls its employee performance evaluation process Strategic Performance Management. The Company represents that its evaluation process has benefits for employees, supervisors, and the Company as a whole. These benefits are described below.[91]

- Employee Benefits
    - Open lines of communication between the employee and the supervisor.
    - Establishes responsibilities and objectives and the relationship between individual responsibilities and objectives and overall corporate strategic objectives.
    - Improvement of his/her job performance.
    - Receives self-satisfaction and recognition.
    - Provides career development.
- Supervisor Benefits
    - Opens lines of communication between the supervisor and the employee.
    - Improves the performance of employees and aligns performance with corporate objectives.
    - Improves the performance of the department.
    - Documents performance characteristics.
- Company Benefits
    - Communicates the organization's vision and strategic objectives and how it is linked to a set of departmental and/or individual objectives.
    - Improves the overall effectiveness of the organization.

[88] Interview with Kathy Casella, General Manager, Compensation & Benefits, 11/15/12.
[89] Response to Discovery, OC-133.
[90] http://housedocs.house.gov/energycommerce/TIMELINE.pdf.
[91] Response to Discovery, OC-144.

- The results aid in providing the basis for succession planning.

The objectives of the Strategic Performance Management Program are to: establish an ongoing formal line of communication between employees and their supervisors to discuss how their job performance relates to the overall organizational objectives, establish a system to review employee performance and link the employee's performance to annual salary reviews, and serve as a management tool in assessing the strengths and potential of the workforce for the purpose of promotion, transfer, organizational development, and documentation and validation of personnel practices.[92]

The Strategic Performance Management Program was developed by an external consultant and has used the balanced scorecards as a management tool for all SJI affiliates since 2005.[93] The Program begins with the supervisor of each employee determining and documenting the employee's balanced scorecard objectives and the weighting for each objective as well as the weighting for the core competencies that are used company-wide.[94] The employee is allowed to have some input in determining the scorecard objectives; however, the final decision on the objectives is made by the supervisor or manager.[95] Each employee scorecard must have at least one goal in each of the four sections of the scorecard: Financial, Customer, Process, and Learning and Growth. In addition, at least one goal must be considered a stretch goal.[96] The goals and their weights are set during the first quarter of the fiscal year. There is a mid-year review conducted in June.[97] The mid-year review is an informal review to discuss how the employee is progressing with the achievement of the goals that were set at the beginning of the year. Goals can be adjusted during the mid-year review if necessary. However, the mid-year reviews are not retained in the HRIS (Lawson) system, nor are there any actions taken regarding compensation based on the mid-year review.[98] The final performance review takes place in December. This is when the supervisor or manager gives ratings to his or her employees for both core competencies and balanced scorecard objectives based on the following scale.

- 5 – Far exceeds the level of expected performance and surpasses the position requirements in every relevant activity.
- 4 – Exceeds the level of performance expected and continually surpasses the requirements of the position.
- 3 – Performs at a level commensurate with expectations and meets accountabilities and objectives in a fully competent manner.
- 2 – Does not meet expectations in some phases of the position requirements.
- 1 – Performance at a level which is far below the position requirements in every relevant activity.

92 Ibid.
93 Response to Discovery, OC-363.
94 Response to Discovery, OC-144.
95 Response to Discovery, OC-363.
96 Response to Discovery, OC-363.
97 Response to Discovery, OC-144.
98 Interview with Kathy Carl, Director of HR, 11/15/12.

The ratings for the competencies determine the amount of base salary increase for an employee. The ratings for the balanced scorecard objectives determine the percentage payout for the annual cash incentive award.[99]

Once all of the employee evaluations have been completed, the Internal Compensation Committee reviews the data and proposed salary adjustments. Once reviewed, the Committee approves the salary adjustments and returns the evaluations to the supervisors to review them with their subordinates.

The performance review process is paper intensive. The forms are available electronically; however, most employees print them out in order to obtain signatures. When HR receives the completed evaluations, the department scans them into the Lawson system, using Image Now software. The scanned documents are filed electronically as opposed to filing the hard copies, which was the protocol until the process was changed in 2006.

SJI employs a sound process for assessing employee performance. The rating system that is used to assess employee performance is straightforward and easy to understand. One improvement that can be added to the process is to retain documentation anytime a goal is adjusted between the goal setting process and the year-end performance review.

Represented (union) employees at SJI are not subject to the Strategic Performance Management process. The Business Partners in HR work with the line managers to manage the performance of union employees. Typically, new union employees have a 180 day probation period during which their performance is evaluated to determine whether the employee is retained.[100] After this probationary period, a represented employee's work performance is governed by the collective bargaining agreement for the union which represents them.

Employee Training

In order to maintain an effective and efficient workforce, SJI continually develops its employees through various methods and types of training. As mentioned earlier in this chapter, when new employees begin working at SJI and its affiliates, they receive Ethics and Compliance training that is to be completed within 60 days of the employee's start date.[101] During the audit period (2009-2011), SJI employees were required to participate in periodic training relating to SJI's Drug and Alcohol policies as well. In 2009, SJI provided specific training to its managers and supervisors entitled "SJI Industries Leadership Influence to Manage Change". This training was presented by the Dale Carnegie Management Consultants. In addition to this specific training, SJI has also made available to its management employees online classes instructed by Cornell's Graduate School of Management and School of Industrial Relations. The topics of

[99] Response to Discovery, OC-144.
[100] Interview with Kathy Carl, Director of HR, 11/15/12 and Response to Discovery OC-139.
[101] Response to Discovery, OC-67.

these courses include management themes in the areas of leadership, strategy, finance, and human resources.[102]

In 2012, SJI made plans to expand its training offerings to its employees with the goal of attaining a robust organizational development plan. A Customized Training Grant from the New Jersey Department of Labor and Workforce Development provided the resources to implement these new training offerings, which have the objective of developing a stronger, more competent workforce. There are four principal components included in this organizational development plan. They are listed below.[103]

- Leadership Development Training – The first component is directed at front-line supervisors and mid-level managers. The objective of the training is to help these employees understand their role in the organization through supporting SJI goals and positively impacting their subordinates. By completing these objectives, the Company seeks to improve performance metrics and overall business results.
- LEAN Six Sigma – This training includes applying LEAN Six Sigma techniques to key processes in order to reduce waste and increase the value of SJI's resources. The LEAN Six Sigma techniques are implemented to improve the productivity for union workers in the areas of construction activities and emergency response.[104]
- Written Communication Training – This component of the training plan provides a business writing course to SJI's professional employees. The goal of this training is to improve communication skills to internal and external customers.
- Advanced Excel Training – This final component of the training plan seeks to instruct employees on more advanced methods of data analysis using Excel in order to optimize the productivity and accuracy of information.

In addition to the non-technical training programs, SJI provides technical and safety training to its operational employees. SJI uses both in-house trainers and outside vendors to provide the training. The in-house trainers conduct training sessions that are repeated annually, while the outside vendors provide training that is more dynamic in nature.[105]

The effectiveness of training sessions at SJI is measured in various ways. For training sessions related to safety, the number of incidents or accidents is used to monitor training effectiveness. For other technical training programs, productivity may be used to measure training effectiveness.[106] For many non-technical training sessions, a training evaluation is completed by the attendees, which is another method used by SJI to determine the effectiveness of its training sessions.[107]

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[102] Response to Discovery, OC-136.
[103] Ibid.
[104] Response to Discovery, OC-142.
[105] Response to Discovery, OC-136.
[106] Interview with HR managers (Kristy Calo, Kathleen Carl, and Kathy Casella), January 22, 2013.
[107] SJI provided as an example training class evaluations as part of the response to OC-708.

During the annual performance review process, managers work with their direct reports to ensure that employees are being developed to meet the needs of that particular business line. The managers have received training on how to properly complete development plans through a program conducted by the Dale Carnegie Management consultants with support from the SJI HR department.[108]

Access to Personnel Information

Lawson is the information system that is utilized by the Human Resources department of SJI. The system was developed by a third party vendor. A wide range of personnel information for the employees of SJI is retained in Lawson including: personal information, job position information (e.g. title, job class, etc.), labor union information, compensation data, attendance records, employee benefits information, and much more. Some personnel information is retained outside of the Lawson system as a hard copy in employee files. This information includes, but is not limited to the following: application documentation, employee benefit forms, organizational announcements, and letters of resignation.[109]

Access to the Lawson HRIS appears to be appropriately restricted. Only HR and Payroll employees have access to the Lawson system. The hard copy employee files are only accessible to the Human Resources staff. Overland reviewed the list of SJI employees that are able to edit, add, or remove human resource information. The list, including access levels is shown below.

Table 15-14 - Lawson HRIS Access Table

South Jersey Industries Lawson HRIS Access Table		
Employee Name	**Employee Position**	**Edit/Add/Remove Level Access**
Kathleen Casella	GM Compensation and Benefits	All HRIS Information
Heide Silva	HRIS Administrator	All HRIS Information
Kim Mattioli	Comp & Benefits Analyst	Benefits Information
Michelle Tavani	Benefits/Disability Coordinator	Benefits Information
Kristy Calo	Manager, Diversity/Recruitment	Applicant Information
Naomi Tavarez	Recruiter	Applicant Information
Lisa Cottman	Recruiter	Applicant Information
Matt Neal	GM, HR-Business Partner	Applicant and Grievance Information
Michelle Tobler	GM, HR-Business Partner	Applicant and Grievance Information
Maureen Kemler	Recruiting Coordinator	Applicant Information
Suzanne Rudder	Manager, Employee Labor Relations	Grievance Information
Source: Response to Discovery, OC-741		

The Lawson system does not interface directly with other applications within the SJI. However, many Lawson reports and other outputs provide information for third party vendors (e.g. employee benefit

[108] Response to Discovery, OC-135.
[109] Response to Discovery, OC-741.

providers). For instance, the scanning system for employee performance evaluations, Image Now, interfaces with the Lawson system.

Succession Planning

SJI has been forced to place a high priority on succession planning due to the fact that 306 of SJI's employees (approximately 45%) will be eligible to retire in 2016.[110] SJI has spent a significant amount of time and resources to create a robust succession plan for key roles in the organization in addition to preparing certain employees for stepping into these key roles in the future. SJI took a top down approach to succession planning by starting with the CEO and moving down to the officer/director level from there. SJI has placed such a high importance on succession planning that it has placed an objective on each SJI officer's balanced scorecard relating to succession planning and has given it a 25% weighting, which significantly affects each officer's annual cash incentive payout. The scorecard objective required each officer to identify and assess his or her potential successors as well as develop a plan to prepare the successors for the officer's position in the future.[111] Officer succession management is handled solely by the Vice President and Director of Human Resources, not the department as a whole.[112]

In 2011, SJI contracted with Right Management Group to create and document an emergency/interim succession plan for the CEO and Chairman of SJI as well as an executive talent overview. This document is central to the continuity of the executive leadership at SJI. Through the assessment of talent at the executive level at SJI and its affiliates, the Right Management Group has assisted SJI in identifying potential replacements for the following seven key positions listed in the company: CEO, CFO, General Counsel, VP Corporate Research and Development, Chief HR Officer, COO of SJG and COO of SJES. To determine the best candidates to serve as replacements for these positions, Right Management used a Performance Potential Matrix (9 Box Assessment) to evaluate the candidates based on the executive competencies that are most important to SJI. The candidates were also given assessments of their strengths and development needs with respect to these executive competencies.[113] This Succession Plan and Executive Talent Overview serve as a useful tool as SJI looks to successfully manage executive level and officer turnover in the near future.

In 2011, SJI Human Resources led a project to determine positions within the company that are most likely to have turnover, identify the timeframe of the expected turnover, and gauge the business risk inherent in that position's turnover. The utility employed a rating system from 1-5 for retirement risk (5 represented an employee that was very close to retiring) and for risk to the company (5 being a position that is of critical importance to the company). Below is an excerpt of the retirement risk assessment tool used for the utility. The table below only includes the positions at the utility that are considered to have a high retirement risk. The employee names have been removed.

[110] Response to Discovery, OC-539. (According to the People Development Strategy presentation given on 4/24/12.)
[111] Response to Discovery, OC-117.
[112] Response to Discovery, OC-328.
[113] Discovery document entitled: "SJI Succession Management: CEO and Chairman Emergency/Interim Succession Plan and Executive Talent Overview".

Table 15-15 - Excerpt from SJG Retirement Risk Assessment Tool

[Begin Confidential]

Excerpt from SJG Retirement Risk Assessment Tool SOUTH JERSEY GAS - OPERATIONS AREA TOTAL RISK - HIGH TO LOW						
POSITION	AGE	DATE OF HIRE	YRS OF SVC	RETIREMENT RISK	RISK TO COMPANY	TOTAL

[End Confidential]

The table above shows the non-officer positions with the highest total retirement risk; those with a total score in the range from eight to ten. Overland assumes that the utility will concentrate its efforts on ensuring that these positions have succession plans in place since they represent both important positions within the utility, as well as display a high risk of turnover in the near future. This seems to be a useful tool for: indicating where the utility should concentrate not only its succession planning efforts; recruiting and hiring efforts; and knowledge transfer once the position has been turned over to a new employee.

In 2012, SJI intended to expand its succession planning objectives and processes. This expansion was to be achieved in several steps. The first step includes analyzing areas where voluntary departure risk exists. Another step includes expanding the POWER program. The POWER program is a leadership development program at SJI where the company identifies high potential candidates and rotates them through various departments in SJI and its affiliates in order to gain a broad understanding of SJI business operations.[114] The program had two candidates in 2011 and is on its 3rd cycle of interns. The POWER program has had a 100% conversion rate of interns to full-time employees.[115] SJI has also begun

[114] Response to Discovery, OC-328.
[115] Interview with Sharon Pennington, Chief HR Officer, 11/13/12.

implementing a nine box review in September 2012. In this review, individuals are assessed against the leadership qualities that are desirable for SJI. If any gaps or deficiencies are identified, then a development plan is put in place to close the gaps. Finally, SJI consistently reviews the allocation of work amongst its employees in order to take advantage of individual skill sets to increase the profitability of the company.[116]

Towards year-end 2012, the unionized workforce also engaged in a process that centered on succession planning. During this time, an analysis was started to understand the planned work, staffing requirements, demographics of the unionized utility employees, and any risks the previous three items might have on the utility. From this analysis, a prioritized list of recommendations was created on how to manage the unionized utility workforce within the next five years. Currently, the recommendations are being discussed and finalized; therefore, no action had been taken as of September 2012.[117]

The company has a very thorough process in place with respect to succession planning. SJI utilizes a tool to determine which positions pose high risks of turnover and high risk of critical skill loss. This tool allows them to be better prepared to maintain the business continuity for the affiliates of SJI.

Labor Relations

SJI states that its labor relations strategy is both positive and collaborative. The Company relies on communication of overall business strategy and organizational objectives to help the unions understand the environment in which SJI operates. This is evidenced through various formal and informal labor management meetings with the unions to discuss issues impacting both the Company and the unions, and to reach solutions that improve the operations processes at SJI.[118]

As of January 2013, SJG is under contract with two unions. They are listed below along with the expiration dates of their agreements.[119]

- Local 1293 of the International Brotherhood of Electrical Workers (IBEW), American Federation of Labor – Congress of Industrial Organizations (AFL-CIO). The contract with this union expired February 28, 2013.[120] There were 44 SJG and SJESP employees that were members of this union as of August 31, 2012.[121]
- Local 76 and Local 95 of the International Association of Machinists and Aerospace Workers (IAMAW).[122] The contract with these merged unions will expire August 31, 2014. There were

[116] Response to Discovery, OC-328.
[117] Response to Discovery, OC-330.
[118] Response to Discovery, OC-138.
[119] Response to Discovery, OC-139.
[120] SJI signed a new collective bargaining agreement with the Local 1293 that is effective March 1, 2013 and expires February 28, 2017 per response to discovery, OC-740.
[121] Response to Discovery, OC-532.
[122] On September 11, 2009, the Local 76 and Local 95 of the International Association of Machinists and Aerospace Workers agreed to merge the two organizations based on a Memorandum of Agreement provided in the response to OC-139. In the interview with Sharon Pennington, Chief HR Officer, she mentioned that of the contract provisions that differed between

approximately 283 SJG and SJESP employees that were members of this union as of August 31, 2012.[123]

SJG does not have written policies or procedures addressing management and union relations. SJG's labor contracts with the two unions are the primary documents governing labor relations policy. The Human Resources department takes the lead role in negotiations with the unions. To be able to lead the negotiations with the unions, HR gathers information from the unions, the HR business partners, and some outside sources in order to prepare proposals for discussion with union leaders. In our interview with the Chief HR Officer, it was noted that there are usually three to five major issues that arise in each bargaining agreement negotiation. In recent negotiations, the follow topics came to the forefront:[124]

- <u>Workplace flexibility amongst job class</u> – The Local 76 union agreed to create two job families (groups of jobs for which employees can be easily cross-trained): clerical job family and street/utility job family. SJG could not quantify the benefits from creating the two job families; however, it appears that the job families created will enhance workplace flexibility.
- <u>Implementing caps on medical expenses pre and post 65</u> – SJG was able to negotiate this into the current bargaining agreements and save the Company approximately $16 million in the first year of implementation.
- <u>More equal sharing of health care premium costs between union employees and the Company</u> – SJG found that the market showed employee contributions to their health care premiums at around 25 to 30 percent. Before the current collective bargaining agreement, SJG union employees were contributing 1%. The most recent round of contract negotiations was successful in getting union employees in the Local 1293 union to share a higher percentage of their health care premium costs.

Overland discussed with Human Resources managers how they perceived their relationship with the two unions that represent employees of SJG and SJESP. The Chief HR Officer stated that the relationship that the Company has with the Local 1293 is generally positive, as the Company perceives the union to have a problem solving approach and open communication manner when differences are addressed. On the other hand, the Local 76 (including the merged Local 95) union is perceived as a union that is often challenging and that is at times inflexible when it comes to negotiating and approving agreements and process improvements.[125] SJI has entered into litigation with the Local 76 on two different occasions during our audit period. These two litigation cases and their outcomes are summarized below.

- In 2009, SJG filed an unfair labor practice charge with the National Labor Relations Board that the Local 76 refused to meet and bargain in good faith with SJG to obtain a new collective bargaining agreement to replace the agreement that was to expire 1/14/09. The judge ordered the Local 76 to enter negotiations with SJG for a new collective bargaining agreement.[126]

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the two organizations at that time, some provisions remained separate and others were made consistent between the two organizations.

[123] Response to Discovery, OC-532.
[124] Interview with Sharon Pennington, Chief HR Officer, 11/13/12.
[125] Interview with Sharon Pennington, Chief HR Officer, 11/13/12.
[126] Response to Discovery, OC-534.

- As of June 2012, SJESP filed a charge against the Local 76 for engaging in unfair labor practices. This action was brought by SJESP as a result of the Local 76 not responding and failing to execute the collective bargaining agreement that was to be in effect from October 27, 2009 to August 31, 2014. The judged ordered the Local 76 to immediately execute the contract.[127]

SJI does provide labor relations training as part of the onboarding process for new supervisors. Once a supervisor is employed with SJI, he or she is rotated through a labor relations training course. This training is also provided to management employees up to the position of Vice President.[128]

Grievances

The objective of SJI's grievance policy is "to assure timely, thorough, and uniform responses to written grievances filed by members of company bargaining units". The responsibility for carrying out these objectives rests on the company supervisors. The Director of Human Resources is responsible for monitoring all grievance activity and recommending appropriate action to resolve the grievances.[129]

Though specific procedures for handling grievances may differ between the contracts of the Company's bargaining units, the general grievance resolution procedure at SJI works as follows:[130]

1. A union has 10 days to file a grievance from the time of the alleged violation.
2. Operations management makes the first attempt to resolve the grievance through a hearing with the aid of the Human Resources Business Partner.
3. If Operations management is unable to resolve the grievance, additional hearings are conducted, with the final hearing conducted by the Chief HR Officer with the Vice President of the business line present.
4. If the Chief HR Officer and the VP of the business line are unable to resolve the grievance, the matter is taken before an arbitrator.

The number of grievances at SJI fluctuates over the course of a bargaining contract agreement, with the number of grievances filed typically rising as the contract with the union nears its expiration. During our audit period, the number of grievances has been as follows.[131]

- 2009: There were 32 grievances, none remaining open. Two grievances went to arbitration where the arbitrator decided once for SJG and once for the grievant.
- 2010: There were 39 grievances, with four remaining open. Four grievances went to arbitration. The decisions were not disclosed.
- 2011: There were 30 grievances, with eleven remaining open. None are currently in arbitration.

[127] Response to Discovery, OC-535.
[128] Ibid.
[129] Response to Discovery, OC-116.
[130] Based on the interview with Sharon Pennington, Chief HR Officer, 11/13/12 and supplemented with the response to discovery, OC-139.
[131] Response to Discovery, OC-141.

Interviews of SJG's Union Presidents

We interviewed Laurence Powell, President of the Local 76 International Association of Machinists and Aerospace Workers (IAMAW) and Robert Kimble, President of the Local 1293 International Brotherhood of Electrical Workers (IBEW) to assess the relationship between the unions and SJG. Below is a summary of the interviews.

In general, there is a good working relationship between the Local 1293 IBEW union and SJG, while the relationship between the Local 76 and SJG is more strained. The Local 1293 believes that there is an open line of communication between SJG and the union and while the two parties don't always come to a quick agreement on pending issues, there is a desire on both ends to work together and compromise in order to arrive at a suitable solution for both parties. The Local 76 and SJG have a more contentious relationship. The union president for the Local 76 went as far as saying that the Company's labor relations philosophy is "the opposite of the union's". The president believes that the Company's focus is saving money, while the union's focus is to improve the working conditions, wages, and benefits of the union's employees. The issues that most often cause friction between the Local 76 and SJG are grievances, policies and implementation of the policies.

Both unions communicate with the Company formally and informally through emails, telephone, and face-to-face meetings. Although they both stated that the frequency of the communication was adequate, both mentioned that monthly meetings with the Company have not been held on a consistent basis recently. In the case of Local 1293's monthly meetings with the Company, these meetings have not been given priority due to the collective bargaining agreement negotiations.

Both presidents indicated that the local grievance and arbitration procedures were reasonable. Furthermore, neither union had any grievances that were in arbitration at the time of the interview. Both unions mentioned that the majority of grievances were disciplinary in nature for violations of operations protocols.

The Local 1293 collective bargaining agreement expired on February 28, 2013. At the time of the interview, the big issues identified in the negotiations were health care and retirement benefits, operational issues and wages. Although the collective bargaining agreement for the Local 76 union does not expire until August 31, 2014, the president of the union cited the same general issues when asked what will be the main topics of discussion in negotiation of the next collective bargaining agreement for the union. Both unions stated that they generally prepare for negotiations by obtaining feedback from union employees. Each union has its collective bargaining team that meets to discuss the feedback and formulates a strategy for how issues should be negotiated.

Both unions mentioned that they were allowed some input on the metrics that are used to determine union employees' incentive compensation. The union presidents did not feel that performance metrics were a significant issue during the course of collective bargaining negotiations.

Overall, SJI has a solid working relationship with the two unions. However, the Company should strive to improve its relationship with the Local 76. Improving the relationship with the Local 76 might be achieved through consistent monthly meetings with the union as well as soliciting the help of outside facilitators to conduct relationship building workshops with the Company and the union.

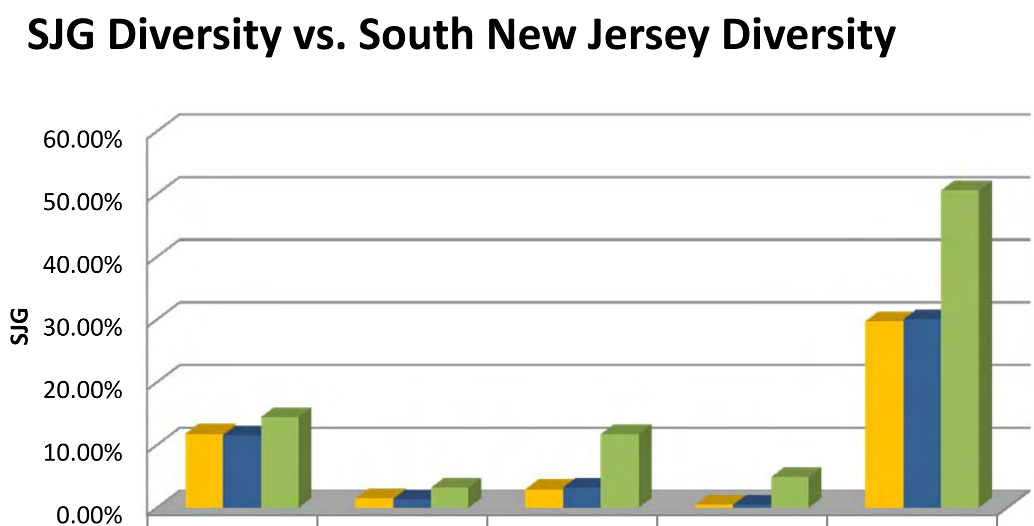
Diversity, Equal Employment Opportunity/Affirmative Action (EEO/AA)

SJI demonstrates that it values diversity through the programs that it has in place for both its employees and business operations. SJI has an Affirmative Action Policy in its HR Manual and represents that it is an equal opportunity employer.[132] The Company's Supplier Diversity Program shows a commitment to attaining a diverse array of suppliers to support SJI's customer services and products by expanding the number of women and minority-owned businesses that SJI uses as vendors, and the existing relationships that SJI has with diverse vendors. The Company is a member of the BPU Supplier Diversity Development Council whose objective is to forge and enhance working relationships between women and minority-owned businesses and New Jersey public utilities.[133]

SJI has devoted a considerable amount of resources to promote and improve the diversity of employees within the organization. There is an entire section of the SJI website devoted to SJI's Diversity Initiative. In the introductory paragraph of the Diversity Initiative page, SJI mentions that "we strive to reflect this diversity [of the seven counties that serves as SJI's primary customer base] in our workforce and organizational culture."[134] Overland analyzed the information in the EEO spreadsheets that are used to prepare the EEO reports that are filed with the state of New Jersey annually. Overland obtained the demographic data from the United States 2010 census for the seven counties in New Jersey that contain most of the SJI customers and compared the census data to the SJG employee demographics. The results of the analysis are shown in the graph below. The first two rows in the data table in the graph represent SJG's employee demographic at those particular points in time.

[132] Response to Discovery, OC-116.
[133] Response to Discovery, OC-143.
[134] SJI website http://www.sjindustries.com/108/diversity_initiative.html.

Table 15-16 - SJG Diversity vs. South New Jersey Diversity



	African American	Asian	Hispanic	Others	Female
JANUARY 1ST, 2011	11.79%	1.47%	2.95%	0.49%	29.73%
SEPTEMBER 2011	11.52%	1.38%	3.23%	0.46%	30.02%
2010 CENSUS	14.47%	3.21%	11.77%	4.88%	50.57%

Source: Response to Discovery, OC-143 and 2010 Census Data for the seven counties that make up SJF's service area (http://www.census.gov/2010census/popmap/ipmtext.php$f=34)

The graph shows that SJG still has room for improvement to reach its goal of reflecting the demographics of the customers it serves in the demographics of its employees. The utility is underrepresented in each minority demographic in 2011 when compared to the 2010 U.S. census. Despite this data, SJI has initiatives in place to obtain access to diverse talent for its workforce. SJI attends job fairs that are specific to placing veterans and other job fairs that are specific to placing female and minority engineers.

SJI Human Resources files two reports with the state of New Jersey concerning the diversity of SJI's workforce. The first report is the EEO1 report. It is prepared by the Manager of Diversity and Recruitment and is filed annually with the State of New Jersey. The report contains a listing of job categories for each of SJI's affiliates and the demographic of the employees that fill those job categories. There are no standards that New Jersey requires SJI to meet in the report. The second report filed with the state of New Jersey is VET-100 Employment Report. It is also prepared by the Manager of Diversity and Recruitment and is filed annually with the State of New Jersey. The report also contains a listing of job categories, and the number of veterans SJI has employed in each job category within each affiliate as well as any veterans that were hired by job category and affiliate in the previous 12 months.[135]

[135] Response to Discovery, OC-550.

The Office of Federal Contract Compliance Programs (OFCCP) conducts reviews of a company's equal employment opportunity policies and procedures to determine if the policies and procedures are in compliance with OFCCP regulations. In 2011, both SJG – Cape May and SJESP had their equal employment opportunity policies and practices evaluated by the OFCCP. The OFCCP found no violations with the SJG – Cape May location. However, the OFCCP found two violations in its evaluation of SJESP. The violations and proposed remedies for SJESP are listed below.[136]

- The OFCCP claimed that SJESP committed a violation by failing to develop and execute action-oriented programs to attain established goals and objectives. Specifically, SJESP could not demonstrate that it made good faith efforts to expand employment opportunities for minorities in First-Mid Level Officials & Managers, Sales, and Office & Clerical; and for females in Sales, Office & Clerical, Craft Workers, and Service Workers.

  The OFCCP proposed, as a remedy to the violation, that SJESP immediately develop and execute programs designed to attain established goals and objectives and expand employment opportunities for the aforementioned Job Groups for minorities and women. SJESP was also required to send job vacancy announcements to the Atlantic County One-Stop Career Center and the Hispanic Affairs Resource Center.

- The OFCCP claimed that during calendar year 2010, SJESP failed to undertake appropriate outreach and positive recruitment activities that are reasonably designed to effectively recruit qualified disabled veterans, covered veterans and qualified individuals with disabilities as required by federal regulations. Specifically, SJESP did not provide documentation that it sent job vacancy announcements to recruitment sources for veterans and individuals with disabilities. Also, SJESP did not provide documentation that it sent written notification of its affirmative action policy to all subcontractors, vendors and suppliers, requesting appropriate action on their part.

  The OFCCP proposed, as a remedy, that SJESP send its job vacancy announcements to the State of New Jersey Vocational Rehabilitation Services, Project Hire/The ARC of New Jersey, and the Atlantic County One-Stop Career Center. In addition, the OFCCP required SJESP to send written notification of it affirmative action policy to all subcontractors, vendors and suppliers, requesting appropriate action, in accordance with the requirement contained in the regulations.

[136] Response to Discovery, OC-549.

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16. Remediation Costs

Although SJG stopped manufacturing gas in the 1950s, the Manufactured Gas Plants (MGPs) previously operated by the Company remain a relevant issue because the environmental work required to sufficiently clean up the damage caused to soil and groundwater at these sites is unpredictable, difficult and costly.[1] The Company's internal processes related to the accounting for, and containment of, these costs are the subject of this Chapter and are the costs referred to herein as "remediation costs."

Summary of Findings

1. SJG is directly responsible for the clean-up of 12 active MGP sites and one additional site contractually assigned to a third party.
2. As of the end of our audit period, cost estimates to complete the remediation activities ranged from $90 million to $217.2 million.
3. SJG amortizes remediation costs (and the carrying costs related to those remediation costs) over rolling seven year periods.
4. Environmental remediation costs will no longer be net of insurance recoveries because SJG reached the limit of its insurance coverage in 2012.
5. The Company has implemented procedures to help ensure that best practices identified during remediation projects are formally documented and available for all environmental remediation contractors.

Recommendations

1. The SJI Audit Committee should continue to perform annual reviews of the MGP Site remediation budget until all sites have been sufficiently repaired.

Background

Environmental remediation costs are the expenditures necessary to investigate and sufficiently rectify the environmental damage caused by MGPs previously ran by SJG or its predecessor companies. SJG has twelve such active MGP locations: Michigan Avenue (Atlantic City); Glassboro; Egg Harbor City; Bridgeton; Florida Avenue (Atlantic City); Salem; Pennsgrove; Millville; Hammonton; Vineland; Pleasantville; and Swedesboro. Additionally, SJG has one additional active MGP site, Kirkman Boulevard, contractually assigned to a third party for restoration.[2]

In a 1992 Order approving a rate increase for SJG, the NJ BPU established SJG's Remediation Adjustment Clause (RAC) as a recovery mechanism for environmental remediation costs incurred by SJG. Under the

[1] Before the natural gas industry had the extensive and reliable pipeline infrastructure that it has today, much of the natural gas used in the United States was "manufactured gas." Manufactured gas was produced by burning coal or oil in an enclosed container. The gas produced was then used for various purposes, including illuminating street lamps.

[2] Response to Discovery, OC-765.

RAC, SJG is allowed to recover all prudently incurred environmental remediation costs (plus related carrying costs) amortized in equal installments over rolling seven-year periods.[3,4]

Accounting for Remediation Costs

As noted earlier, SJG is directly responsible for the active environmental cleanup of 12 of its previously managed MGP sites. Due to the requirements of GAAP regarding liability recognition, as well as the lag time that exists between expenditure and recovery, the accounting for remediation costs is a multi-step process.

Remediation costs appear on SJG's balance sheet and they represent a significant portion of the "Regulatory Asset" line item.[5] These costs are further split into two components: estimates of future expenditures and the unamortized balance of net expenditures already incurred. These two components are described below.

Regarding the estimates of future expenditures, US GAAP requires that a liability be booked if it is probable that a liability has been incurred and the amount of that liability can be reasonably estimated.[6] SJG discloses an estimated range of future environmental remediation costs in its annual financial statements. These costs represent the Company's estimate of future remediation costs that are likely to be expended in the future, but have not yet been expended. The range of these estimates for the years ended 2011, 2010 and 2009 are listed in the table below.

Table 16-1 - Estimated Future Remediation Costs

South Jersey Gas Remediation Costs Estimated Future Expenditures (in millions)		
As of Date	**Low Range**	**High Range**
December 31, 2011	$90.0	$217.2
December 31, 2010	87.4	237.4
December 31, 2009	69.1	248.6
Source: SJG 10-K filings for 2011, 2010 and 2009.		

In accordance with GAAP, SJG records the minimum amount of this range on its financial statements. Accordingly, for the years 2011, 2010 and 2009 SJG recorded on its balance sheet a liability for future

[3] Order approving SJG's environmental remediation cost recovery mechanism dated August 10, 1992 (Docket No. GR9l07l243J) provided in response to Discovery, OC-256.

[4] Although the BPU's 1992 Order declared that the carrying costs related to environmental remediation costs would be absorbed by company shareholders, a subsequent BPU Order that became effective January 1, 2000, approved the recovery of carrying costs on the unamortized MGP expenditure balances. Response to Discovery, OC-256 and OC-620.

[5] Remediation costs represented 43%, 51% and 47% of SJG's total "Regulatory Asset" balance sheet line item in 2011, 2010 and 2009, respectively.

[6] ASC 450-20-25-2, Loss Contingencies [formerly contained in FAS 5].

expenditures, and corresponding regulatory assets, of approximately $90 million, $87.4 million and $69.1 million, respectively.

This liability changes from year to year based on the additional accruals deemed necessary and the expenditures incurred. This activity is summarized for the years 2011 through 2009 in the table below.

Table 16-2 - Remediation Cost Activity

South Jersey Gas Remediation Costs			
	2011	**2010**	**2009**
Beginning of Year	$87,393	$69,056	$64,093
Accruals	21,880	28,987	16,501
Expenditures	(19,289)	(10,650)	(11,538)
End of year	**89,984**	**87,393**	**69,056**
Source: SJG 10-K filings for 2011, 2010 and 2009.			

As previously noted, the RAC approved by the NJ BPU allows for eventual, but not immediate, rate recovery of prudently incurred remediation costs. Specifically, the incurred costs do not flow immediately to rates, but rather are amortized into rates over a seven-year period.

Due to the time lag between expenditure and recovery, SJG utilizes deferral accounts unique to each remediation site with an offsetting entry to accounts payable. A journal entry to record an expenditure at the Bridgeton location, for example, would look like this:[7,8]

Debit: Remediation Site Deferred Account – Bridgeton
Credit: SJG Accounts Payable

The expenditure activity (net of recoveries through the RAC and insurance carriers) for the years 2011 through 2009 is summarized in the table below.

Table 16-3 - Net Expenditures

South Jersey Gas Remediation Cost Net Expenditure Activity (in thousands)	
For Year Ended	**Net Expenditures**
December 31, 2011	$6,759.0
December 31, 2010	(3,868.0)
December 31, 2009	(5,219.0)
Source: SJG 10-K filings for 2011, 2010 and 2009.	

[7] Response to Discovery, OC-046.
[8] The Company also a deferral account (deferred revenue) to book net recoveries from ratepayers.

Internal Controls Over Remediation Costs

SJG performs a variety of internal control procedures regarding the proper recording of environmental remediation costs. The primary controls are described below.

Cost Projection Process

Cost projections of remediation sites are developed by the EAD and its environmental consultants by first determining a method of remediation. The method for remediation is dependent on a number of different factors, including the nature and extent of contamination.[9]

Once a method has been established, it is input into a cost model. The cost model estimates the projected costs through bids for services, market surveys, cost reference manuals, etc. The costs are then compared to completed projects. Once a cost model is established, a timeline is developed. This timeline identifies and assigns the resources necessary to complete the activities for the upcoming year.

Once completed, the cost projection package is presented to the Management Environmental Committee.[10,11] In the past, these cost projections were also provided to and reviewed by SJG's insurance providers. However, in 2012 SJG's insurance coverage for environmental remediation costs was exhausted so this additional review is no longer applicable. Once the cost projection package is accepted by the Management Environmental Committee it is presented to the Board of Directors for informational purposes.

Environmental Contractor Procurement Process

A competitive bid process is generally utilized by SJG's Environmental Affairs Department (EAD) to procure the services of environmental remediation contractors. These services can include consulting, engineering, drilling and / or laboratory services. Overland reviewed an example of the request for proposals (RFPs) sent to contractors, as well as responses to these proposals.[12] Both the RFPs and the proposal responses were adequately detailed.

Invoice Review and Authorization

Monthly invoices from the vendors of environmental services are reviewed and approved by the EAD manager as well as the appropriate Corporate Officer in accordance with South Jersey's "Procedure for Authorization to Contract Services & Approvals Necessary to Authorize Disbursement of Company Funds." Operating Procedure Number A2.1 was amended to authorize the Senior Officer with direct oversight of EAD to be the final signatory.

[9] Response to Discovery, OC-233.

[10] Response to Discovery, OC-053.

[11] Members of this committee include the top members of Senior Management of the gas company and the parent company, including: the President and CEO of SJI, the President of SJG, the Chief Financial Officer of SJI and the General Counsel of SJI.

[12] Response to Discovery, OC-616.

The consultant invoices are prepared monthly and reviewed and approved by the appropriate EAD Staff and Corporate Officer in accordance with A2.1. The contractor invoices are prepared monthly and reviewed by SJG's environmental remediation consultant as well as EAD Staff.

Recovery Review Process

The recoveries from ratepayers are calculated and captured within the company's billing system. These calculations are based upon individual customer consumption for the billing cycle. The booking of recoveries are reviewed by the Rate Department and Accounting Department monthly as part of the closing process.

Lessons Learned Program

While all MGP sites are unique, many of the same issues arise at the different locations. In order to develop a comprehensive list of best practices, the Company implemented a "Lessons Learned" program. As part of this program a "Lessons Learned" document is prepared for each site. This document is a compilation of items that worked well, could be improved or were otherwise noteworthy. Overland reviewed a sample of these "Lessons Learned" documents and found them to be detailed and well-organized.

Oversight of Environmental Remediation Activities

Regulatory Oversight

Various forms of external oversight are performed surrounding the Company's environmental remediation activities. The NJBPU's Audit division periodically audits SJG's RAC.[13] Until recently, remediation activities were directly overseen by the New Jersey Department of Environmental Protection (NJ DEP). SJG has historically maintained constructive a relationship with the NJ DEP, and during the period reviewed by Overland there were no disputes between the Company and the NJ DEP that required intervention by the Office of Accountability.[14,15]

As a result of the Site Remediation Reform Act (Remediation Act) passed in 2009 by the New Jersey State Legislature, the way that the NJ DEP manages remediation sites changed. The Remediation Act established the Site Remediation Professional Licensing Board. This board establishes licensing requirements and oversees the activities of Licensed Site Remediation Professionals (LSRPs). These LSRPs essentially serve as regulators. SJG alternates the environmental consultants that it uses to perform traditional consulting and LSRP functions to avoid a potential conflict of interest.

[13] Response to Discovery, OC-619; Interview with Michael Halter, Director of Environmental Affairs on November 14, 2012.

[14] Response to Discovery, OC-622; Interview with Michael Halter, Director of Environmental Affairs on November 14, 2012.

[15] The Office of Accountability is used as a mediator if disputes between the NJ DEP and SJG cannot be resolved in a mutually agreeable manner.

Company Oversight

As discussed previously, SJG has exhausted its insurance policy. One impact of this change is that costs being passed through the RAC could potentially increase since these will no longer be net of insurance recoveries. Another impact is that removal of the insurance carriers from SJG's environmental remediation process means that the Company is now losing a third-party uniquely interested in cost containment. As stated earlier, the Company is able to fully recover the costs related to environmental remediation of its MGP sites. Therefore, the Company lacks a profit incentive to minimize these costs. Additionally, the Company has an incentive to maximize the costs that it classifies as recoverable. The Company stated that the SJI Audit Committee reviews and evaluates the MGP Site remediation budget annually at the November meeting. These reviews are essential and should continue until these MGP sites are repaired.

17. SUPPORT SERVICES

This chapter covers SJG's support services, which include: Materials Procurement and Management, Fleet Management, Facilities Management, Information Technology, the Legal function, and Records Management. Information Technology, also a support service, is addressed separately in Chapter 18.

Summary of Findings

Materials Procurement & Management

1. SJG's Materials Procurement and Management function is performed by Administrative Services employees in SJI Services (SJIS). SJG purchased approximately $38 million in gas materials during the three year review period (2009 through 2011). SJIS was unable to quantify the goods and services other than gas materials that SJG purchased during the 2009-2011 review period.
2. SJG outsourced the procurement of most gas materials and the management of its storerooms to McJunkin Redman Corp. (McJunkin) in 2006. McJunkin maintains inventories of gas materials in SJG warehouses on consignment and SJG pays for the materials as they are used. McJunkin also supplies project-specific materials outside of the consignment process. **[Begin Confidential]** **[End Confidential]** of the gas materials used by SJG during the three-year review period were sourced by and purchased from McJunkin.
3. Consignment services are covered by a written Supply Agreement with McJunkin. Pricing of consignment materials is based on an "agreed upon" minimum **[Begin Confidential**] **[End Confidential]** after-tax return on sales that was not documented in the original 2006 Agreement, but was added in an amendment in 2011.
4. Under the Supply Agreement, McJunkin is protected by a price floor which guarantees it a minimum return on sales. South Jersey Gas is required to pay a Management Fee for any shortfall. The amended Agreement also requires McJunkin to pay South Jersey Gas for amounts earned above the agreed upon return on sales if the overage is due to "improved operating efficiencies and increased sales volumes."
5. SJI indicated that McJunkin's return on sales was not included in the original Supply Agreement because it was "verbally negotiated" between a McJunkin Vice President and a former SJI Vice President of Administrative Services who no longer works for the Company.[1] SJI also indicated that the lapse in documenting the verbal agreement was remedied in 2011.
6. McJunkin's actual after tax return on sales during the review period was **[Begin Confidential]** **[End Confidential]** in 2009, **[Begin Confidential**] **[End Confidential]** in 2010 and **[Begin Confidential]** **[End Confidential]** in 2011.
7. In addition to consignment sales, McJunkin sourced and sold **[Begin Confidential]** **[End Confidential]** in project-specific gas materials to SJG during the 2009-2011 review period. We did not learn of this additional category of sales until we were finalizing the Support Services chapter of

[1] Email from Marie Schaffer to Christopher Moschella, June 30, 2013, forwarded to Overland, based on a question sent via email by Overland.

the audit report; as such, we are not familiar with the pricing or profit terms under which these materials were provided. However, based on the annual consignment sales statements that we received, it appears that McJunkin fully covered its site-specific costs (e.g. labor and other SJG-specific expenses) plus an allocation of corporate overheads with its consignment sales alone, making it likely that any margins earned in markups to project-specific materials were 100% profit.

8. The Supply Agreement with McJunkin has not been put up for bid since its initiation in 2006. SJG has not benchmarked McJunkin's prices against other vendors since 2006. McJunkin's after-tax returns exceeded the **[Begin Confidential]** **[End Confidential]** agreed-upon level during each year of the review period (**[Begin Confidential]** **[End Confidential]** in 2009, **[Begin Confidential]** **[End Confidential]** in 2010 and **[Begin Confidential]** **[End Confidential]** in 2011). In comments to our draft report, the Company asserted that, in accordance with the 2011 amendment to the Agreement, earnings above the agreed-upon return on sales were returned to SJG.[2]
9. The McJunkin Supply Agreement provides for Key Performance Indicators (KPIs) to monitor contractor performance. "Cost savings" statistics and associated performance against a baseline savings rate of 3% annually were either not maintained or were not provided as part of the KPI package we requested. A "service-level KPI matrix" specified in the Supply Agreement for use in the annual "financial review process" is not maintained and there is no evidence that KPIs are "jointly reviewed and targets set [annually]" and "mutually adjusted for continuous improvement," as required by the Supply Agreement.
10. Other than "diverse supplier" statistics required by the BPU, SJI does not internally maintain cost or efficiency statistics for its supply chain processes, nor does it use benchmarking to compare the performance of the purchasing and stores functions against the performance of other utilities.[3] SJG has not attempted to implement any industry best practices for materials and stores since 2008.[4]

Fleet Management

1. SJI's fleet consists of approximately 500 units of rolling stock, of which approximately 435 units (85%) belong to SJG. SJI outsourced the fleet maintenance function in 1999. Since then, the maintenance contract has been reviewed and consideration has been given to issuing a new RFP every three years. As a result of the most recent review, in 2011, SJI switched from Penske to First Vehicle Services. The Company stated that the vendor change resulted primarily from **[Begin Confidential]** **[End Confidential]**
2. In 2011 SJI began a program to convert SJG's fleet from gasoline to compressed natural gas. SJG completed a CNG fuel station at its Glassboro Operations Center in 2012 and had plans to complete two additional stations in 2013. As of November, 2012 SJG had purchased 31 CNG vehicles at an average of about $25,000 above the cost of a gasoline equivalent vehicle. Purchases through November 2012 represent approximately 7% of SJG's fleet.

[2] However, given that this was asserted by the Company after the audit was completed, and given that no source data was provided to support it, Overland has not verified it.

[3] Response to Discovery, OC-416-A & B.

[4] Response to Discovery, OC-416-C.

3. SJG stated it was not tracking the ownership or operating costs per vehicle for the CNG fleet, which means it is also not comparing the per-vehicle costs of CNG and gasoline. Depending on the gasoline gallon-equivalent (gge) price of CNG used in the calculation (which appears to be between **[Begin Confidential]** **[End Confidential]** the estimate in SJG's CNG Business Plan, and $1.88, the actual Glassboro price as of May, 2013), the payback period for the additional capital cost of the CNG vehicles appears to be between **[Begin Confidential]** **[End Confidential]** and 10 years. 10 years is close to the average life span of an SJG vehicle. If natural gas prices rise significantly without a reduction in the $25,000 average CNG vehicle cost premium, the payback period could exceed the life cycle of the vehicles.
4. SJI's Glassboro fueling station is also open to other CNG fleets. SJG identified three fleets within range of its planned CNG facilities. As of May 30, 2013, CNG at the Glassboro station was priced at $1.88 per gasoline gallon equivalent. This was less expensive than most fueling stations in the Northeast.[5]
5. Unlike many, if not most other utilities, SJG does not maintain per-vehicle operating or ownership cost statistics and it does not benchmark its fleet operating efficiency or costs against other utilities. Many of the utilities that track fleet costs and efficiency benchmark themselves against other fleets using a specific vendor that specializes in utility fleet benchmarking. Benchmarked performance measures typically include average vehicle age, maintenance and repair hours per employee, units maintained per mechanic, and cost statistics such as operating cost (broken by category such as fuel, maintenance, etc.), support costs, such as supervision, and capital costs such as lease costs, or depreciation and interest. Although SJI's fleet maintenance vendor, First Vehicle Services, maintains a limited number of performance metrics relating to its maintenance performance, neither SJI nor the vendor track vehicle cost or operating statistics similar to those tracked by other utilities that Overland has audited.

Facilities Management

1. SJG charges affiliates SJI and SJI Services (SJIS) for their use of space in SJG's Folsom General Office building based on a "market proxy" rate for Class A office space in the Philadelphia area plus the cost of energy. In 2011, the annual market proxy rate per square foot was $25 and the cost of energy was $3 (a total of $28 per square foot).
2. SJG does not charge affiliates for the Folsom building based on the "higher of cost or market," as indicated by EDECA rules. In response to a data request for details concerning the cost of the Folsom building, the Company provided information showing the cost of the Folsom building in 2011 to be $27.89 per square foot, slightly lower than the market rate being charged. However, the Company's calculation excludes the return on investment and income tax components of cost that would normally be expected in a utility cost of service calculation.
3. SJI does not maintain facilities-based ownership and operating cost statistics on its buildings. A calculation of the 2011 cost of the Folsom building was prepared in response to our audit inquiry, but is not something that is regularly prepared or compared year to year.

[5] According to CNGPrices.com, May 30, 2013.

4. SJG provides space in Company garages to South Jersey Energy Services Plus (SJESP) to enable it to maintain its vehicles. The garages are located in various operations buildings in SJG's service territory. During the review period SJESP did not compensate SJG for the use of its garages to maintain SJESP vehicles.
5. SJI does not benchmark its facilities costs against the costs of other utilities. The International Facilities Management Association performs surveys for the purposes of developing facilities benchmarking statistics. Although SJI's Facilities Manager belongs to the IFMA, the Company does not participate in IFMA benchmarking surveys. SJI and SJG also do not regularly calculate metrics such as building cost per square foot for their own internal use.
6. During the years 2010 and 2011 SJI implemented measures which it stated reduced its facilities costs. These measures included purchasing solar electric power from an affiliate at approximately 6 cents per kwh, an approximate 5 cent per kwh discount to the average price of utility-generated power. SJI also negotiated price freezes for contractor-provided building and grounds maintenance services.
7. In 2011 SJG hired U.S. Facilities (USF) to run its mailroom operations and manage various facilities contractors who help maintain SJG buildings, systems and grounds. USF also manages facilities improvement projects. SJG pays USF about over **[Begin Confidential]** **[End Confidential]** [6] The Company indicated that although savings and operating efficiencies were anticipated from hiring USF, they were not part of the calculus that lead to hiring USF and they have not been quantified. Although SJG did not provide a requested quantification of savings, it is reasonable to suppose that USF should replace at least one SJG mailroom / reprographics employee and perhaps, eventually, the currently-staffed Facilities Manager position, whose current oversight responsibility for USF may in the future be rolled up to a higher-level of management.

Legal

1. There is no cost center established for the Legal Affairs function, as all of its costs are distributed to other departments and affiliates.
2. Most of the work performed in the Legal Affairs group relates to review and drafting of contracts, resolving minor litigation matters, handling disputes with 3rd parties, and regulatory filings. Major litigation matters are outsourced.
3. SJI internal legal costs increased 42% from 2010 to 2011 due to the hiring of two new positions in 2011.
4. The balanced scorecard for the Director of Legal Affairs did not show actual results for 2010 or 2011. Without the actual results, there is no way to evaluate whether or not the Legal Affairs function is achieving its goals.
5. Only one BSC metric was defined quantitatively. The remaining metrics were ambiguous as to how the objective was to be achieved.

[6] Response to Discovery, OC-491-C.

6. No BSC was provided that covered 2009. The Legal Affairs group should have a BSC that is updated every fiscal year.
7. The Legal Affairs group does not utilize benchmark studies to compare its operation to its peers.
8. SJI's Legal Affairs function does not subject the law firms it uses for outside counsel to a competitive bidding process. One firm has historically received over **[Begin Confidential]** **[End Confidential]** of the legal costs incurred.

Insurance and Claims

1. The insurance policies at SJI are adequate, containing a wide array of insurance policies that mitigate the company's risk relating to employees, property, environment, and the general public. SJI appears to adequately track and document how its business risks are mitigated through its insurance policies and how the costs for the insurance policies are distributed to the SJI affiliates.
2. In 2011, SJI performed an analysis of its insurance policies and procedures for mitigating business risks. The analysis lead to a report that included benchmarking data, consultations with internal business line leaders and external insurance resources as well as recommendations to further reduce SJI's risk exposure. This analysis and report is to be performed on a biannual basis going forward.
3. The SJI Insurance Department participates in the American Gas Association's (AGA) Risk Survey Report, The Risk Management Society (RIMS) benchmarking survey, and another more informal survey created by a subgroup of risk managers belonging to RIMS.
4. Overland could not confirm the information provided by SJI to the AGA Risk Benchmarking Survey for insurance premiums for three of the insurance types and coverage limits for three of the insurance types.
5. The data provided by SJI to the AGA Risk Benchmarking Survey is inconsistent with internal documentation. Some data pertains to the utility only, while other data relates to SJI. The benchmarking survey shows SJI having Side A D&O insurance, while the 2011 Insurance Analysis report states that the Company does not have that type of insurance.
6. Overland found that for every single type of insurance, SJI was either at or below the median with respect to the insurance limits on all of its policies, and at or below the 25th percentile in all but one policy type. However, SJI resided above the median in some policy types, yielding the potential conclusion that SJI could be overpaying for certain types of insurance when looking at premium cost versus benefits from reduced risk exposure.
7. Manager of Insurance Thomas Hewitt's balanced scorecard contains a good mix of qualitative and quantitative objectives and targets. Some of the objectives appear to have challenging goals which encourages employees to perform at their highest levels. Furthermore, Mr. Hewitt's balanced scorecard includes objectives relating to achieving targets relating to benchmarking and providing an overall review of his department's operations.

Recommendations

Materials Procurement & Management

1. In response to discovery request OC-506, the Company indicated that it was "unable to quantify the dollar value of goods and services [other than gas materials] procured for SJG." It stated that "payables information is not classified by goods or services, so there is not a way to pull this information directly." The employees in charge of procurement activities should be able to quantify the purchases they make for an entity by type and by vendor. We recommend SJI and SJG take whatever steps are necessary to develop the capability to quantify the scope and dollar value of all managed procurement.
2. Most utilities gauge the performance and efficiency of their supply chain processes by benchmarking themselves against other utilities. Typical metrics include supply chain expense as a percentage of procurement spending, and various cost reduction and cost avoidance statistics. Survey-based benchmarking data covering supply chain activities is readily available. After it develops the capability to fully quantify the goods and services it purchases (as recommended above), we recommend SJG benchmark its supply chain costs and activities against peer utilities.
3. SJI indicated that it has not attempted to survey or implement any industry best practices in the supply chain area. We recommend SJG become familiar with, and to the extent feasible, implement, industry best practices for the sourcing of gas materials and other goods and services as well as inventory management.
4. The McJunkin contract has not been rebid and its pricing has not been compared with other vendors since it was initiated in 2006. We recommend SJG benchmark the prices of outsourced gas materials procurement and storeroom management performed by McJunkin against other vendors. If benchmarking the price of equivalent services from other vendors is not possible, or if it shows that McJunkin is or may be a higher cost provider than other vendors, SJG should put the contract out for re-bid or at least use the benchmark results as a basis for negotiating cost reductions in the following year's Supply Agreement with McJunkin.
5. We recommend SJI and McJunkin adhere to all of the requirements of their Supply Agreement in the area of Key Performance Indicators (KPIs). Specifically, we recommend: A) McJunkin maintain and provide to SJG, in advance of discussions of annual performance, the "service-level KPI matrix" required in the Supply Agreement; B) McJunkin quantify cost savings at least annually, clearly show what the savings involve and how they were calculated, and show savings performance against the **[Begin Confidential]** **[End Confidential]** cost reduction baseline provided in the Supply Agreement; and C) SJG and McJunkin jointly review and reset KPI targets annually, as required in the Supply Agreement, and annually document the process of doing so. Our requests for the information covered in this recommendation resulted in no evidence that any of these requirements of the Supply Agreement were performed.

Fleet Management

1. As is currently done by most utilities, we recommend the following: 1) SJI and SJG should track fleet costs and performance metrics at the per-vehicle and total function level, and 2) SJI and SJG should benchmark fleet operations and costs against peer utilities using a recognized benchmarking company such as Utilimarc and establish “best in class” performance targets using the benchmark statistics.
2. We recommend SJG begin to track the actual costs (ownership and operations) of its CNG fleet, and compare CNG ownership and operating costs with those of equivalent gasoline-powered vehicles.

Facilities Management

1. We recommend SJG prepare lease agreements for SJI, SJIS and other affiliates that utilize SJG-owned facilities such as Folsom. We also recommend that SJG invoice its affiliates monthly for rent and other facilities costs owed.
2. We recommend SJG track facilities costs at the facility level, particularly for the Folsom headquarters building, which is operated by SJG and at least two affiliates.
3. With regard to the pricing of space at the Folsom building, we recommend SJG: A) Annually obtain and review support for its market-based pricing; B) Annually compare this with the fully distributed regulated cost of the Folsom facility, which should include the return on investment and related income tax associated with the rate-based value of the building; and C) Annually charge affiliates using any SJG facilities the higher of market or fully distributed regulated cost.
4. SJI and SJG should participate in the International Facilities Management Association’s (IFMA’s) facilities benchmarking program. SJI and SJG should benchmark facilities-based costs (prepared in accordance with the recommendation above) and facility operating characteristics with IFMA benchmark statistics and identify opportunities for improvements and reductions in cost.

Legal

1. The Legal Affairs function should have its own cost center where it can track all SJI internal and external legal costs, as well as analyze budget and actual expenditures.
2. The Legal Affairs function (or the leader of the function) should have a BSC that contains well-documented, unambiguous, and/or quantitative metrics upon which to base the achievement of stated objectives.
3. The Legal Affairs function (or the leader of the function) should have a BSC that is updated and completed on a yearly basis.
4. The Legal Affairs group should obtain benchmark studies to compare its operations to other companies to find where it can make its operations more efficient.
5. The Legal Affairs group should employ a competitive bidding process when selecting the law firms it will use to provide SJI with outside legal counsel.

Insurance/Claims

1. SJI should ensure that the data provided to the benchmarking surveys are consistent and accurate according to its Insurance Schedule, where SJI's insurance policies are tracked.

Materials Procurement and Management (Supply Chain)

The Materials Management function is headed by Marie Schaffer, Manager, Administrative Services. Ms. Schaffer reports to Chris Moschella, Director, Corporate Development. A Supervisor, Purchasing and Fleet and Contract Administrator report to Ms. Schaffer.[7] A Materials Analyst, Materials Clerk and Administrative Services Assistant report to the Supervisor, Purchasing and Fleet. Prior to 2011, Stephen Rulis, Manager, Facilities, also reported to Ms. Schaffer. All employees work for the service company, except the Materials Clerk and Materials Analyst, who work for SJG.

The Administrative Services department is responsible for sourcing and managing purchases of materials and services. As discussed below, since 2006 most gas materials have been managed under a third-party consignment contract. In addition to managing the procurement process, Materials Management qualifies new suppliers and sometimes manages competitive bids (other than construction).
Cost centers for which Ms. Schaffer was responsible during the review period (other than facilities cost centers, discussed below), are as follows:

Table 17-1 – Purchasing & Administrative Services

South Jersey Gas and South Jersey Industries Services Purchasing & Administrative Services Budgeted and Actual Expense by Cost Center								
Description	2009		2010		2011		2012	
	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget
Purchasing 10_850 (SJIS)	653,900	645,700	688,009	704,645	668,720	746,030	697,900	664,700
Admin Services 10_841 (SJG	47,624	60,390	46,377	52,770	25,975	51,840	N/A	N/A
Admin Services 10_842 (SJG	59,402	67,524	64,693	73,080	35,938	74,744	N/A	N/A
Admin Services 10_843 (SJG	39,365	48,564	41,960	41,520	22,427	41,325	N/A	N/A
Admin Services 10_844 (SJG	36,150	50,364	37,857	41,766	25,164	42,531	N/A	N/A
Admin Services 10_845 (SJG	55,456	65,940	59,485	58,819	31,667	62,489	N/A	N/A
Mgmt System 10_848 (SJG)	197,271	207,672	215,668	195,132	111,909	228,045	N/A	N/A
Purchasing 10_850 (SJG)	56,419	58,550	51,836	59,100	94,370	60,240	59,800	-
Total	1,145,587	1,204,704	1,205,885	1,226,832	1,016,170	1,307,244	757,700	664,700
Source: Response to Discovery, OC-500 & OC-723								

SJG administrative services in the field offices (cost centers 841 through 845), as well as management systems in McKee City (cost center 848) for which Ms. Schaffer was responsible during the review period consist primarily of telecommunications expenses (wireless, local and long distance wireline and data

[7] A Receptionist in another department also reports to Marie Schaffer. In addition, a Supervisor, Business Continuity is included in the Materials Management department, but reports to Chris Moschella, Director of Corporate Development.

circuits). Components of cost in the Purchasing cost center originate in both SJG and SJIS. The SJG component of Purchasing consists primarily of office supplies and a minor amount of payroll. The SJIS component of Purchasing includes the salaries and benefits of Ms. Schaffer and employees reporting to her. Most of the costs discussed below, including the costs of the McJunkin contract, are not included in the cost centers in the table above.

Outsourced Procurement and Storeroom Management

In 2006 SJG entered into an agreement with the McJunkin Corporation (known today as McJunkin-Red Man Corp.) to provide storeroom management services and procure gas materials. Under the agreement, McJunkin supplies SJG with gas materials, including a "range of core Gas and Pipe, Valve and Fitting Goods with the goal of overall cost savings."[8] The table below provides a breakdown of the value of gas materials procured for SJG. It shows that McJunkin purchased **[Begin Confidential]** **[End Confidential]** of SJG's gas materials during the review period.[9]

Table 17-2 – Procurement on behalf of South Jersey Gas

[Begin Confidential]

South Jersey Gas South Jersey Gas Procurement By Category				
Category	**2009**	**2010**	**2011**	**Total**

[End Confidential]

McJunkin provides procurement and storeroom management services using its own employees located on-site at client facilities. During the review period five McJunkin employees worked at SJG's Waterford Works facility. They included a Branch Manager, a Warehouse Manager, two Warehouse Associates and a Driver.[10]

[8] Response to Discovery, OC-412 Attachment, McJunkin Integrated Supply Agreement, February 1, 2006.

[9] Response to Discovery, OC-506. In response to OC-506-C, SJG stated that it is unable to quantify the dollar value of goods and services other than gas materials procured for SJG.

[10] Response to Discovery, OC-502.

Most gas materials are purchased from McJunkin on a consignment basis in accordance with a Supply Agreement between SJI and McJunkin. Under the agreement McJunkin stocks SJG's storerooms and maintains inventories of "normal stock items" at agreed-upon levels. SJG pays for materials as they are used. McJunkin also provides a 24-hour service to respond to emergency calls for goods.[11] SJG stated that the initial term of the McJunkin Supply Agreement was three years, and that it has been renewed on a year-to-year basis since its initial term expired. The contract has not been put up for bid and no companies, other than McJunkin, have been considered to supply gas materials on a consignment basis since 2006.[12]

Materials Sourcing - McJunkin is responsible for materials sourcing activities for items provided on consignment under the contract. This means that McJunkin is responsible for meeting quality, safety and diversity standards for materials purchases.[13] Although the Supply Agreement covers the subject of Key Performance Indicators, we found no indicators covering the areas of quality, safety or diversity. SJG participates in McJunkin's Customer Commodity Council, which includes SJG and other gas companies served by McJunkin. The primary purpose of the Council is to develop common specifications for gas materials, which facilitates the purchase of larger quantities on behalf of multiple utilities. SJG states that this process produced a savings of approximately $420,000 to SJG during the three-year period 2008 through 2010.[14] However, it should be noted that since McJunkin is compensated as a percentage of the amounts it purchases and sells to its client utilities, its natural economic incentive is not to minimize the cost of its purchases.

McJunkin's Compensation –The Supply Agreement with McJunkin states that compensation is to be based on **[Begin Confidential]** **[End Confidential]** Supplier's cost of goods into the Waterford, NJ facility [including freight]" and that the margin rate is "to be held firm so long as [McJunkin] is able to achieve [an agreed-upon] return on sales after tax."[15] If the "agreed upon return on sales is not achieved," SJG must pay a "Management Fee" equal to the shortfall. As shown below, the actual margins earned have been higher than **[Begin Confidential]** **[End Confidential]** targeted in the Agreement and increased during each year of the review period.

[11] According to the Supply Agreement, Attachment 4, Off-hour fees are $50 per hour for a Delivery Driver with Truck, and $35 for a Warehouseman. Both fees come with a four-hour minimum charge.
[12] Interview, Marie Schaffer, Sept. 26, 2012.
[13] Response to Discovery, OC-412-E.
[14] Id.
[15] Response to Discovery, OC-412, Integrated Supply Agreement, Section 4.1 .

Table 17-3 – McJunkin Sales and Margin Statistics

[Begin Confidential]

South Jersey Gas McJunkin Sales and Margin Statistics			
Year	Sales	Margin	Margin Pct. Of Sales

[End Confidential]

In response to follow-up questions, SJI provided schedules showing the calculation of return on sales for the years 2009-2011. The schedules show an "agreed rate of return (after tax)" of **[Begin Confidential]** . **[End Confidential]** This rate was not referenced anywhere in the original 2006 Supply Agreement, but was noted in a 2011 amendment to the agreement. During the review period McJunkin earned more than a **[Begin Confidential]** **[End Confidential]** after-tax return on sales. Specifically, actual after-tax returns on sales were **[Begin Confidential]** **[End Confidential]** in 2009, **[Begin Confidential]** **[End Confidential]** in 2010 and **[Begin Confidential]** **[End Confidential]** in 2011.

Key Performance Indicators - The Supply Agreement includes "Key Performance Indicators (KPIs)" to track supplier performance in areas such as "cost savings, on-time delivery, inventory accuracy and shipping accuracy."[16] The specific KPI's and targets, set forth "for illustrative purpose" in Attachment 7 to the Agreement, are as follows:

- On-time delivery 95%;
- Number of stockouts in service centers - 2 percent of "lines";
- Emergency call response time - 4 hours; and
- Reduction in cost versus baseline -3 percent.

A 2011 Amendment to the Supply Agreement added minimum acceptable "after hours call response" time of "less than one hour" and added a 95%target for "fill rate." Small penalties are attached to not meeting on-time delivery and fill rate targets, but no time period is specified. Given McJunkin's reported achievement of nearly 100% on-time delivery, and over 98% "fill rates," it seems unlikely that penalties will ever be imposed.

According to the Supply Agreement, KPIs should be reviewed monthly or quarterly, and "during the fourth quarter of each year, performance against the current year's KPI's shall be jointly reviewed and

[16] Response to Discovery, OC-412, Integrated Supply Agreement, Section 14.1.

targets for the coming year shall be mutually adjusted for continuous improvement.”[17] The Agreement also specifies that the “process of continuous improvement for the KPIs, including any KPIs measuring cost savings, shall be conducted each and every year . . . through the life of this Agreement” and “[a] service level KPI matrix shall . . . be included in the financial review process in calendar years 2006 and every year thereafter.”

We requested KPI reports and the “service level KPI matrix included in the financial review process” for the years 2009 through 2011.[18] Based on what we were provided, we conclude that the process for collecting KPIs and comparing them to targets for the purpose of encouraging “cost savings” and “continuous improvement” is deficient. Following are specifics from SJG’s response to our request for KPI reports that lead to this conclusion:

- No statistics of any kind were provided for the 2009.
- No meaningful “cost savings” KPIs were provided for any of the requested years, and no comparison to a 3% baseline - the “target” documented in Attachment 7 to the Supply Agreement – was found. The table below contains the statistical information from a sheet entitled “Cost Savings” in the KPI statistics file provided for 2010.[19] We were unable to discern either context or meaning from the information. A similar “Cost Savings” sheet in the 2011 statistics file contained no data.

Table 17-4 – Cost Savings Sheet – 2011

[Begin Confidential]

Customer	Event	Record Number	Descriptor	Contact	Date	Savings	Status	Date Changed	Industry	Solution Provider	Provider Location
Saving						$199,629.66					

[End Confidential]

- We found no meaningful KPIs that correlated with the KPI categories “inventory accuracy” or “shipping accuracy” indicated in the Supply Agreement.[20]
- Although a 2011 Amendment added a one-hour target for “after hours calls,” there was no meaningful data produced for such calls in 2011, as evidenced in the following table provided with the KPI statistics:

[17] Id.
[18] Response to Discovery, OC-501.
[19] Response to Discovery, OC-501-A, “DR 501A SJG 2010 KPI Report.xls,” “Cost Savings” sheet.
[20] “Fill rate” statistics were provided. These may correlate somewhat with “shipping accuracy.”

Table 17-5 - After Hours Calls 2011

South Jersey Gas After Hours Calls 2011			
QTR 1	QTR 2	QTR 3	QTR 4
None	None	None	None

- Although we specifically requested the "service level KPI matrix" specified in the Supply Agreement as part of the "financial review process," no matrix was provided. It appears unlikely that it has ever been developed or used.
- Apart from adding "fill rate" and "after hours calls" to the list of KPIs in 2011, there is no evidence that KPIs and targets are annually "jointly reviewed" or "adjusted for continuous improvement."

Administrative Services Performance Measurement

Balanced Scorecard Objectives – Most of the objectives in 2010 and 2011 Balanced Scorecard for the Manager, Administrative Services relate to the fleet or facilities, both of which are covered in separate discussions. Balance Scorecard objectives include "financial," "customer" and "process." As noted below, the Company does not maintain a set of functional metrics for its materials management or fleet functions and it does not benchmark them against other utilities. This is mirrored in the Balanced Scorecard of the Administrative Services Manager, which does not include objectives with specific quantifiable metrics.

Key Performance Indicators and Benchmarking - SJG does not internally maintain procurement or supply chain cost or efficiency statistics, nor does it use benchmarking to compare the performance of the materials and stores function against the performance of other utilities.[21] SJG has not attempted to implement any industry best practices for materials and stores since 2008.[22] The only performance indicator that SJG currently maintains internally relates to supplier diversity. As required by the NJBPU and as discussed below, SJG maintains statistics on its total purchases and its "diverse spend" (purchases from women and minority-owned businesses).

SJG pointed to its outsourcing of the materials and stores function to McJunkin as the reason for a lack of internally-maintained performance indicators and a lack of best-practices implementation since 2008. However, McJunkin is responsible for only a portion of the procurement conducted on behalf of SJG. In addition, as discussed above, SJG was unable to provide statistics demonstrating that a meaningful set of KPIs and related targets has been developed to monitor McJunkin, as set forth in the Supply Agreement. Finally, SJI has not benchmarked McJunkin against other vendors since the inception of

[21] Response to Discovery, OC-416-A & B.
[22] Response to Discovery, OC-416-C.

services in 2006, and when asked, Ms. Schaffer was not familiar with any vendors that provided services similar to those provided by McJunkin.[23]

Diverse Supplier Spending – As noted above, diverse supplier spending is tracked and compared with that of other New Jersey regulated utilities under a BPU monitoring program. As shown in the following table, SJG has recently increased the percentage of spending attributable to women and minority-owned companies. However, as of 2011 it was still among the lowest-scoring New Jersey utilities with respect to this statistic.

Table 17-6 – Comparison of Purchases from Diverse Suppliers, New Jersey-Regulated Utilities

Comparison of Puchases from Diverse Suppliers
New Jersey-Reglated Utilities
Amounts in 000s

UTILITY	2009			2010			2011		
	Total Spend	Diverse Spend	% Diverse Spend	Total Spend	Diverse Spend	% Diverse Spend	Total Spend	Diverse Spend	% Diverse Spend
AGL Resources Inc.	528,622	26,923	5.1%	622,900	52,990	8.5%	93,900	4,366	4.7%
AT&T	48,200,000	6,882,000	14.3%	48,800,000	9,215,000	18.9%	52,200,000	12,076,000	23.1%
Atlantic City Electric	88,824	9,938	11.2%	115,039	11,055	9.6%	140,597	13,710	9.8%
Comcast	5,279,000	640,000	12.1%	5,209,000	673,000	12.9%	5,486,000	768,000	14.0%
JCP&L-FE	1,653,232	79,034	4.8%	1,675,870	85,886	5.1%	3,441,462	192,566	5.6%
NJ American Water	285,000	7,767	2.7%	450,415	4,606	1.0%	477,775	18,535	3.9%
NJ Natural Gas	71,794	5,115	7.1%	64,636	7,395	11.4%	145,843	10,358	7.1%
PSE&G	1,441,474	211,690	14.7%	1,799,530	228,478	12.7%	1,616,349	224,106	13.9%
Rockland	118,512	8,221	6.9%	128,979	8,165	6.3%	111,956	10,740	9.6%
South Jersey Gas	92,014	1,538	1.7%	103,752	2,309	2.2%	135,769	4,159	3.1%
Jersey	394,841	2,141	0.5%	146,757	2,227	1.5%	129,478	2,005	1.5%
Verizon	388,445	75,259	19.4%	300,824	61,319	20.4%	247,240	54,467	22.0%
Total	**58,541,758**	**7,949,625**	**13.6%**	**59,417,702**	**10,352,431**	**17.4%**	**64,226,368**	**13,379,011**	**20.8%**

Source: Response to Discovery, OC-413

Fleet Management

Marie Schaffer, Manager, Administrative Services is responsible for fleet management. SJI maintains a fleet of approximately 500 units of rolling stock. Approximately 85 percent of the fleet is dedicated to SJG, approximately 10% is dedicated to SJESP and the remaining 5% consists of cars and SUVs used by the parent company and other affiliates. Garages are co-located with operations facilities at five locations.

Summary of SJI's Fleet

SJI's fleet consists of vehicles (cars, vans, and trucks), motorized work equipment (backhoes, cranes, ditch-witches, compressors, welders) and non-motorized work equipment (trailers, arrow boards). The following table summarizes total units of rolling stock since 2008:

[23] Interview, Marie Schaffer, Sept. 26, 2012.

Table 17-7 – South Jersey Industries, Rolling Stock Totals by Year, Owned and Leased

South Jersey Industries Rolling Stock Totals by Year Owned and Leased	
Year	**No. of Units**
2008	490
2009	486
2010	514
2011	528
2012	511
Average	**506**
Source: Response to Discovery, OC-407	

As shown below, in 2012 approximately 85% of the fleet belonged to SJG. SJESP, SJI and other affiliates have separate vehicles.

Table 17-8 – South Jersey Industries – Rolling Stock by Category and Affiliate, October 2012

South Jersey Industries Rolling Stock by Category and Affiliate October, 2012												
Vehicle Category	**SJG**		**SJESP**		**SJI**		**SJES**		**Marina**		**SJIS**	
	Owned	**Leased**	**Owned**	**Leased**	**Owned**	**Leased**	**Owned**	**Leased**	**Owned**	**Leased**	**Owned**	**Leased**
Arrow Board	8											
Backhoe/Loader	47											
Boat	1											
Box Truck	2		2	2								
Compressor	1											
Crane/Coring/Vac Truck	3											
Ditch Witch	8											
Dump Truck	16											
Light Tower	3											
Pickup	28			3					2			
Sedan	34			6	6		12				4	
Stake Body Truck	1											
Street Truck	47											
SUV	42				1		1					
Trailer	75											
Utility Truck	34											
Van	77			37								
Welder	7											
Wood Chipper	1											
Totals	**435**	**0**	**2**	**48**	**7**	**0**	**13**	**0**	**2**	**0**	**4**	**0**
Source: Response to Discovery, OC-407												

The following table summarizes SJG's rolling stock, by type of unit, since 2008:

Table 17-9 – South Jersey Gas, Rolling Stock and Category and Year, October 2008 through October 2012

South Jersey Gas
Rolling Stock by Category and Year
October 2008 through October 2012

Vehicle Category	2008	2009	2010	2011	2012
Arrow Board	12	10	10	9	8
Backhoe/Loader	38	44	50	48	47
Boat	1	1	1	1	1
Box Truck	2	2	2	4	2
Compressor	6	4	4	4	1
Crane/Coring/Vac Truck	1	1	1	1	3
Ditch Witch	7	9	9	8	8
Dump Truck	8	8	10	14	16
Light Tower	1	1	1	3	3
Pickup	15	13	16	22	28
Sedan	43	34	48	39	34
Stake Body Truck	2	2	1	1	1
Street Truck	53	45	51	54	47
SUV	15	25	31	36	42
Trailer	69	70	74	68	75
Utility Truck	34	47	45	46	34
Van	78	66	67	75	77
Welder	5	6	6	7	7
Wood Chipper	1	1	1	1	1
Totals	391	389	428	441	435

Source: Response to Discovery, OC-407

Outsourced Vehicle Maintenance Services

SJI outsourced its fleet maintenance function in 1999.[24] During the years 2009 through 2011 the maintenance function was contracted to Penske. Since 1999, the contract has been evaluated every three years. SJI put the contract up for bid in November, 2011, the last year of the most recent contract cycle. Based on information received in response to a data request it appears that there were three bidders: Penske, First Vehicle Services (FVS) and Vector Fleet Management.[25] All three vendors submitted proposals to perform the maintenance function for between **[Begin Confidential]** **[End Confidential]** in 2012.

The FVS Contract Award –In terms of estimated total cost, Penske was the low bidder in the 2011 rebid, but only by a small amount. SJI stated that it awarded the contract to FVS based on qualitative factors, which it explained as follows:[26]

[24] Interview, Marie Schaffer, Manager, Administrative Services, Sept. 26, 2012.
[25] Response to Discovery, OC-403-B, Attachment, 2011 RFP Fleet Analysis.
[26] Response to Discovery, OC-403-B, C, D & E.

- "More robust, reliable emergency road assistance program" (SJI stated that it had response problems with Penske, which had not improved despite review with the vendor).
- FVS proposed to dedicate a manager to directing SJI's vehicle maintenance activities "on a daily basis," while Penske's direct supervision had responsibility for other Penske garages and "was not always responsive."
- SJG had concerns about the quality of Penske's preventative maintenance for backhoes.
- FVS accepted a purchasing card (credit card) for payment for services; SJI stated Penske would not accept credit card payments.

SJI's vehicles are serviced by six mechanics. Before the contract transferred from Penske to FVS, all of the Penske mechanics working on the SJI contract were interviewed for possible employment by FVS. Three were offered employment with FVS but one of these stayed with Penske. As a result, there are four new mechanics servicing SJI vehicles under the FVS contract.[27]

Vehicle Maintenance Services Pricing - Penske – The following table contains actual costs incurred under the Penske contract during the 2009-2011 review period. The Company stated that it does not have the capability of breaking out the components of the charges (fixed vs. time & materials costs) for affiliates other than SJG.

Table 17-10 – South Jersey Industries, Penske Vehicle Maintenance Costs by Affiliate

South Jersey Industries Penske Vehicle Maintenance Costs by Affiliate									
Co. Name	2009			2010			2011		
	Fixed Charges	T&M Charges	Total	Fixed Charges	T&M Charges	Total	Fixed Charges	T&M Charges	Total
SJG	720,226	151,087	871,313	766,644	221,737	988,381	817,124	183,655	1,000,779
SJI Services	n/a	n/a	9,058	n/a	n/a	5,856	n/a	n/a	9,546
SJI Parent	n/a	n/a	12,676	n/a	n/a	13,175	n/a	n/a	16,683
SJ Energy Solutions	n/a	n/a	21,630	n/a	n/a	21,094	n/a	n/a	22,749
SJ Energy Services Plus	n/a	n/a	175,766	n/a	n/a	173,093	n/a	n/a	155,377
Totals:			**1,090,444**			**1,201,598**			**1,205,134**

Source: Response to Discovery, OC-513-A
Note: SJIS states it is not able to break out fixed charges and time & material costs for affiliates other than SJG because "vehicle charges are directed to a single account and different categories cannot be easily identified."

Of note is the fact that amounts charged to SJG increased by 15% between 2009 and 2011, while charges for SJESP decreased. It is likely that costs for SJESP's costs decreased in conjunction with its sale of appliance warranty contracts to HomeServe USA. This resulted to a reduction of approximately one-third of SJESP's workforce. Even though SJG's costs increased during the period, the 83% share of the 2011 costs charged by Penske is consistent with its 85% share of the 2012 fleet, as shown above in the table of rolling stock.

[27] Interview, Marie Schaffer, Manager, Administrative Services, Sept. 26, 2012.

__Vehicle Maintenance Services Pricing – FVS__ - There are two components to the new FVS maintenance contract: a fixed component of approximately $22,000 per month and a variable preventative maintenance (PM) component that varies by vehicle. The table below summarizes the negotiated pricing for "year 2" (presumably, 2013) under the new FVS contract. It is important to emphasize that the contract covers routine PM, including labor and associated parts and supplies (tires, oil and other consumables), but does not cover repairs (work other than PM), which are charged on a time and materials basis. [28]

Table 17-11 – SJI Vehicle Maintenance, First Vehicle Services – Year 2 Contract Pricing

[Begin Confidential]

SJI Vehicle Maintenance First Vehicle Services - Year 2 Contract Pricing			
Description	**Total Vehicles**	**Annual Per Unit**	**Annual Total**

[End Confidential]

SJG pays the contractor for fleet maintenance services and is reimbursed by the parent and other affiliates based on the number of units maintained for each affiliate.[29]

[28] Id.
[29] Marie Schaffer explained that contractor maintenance costs are allocated on a per-unit basis.

Conversion to a Compressed Natural Gas (CNG) Fleet

In 2010 SJI purchased 51 vehicles. Of these, 44 were purchased for SJG, four for SJE and three for SJI's parent organization. Additional vehicles were acquired in 2011 and 2012. As shown in Table 17-9 above, SJG's fleet grew from 391 units in 2008 to 441 units at the end of 2011.

In 2011 SJG produced a business plan to convert its fleet to compressed natural gas over a 10 year period and to make CNG available to the public and to owners of other CNG-based commercial fleets.[30] The plan called for the conversion of 16 gasoline vehicles in 2011 at an average retrofit cost of $30,000 and for new vehicles purchased for the gas company to be retrofitted for CNG, when CNG is available for the vehicle. The plan included building several CNG stations at locations in and around SJG's territory and assumed that the costs would be recouped from SJG's retail customers (through inclusion in rate base). The following table summarizes the costs of the initial CNG fueling station as it was envisioned in the 2011 CNG Marketing and Business Plan:

[30] Response to Discovery, OC-408, CNG Marketing and Business Plan (confidential).

Table 17-12 – SJI Estimated CNG Station Construction Costs

[Begin Confidential]

South Jersey Industries SJI Estimated CNG Station Construction Costs		
Item Descriptions	**Cost - Single Compressor**	**Cost - Dual Compressor**
	g	

[End Confidential]

November 2012 Status of CNG Fueling Stations - A fast-fill CNG fueling station, owned by SJG, was completed and made operational at the site of the Glassboro Division office sometime prior to November 2012.[31] SJG vehicles that use CNG are being fueled at this station, as well as at other third-party stations in SJG's service area.[32] SJG stated that "other (3rd party) fleets are currently using the Glassboro station for their CNG fueling needs."[33]

As of November, 2012, SJG was preparing to construct two additional CNG fueling stations.[34] One is located at the Millville Division office, and was scheduled to be operational during the first quarter of 2013. A third station was expected to be operational in Lindenwold by the second quarter of 2013. It is

[31] Response to Discovery, OC-507-A. The completion date is vague because Overland neglected to ask the date of completion, and the company did not include it in the data response.
[32] Response to Discovery, OC-507-B.
[33] Response to Discovery, OC-507-F.
[34] Response to Discovery, OC-507-H.

SJI's intent that SJG own and operate all of the stations and that all third-party fueling transactions take place within NGV Fuel portion of SJG's tariff.[35]

Tax Incentives Associated with CNG Vehicles – SJG indicated that there are federal or state tax *credits* associated with CNG conversions, but that SJG was eligible for and took advantage of a bonus depreciation deduction on its federal tax return in 2011 and will do so again in 2012.[36] A bill to subsidize conversion to CNG was introduced in the U.S. House of Representatives in 2011, but the bill has not advanced. A federal excise tax credit of 50 cents per gallon-equivalent was available for natural gas used in vehicles was available, but it expired at the end of 2011.

CNG Fleet Capital Costs - The original CNG plan, discussed above, envisioned the conversion of at least some existing gasoline vehicles to CNG. As SJG has progressed with fleet conversion, it decided to acquire new CNG vehicles, and not convert any existing gasoline vehicles to CNG. As of November, 2012, SJG had purchased 32 CNG vehicles, resulting in the conversion of about 8% of its total fleet to CNG at an average incremental cost of $25,640 per vehicle. The table below summarizes SJG's CNG fleet as of November, 2012:

[35] Response to Discovery, OC-507-I.
[36] Response to Discovery, OC-508-A.

Table 17-13 – South Jersey Gas, CNG Vehicle Fleet as of November, 2012

South Jersey Gas CNG Vehicle Fleet as of November, 2012				
Vehicle Type	**Year**	**Vehicle Cost**	**Equivalent Gasoline Vehicle Cost**	**Incremental Cost of CNG Vehicle**
Inspector Van	2011	43,273	26,954	16,319
Inspector Van	2011	43,273	26,954	16,319
F550 Street	2012	143,983	112,153	31,830
F550 Street	2012	143,983	112,153	31,830
F350 Utility	2011	82,600	55,801	26,799
F350 Utility	2011	82,600	55,801	26,799
F350 Utility	2011	82,600	55,801	26,799
F350 Utility	2011	82,600	55,801	26,799
F550 Street	2012	143,983	112,153	31,830
F550 Street	2012	143,983	112,153	31,830
F550 Street	2012	143,983	112,153	31,830
F550 Street	2012	143,983	112,153	31,830
F550 Street	2012	143,983	112,153	31,830
F550 Street	2012	143,983	112,153	31,830
F550 Street	2012	143,983	112,153	31,830
Honda Civic	2012	27,818	18,563	9,255
Inspector Van	2012	44,224	27,612	16,612
Inspector Van	2012	44,224	27,612	16,612
Inspector Van	2012	44,224	27,612	16,612
Inspector Van	2012	44,224	27,612	16,612
Inspector Van	2012	44,224	27,612	16,612
Leak Survey Van	2012	44,224	27,612	16,612
Inspector Van	2012	44,224	27,612	16,612
Inspector Van	2012	44,224	27,612	16,612
F350 Utility	2012	84,936	54,567	30,369
F350 Utility	2012	84,936	54,567	30,369
F350 Utility	2012	84,936	54,567	30,369
F350 Utility	2012	84,936	54,567	30,369
F350 Utility	2012	84,936	54,567	30,369
F350 Utility	2012	84,936	54,567	30,369
F550 Street	2012	150,969	112,894	38,075
Totals		**2,754,988**	**1,966,244**	**788,744**
Source: Response to Discovery, OC-510, Attachment "DR #510A - CNG vehicle data.xls"				

Cost of Operating the CNG Fleet – SJG's CNG Marketing and Business Plan calculated the payback period for a CNG to be **[Begin Confidential]** **[End Confidential]** as of April, 2011. This was based on a retrofit cost of approximately **[Begin Confidential]** **[End Confidential]** per vehicle, an average gasoline price of **[Begin Confidential]** **[End Confidential]** per gallon (reasonably close to the average price as of May, 2013), and a CNG price of **[Begin Confidential]** **[End Confidential]** per gasoline gallon equivalent (gge), for a savings of **[Begin Confidential]** **[End Confidential]** per gge over gasoline.[37] The actual *customer* cost of CNG at SJG's Glassboro station as of May 30, 2013 was $1.88, approximately **[Begin Confidential]** **[End Confidential]** estimated in SJG's business plan.[38] [39] At this price, the payback period is **[Begin Confidential]** **[End Confidential]**, and based on the average SJG vehicles being owned for 10 years, the additional capital costs of a CNG vehicle just barely pays back over the life of the vehicle. However, it is unclear whether the cost to be passed on to SJG's regulated utility customers is the **[Begin Confidential**] **[End Confidential]** "SJG Rate" from the Business Plan or the current $1.88 "customer rate" at the Glassboro fueling station. When we asked SJG if it was tracking the operating and ownership costs of its CNG vehicles, it stated that it was not. The reason given was that the "vehicles have been in service less than one year."[40]

Performance Measurement

Balanced Scorecard – Balanced Scorecard objectives for the Manager, Administrative Services are discussed above in the section on Materials Procurement and Management.

Key Performance Indicators and Benchmarking - SJI does not internally maintain statistics on vehicle age, utilization or ownership and operating costs. Given that it does not collect fleet cost or operating data, SJI also does not benchmark its fleet against other utility fleets. According to the Company, Penske and First Vehicle Services, the contractors to whom vehicle maintenance services were outsourced during the audit period, track certain key performance indicators. A review of the current contract with First Vehicle Services shows the following maintenance-related KPIs are kept to measure performance required by the contract:[41] [42]

- Vehicle Availability, three sub-categories (light duty, medium / heavy duty and total fleet) – Minimum Standard: 95% availability for each sub-category. Preventative Maintenance Turnaround Time – Minimum Standard: 95% completed within one business day of vehicle delivery
- Emergency Road Service Dispatch – Minimum Standard: 95% dispatched within 30 minutes of request for service call. Emergency Road Service Time to Service Vehicle On-Site – Minimum Standard: 95% within 60 minutes of request for service call
- Emergency Road Service "Quick Fixes" – Minimum Standard: 95% completed within two hours of request for service call.

First Vehicle Services does not maintain any metrics on total vehicle operating or ownership cost, age or utilization because these outside the scope of its maintenance contract.

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[37] Response to Discovery, OC-408, "DR #408 CNG Marketing Business Plan.pdf" (confidential).
[38] CNGPrices.com, South Jersey Gas, Glassboro, May 30, 2013.
[39] In addition, it should be noted that SJG's price is at the low end. On May 30, 2013, GGE prices for CNG in the Northeast ranged from a low of $1.88, at the Glassboro facility, to a high of $3.79 at a CNG facility in Hartford, CT.
[40] Response to Discovery, OC-510-B.
[41] Response to Discovery, OC-403, FVS Fleet Contract, Appendix A.
[42] The contract provides for penalties of up to**]**$500per category per quarter when KPIs show that minimum standards are not met.

Facilities and Building Services

Department Staffing and Responsibilities

The Facilities and Building Services department consists of two employees: Stephen Rulis, Manager, Facilities, and a Senior Maintenance Mechanic who reports to Mr. Rulis.[43] Mr. Rulis is an employee of SJIS and currently reports to Christopher Moschella, Director of Strategic and Financial Planning. In 2009 and 2010 he reported to Marie Schaffer, Manager, Administrative Services. The Senior Maintenance Mechanic is an employee of SJG. Budgeted and actual costs are summarized below.

Table 17-14 – South Jersey Gas and South Jersey Industries Services – Facilities Management

South Jersey Gas and South Jersey Industries Services
Facilities Management
Budgeted and Actual Expense by Cost Center

Cost Center	2009		2010		2011		2012	
	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget
Corporate Facilities 10_859 (SJIS)	285,500	286,400	299,198	309,706	294,970	331,970	286,700	288,000
Corporate Facilities 10_851 (SJG)	120,975	105,800	129,267	102,600	330,569	108,400	640,304	530,441
Corporate Facilities 10_852 (SJG)	148,357	147,900	162,404	138,100	85,073	134,900	10,172	-
Corporate Facilities 10_853 (SJG)	142,535	155,400	145,182	156,900	90,301	146,480	55,596	-
Corporate Facilities 10_854 (SJG)	118,169	99,500	132,519	114,800	61,327	121,780	4,259	-
Corporate Facilities 10_855 (SJG)	94,777	110,500	99,742	107,000	41,651	103,000	956	-
Corporate Facilities 10_859 (SJG)	341,687	192,881	343,130	232,000	458,517	202,350	439,792	393,746
Total	1,252,000	1,098,381	1,311,442	1,161,106	1,362,408	1,148,880	1,437,779	1,212,187

Source: Response to Discovery, OC-500 & OC-723

Mr. Rulis' responsibilities include the operation and maintenance of gas company buildings, including the Folsom General Office building. He is also a "liaison for" space leased by affiliates.[44] His responsibilities include space planning and coordination of space usage, building contract and lease compliance, building security and the Folsom cafeteria. In addition, he is responsible for OSHA and other safety standards compliance, fire prevention, execution of a preventative maintenance program and inspections, and the management of janitorial and building maintenance services, including the movement of furniture and equipment. When building changes or improvements are made, Mr. Rulis is responsible for overseeing design, engineering and construction, including space allocation, project cost estimates and budget management.[45]

Outsourced Facilities Management Services

SJI began outsourcing administrative and support services for the fleet maintenance function in 1999. It outsourced most gas materials procurement in 2006, and most recently, it outsourced some facilities management responsibilities. In 2011 SJI hired U.S. Facilities (USF) to manage various facilities

[43] Response to Discovery, OC-5 (Organizational Data).
[44] Interview, Stephen Rulis, Manager, Facilities, Sept. 25, 2012.
[45] Response to Discovery, OC-71, Supplemental (Job Description – Rulis).

contractors and projects. USF's primary responsibilities include oversight of contractors, performance of "mailroom services" and management of facilities projects.[46] Contractors performing landscaping and snow removal, HVAC maintenance, emergency generator maintenance and inspection, safety and fire system monitoring currently report to USF.

Since 2011, USF has also managed various improvement projects, including replacement of windows in the Folsom building, replacement of an emergency generator in the Glassboro Division, installation of secure IT equipment storage in Folsom, and others.[47] SJI stated that USF charges a monthly fee of approximately **[Begin Confidential]** **[End Confidential]** mailroom services and **[Begin Confidential]** **[End Confidential]** monthly for project and subcontractor management.[48] In addition, USF adds a **[Begin Confidential]** **[End Confidential]** administrative fee to managed contractor billings and contractor project costs. The Company stated that this amounted to **[Begin Confidential]** **[End Confidential]** for the year 2012 through November.[49]

SJI indicated that it anticipates savings and operating efficiencies from hiring USF but it did not provide our requested quantification of savings or describe any productivity improvements it expected to achieve.[50] We believe it is likely that USF's mailroom responsibilities replaced the need for at least one, and perhaps more than one, mailroom / reprographics employee. We also expect that the management responsibilities given to USF would normally be, and previously were, handled by a Facilities Manager such as Mr. Rulis. Thus, it appears reasonable to expect that USF or a similar vendor may eliminate the need to fill the Facilities Manager's position once Mr. Rulis retires. However, as noted, SJI does not currently acknowledge or quantify this as savings. If savings are not achieved, absent other improvements in productivity, USF simply adds to SJI's and SJG's cost structure.

SJI / SJG Facilities

SJI's owned buildings are owned and occupied primarily by SJG. They include:

- Folsom General Office – The Folsom office building contains approximately 60,000 square feet of space. It is owned by SJG, but it serves as SJI's headquarters and is occupied by SJG, SJI and SJIS. It houses approximately 225 employees of SJIS, SJI and SJG. Among the functions housed in the building are Executive, Customer, Dispatch, Accounting, Tax, Computer Operations, Network Services and other administrative and management departments.
- Pleasantville (Atlantic) Operations Office – Approximately 55 employees.
- Millville (Cumberland) Operations Office – Approximately 40 employees.

[46] Response to discovery, OC-491-A & B.
[47] Id.
[48] Response to Discovery, OC-491-C.
[49] Id.
[50] Response to Discovery, OC-491-F.

- Cape May Operations Office - Approximately 50 employees, 45 who work for SJG and 5 who work for SJESP.[51]
- Glassboro Operations Office – Approximately 65 employees.
- Waterford Operations Office – Approximately 35 employees.
- McKee City – SJG Production and Transmission, Gas Allocations and Gas Supply /Off Systems Sales departments, as well a liquefied natural gas system injection facility. Approximately 35 employees.

New Jersey facilities owned by third parties, leased by SJI subsidiaries other than SJG:

- Absecon – One of two operations facilities for SJESP. Also housed employees of SJES. Approximately 40 employees. Closed in 2011.
- Franklinville – One of two operations facilities for SJESP. Approximately 45 employees. Closed in 2011.
- Hammonton North (One Whitehorse Pike) - SJE, SJES (Accounting / Billing and Executive) and SJI Services (certain Human Resources and Communications employees), approximately 75 employees.
- Hammonton South (420 2nd Road) – SJESP Operations and Dispatch. Approximately 40 employees, since 2010.
- Mays Landing – SJE and SJES Executive, Accounting, Mass Markets and Marina Energy. Approximately 50 employees through 2010. Since 2011, only one employee remains, an Environmental Manager for Marina Energy's Energenics partnership.
- Mt Laurel, 1317 Rt. 73– SJES Mass Markets and Marina Energy. 18 employees, since 2011.

Out-of-state facilities leased by SJI subsidiaries (SJG affiliates) are located in the following cities:

- Bedford, Texas – SJRG Gas Trading, Dispatch and Accounting, 11 employees.
- Dubois, Pennsylvania - SJES (Open Flow Energy), 8 employees.
- Hershey, Pennsylvania – SJES – 3 employees, since 2012, 3 employees.
- Las Vegas, Nevada – SJES (Marina Energy), 1 employee.

Affiliate Use of SJG's Folsom Facility - Although the Folsom building serves as headquarters for SJI, it is owned by SJG. In addition to SJG, parent company SJI and affiliate SJI Services are the primary occupants of the building. Mr. Rulis stated that SJG charges affiliates for the space they occupy in the Folsom building based on a "market" rate of $28 per square foot.[52] There is no lease or written

[51] In SJG's comments on our draft report, the company noted that the five SJESP employees had 'access' to a storage closet in the division; however, they did not have other office space assigned and therefore were not 'occupants' as shown. Overland did not have an opportunity to verify this claim by SJG.
[52] Interview, Steven Rulis, Facilities Manager, September 25, 3012.

agreement between SJG and affiliates using its facilities and there are no invoices to evidence the billings to the affiliates.[53]

The Company states that the market basis for **$**28 is the average market price for Class A office space in Philadelphia.[54] Additionally, embedded in the $28 rate is a **$**3 per square foot charge for electric usage "determined by taking the 2010 cost of electric ($276,000) adjusting for estimated usage by the Data Center . . . and dividing by the building's square footage. Subtracting the **$**3 per-square foot energy charge provides a $25 rate for rent. To support this, SJI provided a "Marketbeat" report from Cushman & Wakefield for the Philadelphia Suburban Office market for the second quarter of 2011. It shows "overall weighted average gross rental rates" for suburban Philadelphia to be around $25 per square foot in early 2011.

EDECA rules indicate that SJG should receive the *higher* of cost or market for the office space it leases to affiliates. During our interview, Mr. Rulis stated that he thought the actual cost per square foot of the Folsom building, based on a calculation he believed was made circa 2006, was $60, much higher than the $28 market-based rate currently being charged. When we requested support for this calculation, Mr. Rulis' stated in a data response that the $60 figure was a "recollection of a calculation from about 6 years ago that in retrospect included not only facilities operation costs, but also functional costs such as the IT Data Center and mailroom operations."[55] The data response provided a calculation of the Folsom facility's 2011 operating costs which turns out to be slightly *less* than the market rate charged by SJG to its affiliates. The table below summarizes the calculation.

[53] Response to Discovery, OC-399-C and D.
[54] Id.
[55] Response to Discovery, OC-398-A.

Table 17-15 – South Jersey Gas – Folsom Headquarters Building, 2011 Building Operating Costs, Per SJIS

South Jersey Gas - Folsom Headquarters Building 2011 Building Operating Costs, Per SJIS			
Category	**2011 Cost**	**Rentable Square Feet**	**Cost / Square Foot**
Admin. & Contract Labor	395,871		
Utilities	329,085		
Custodial Services	132,208		
Repair & Maintenance	201,306		
Grounds & Security	119,918		
Property Insurance	35,533		
Real Estate Taxes	153,669		
Depreciaion	267,719		
Total	1,635,309	58,633	27.89
Source: Response to Discovery, OC-398, "DR #398 Folsom Operating Costs.xls"			

Overland did not attempt to conduct a complete audit of the above calculation. For example, we did not independently attempt to determine whether the Company captured all of the HVAC, elevator, septic and water, tools and equipment and miscellaneous repair costs incurred in 2011 that should have been included in the category "Repairs and Maintenance." However, we note that one cost category missing from the above table that would normally be included in a regulated cost of service calculation is the return on investment and related income taxes associated with SJG's rate-based investment in the building. It is likely that the addition of return and income tax would raise $27.89 **cost**-basis of the Folsom building above the $28.00 stated to have been charged to affiliates. However, given that between 75% and 80% of the costs charged to SJI and SJIS are eventually charged back to SJG, the impact of any costs that should have been, but were not charged to SJI and SJIS, is probably immaterial.

Productivity and Cost Reduction Initiatives

The Facilities function implemented the following enhancements to reduce costs or improve quality during the years 2009 through 2011:

- Contracted with affiliate SJE to provide solar power to the Folsom General Office building and to the McKee City LNG facility. Since 2010, SJG has paid its affiliate SJE approximately 6 cents per kwh for electricity to supply supplemental solar power to the McKee City LNG facility and the Folsom General Office building. SJG also makes a small amount of money leasing space to SJE for the equipment to provide the solar power. Statistics provided by SJG show that its annual savings, compared with an "average utility rate" of approximately 13 cents per kwh for power, was $79,000 in 2010, $82,000 in 2011 and $82,000 in 2012 through September. Most of the solar power, and most of the savings, are attributable to the McKee City LNG facility.[56]

[56] Response to Discovery, OC-400, Attachment "DR #400-E SJG-Solar Savings."

- Froze prices for lawn care, janitorial services and HVAC maintenance in 2010 to save $50,000 annually.
- Hired U.S. Facilities to consolidate the management of facilities contractors and manage facilities-based capital projects.[57]

Performance Measurement and Evaluation

Benchmarking and Cost Metrics - The International Facilities Management Association (IFMA) is probably the best-known source of facilities benchmarking data. The IFMA periodically surveys its members to develop data for benchmark comparisons of various performance metrics and practices. As described on the IFMA website:[58]

> *IFMA conducts a benchmarking survey of its members annually, and the results are eagerly anticipated by facility managers. The objective of IFMA's benchmarking surveys is to collect facility data that will easily allow comparison of costs and practices. This year's survey is more general in nature in that it gathers costs from all facility areas including housekeeping, maintenance, utilities, security, environmental, project, support and space planning. Respondents also are required to provide a description of the facility, including size, type, hours of operation, location, industry, leasing arrangements and number of occupants.*

Although he is a member of the IFMA, Mr. Rulis indicated that SJI does not participate in the IFMA survey, nor does the Company utilize the IFMA survey or any other source of data to benchmark its facilities costs or operations.

Apart from the issue of benchmarking, SJG does not generally track the costs of its buildings internally. During our interview, Mr. Rulis indicated it had been several years since he calculated the cost per square foot of SJG's Folsom General Office building. As discussed above, the Company prepared a calculation showing that 2011 costs for SJG's Folsom headquarters building were $27.89a foot. However, it appears this calculation was prepared in response to our audit inquiry, and that facilities-based cost calculations are not prepared on a regular basis for the purpose of capturing trends or identifying opportunities for savings.

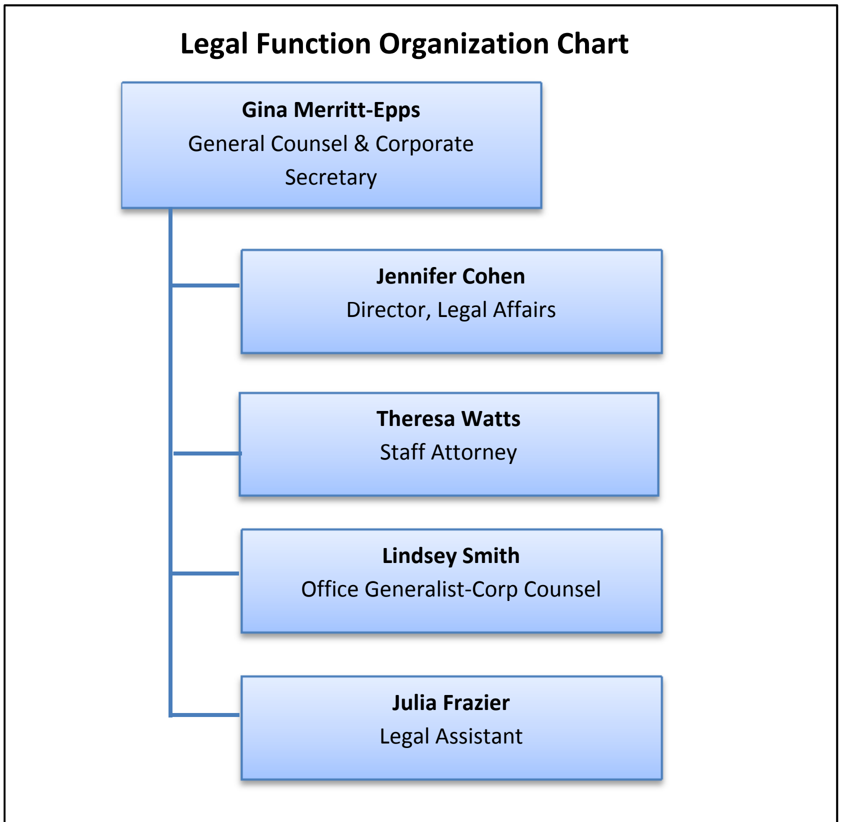
Legal Function

SJI's Legal function is housed within the Executive Department of the parent company. It is a very small group for which there is no specific cost center.[59] There was no cost center established for the legal function of SJI, primarily because all of the costs incurred by the legal function were distributed to the cost center that benefitted from the service.[60] The Legal function reports up to the General Counsel &

[57] Response to Discovery, OC-491.
[58] www.ifma.org/publications/books-reports/benchmarks-v-annual-facility-costs.
[59] Response to Discovery, OC-433.
[60] Interview with Steven Cocchi, Director of Rates and Revenue Requirements, 9/25/12.

Corporate Secretary. From 2009 through October 2011, Steven Cocchi was the Director of Legal Affairs. During that time, the Legal function totaled three people (General Counsel & Corporate Secretary, Director, and a Legal Assistant). After reorganization in October 2011, the Legal function was structured as shown below.

Table 17-16 - Legal Function Organization Chart



Source: Response to Discovery, OC-5.

The legal function serves all SJI affiliates. Most of the work performed in this group relates to review and drafting of contracts, resolving minor litigation matters, and handling disputes with 3rd parties, and regulatory filings. Major litigation matters are outsourced.[61]

The legal function mainly uses Microsoft Office to create internal reports and track information related to legal matters. A litigation log is maintained and updated in Excel.[62] A major issues report for SJI affiliates and departments is distributed monthly to management and the Board of Directors. The report is divided into three sections: SJG, non-regulation, and support services.[63]

[61] Ibid.
[62] Response to Discovery, OC-431.
[63] Response to Discovery, OC-432.

Internal Costs and Internal Cost Distributions

Table 17-17 – SJI Legal Function – Internal Operations Costs – Cost Distributions to Subsidiaries

SJI Legal Function Internal Operations Costs - Distributions to Subsidiaries						
	2009		2010		2011	
Subsidiary	Amount	Pct	Amount	Pct	Amount	Pct
SJI	348,804	81.8%	326,655	80.3%	460,844	79.7%
SJG	56,816	13.3%	49,646	12.2%	77,799	13.5%
SJE	6,683	1.6%	6,049	1.5%	6,461	1.1%
SJIS	2,534	0.6%	552	0.1%	417	0.1%
SJES	2,753	0.6%	2,929	0.7%	5,386	0.9%
SJRG	5,879	1.4%	5,153	1.3%	11,466	2.0%
Marina	2,174	0.5%	5,095	1.3%	9,657	1.7%
Marina Energy	(2,478)	-0.6%	843	0.2%	-	0.0%
SJESP	2,785	0.7%	9,987	2.5%	6,155	1.1%
R&T Group	99	0.0%	-	0.0%	-	0.0%
SJF	-	0.0%	-	0.0%	-	0.0%
EMI	609	0.1%	-	0.0%	143	0.0%
Total	**426,659**	**100.0%**	**406,909**	**100.0%**	**578,329**	**100.0%**

Source: Response to Discovery, OC-529.

Note: These amounts consist primarily of salary expense of Legal Function employees. However, they exclude the compensation costs of the Corporate Counsel & Secretary, whose costs are included in the Executive function.

As shown in the table above, the legal function's internal costs rose significantly in 2011 versus 2010 and 2009. The reason for this increase was due primarily to the hiring of two new positions in 2011: Staff Attorney in February 2011 and Office Generalist-Corporate Counsel in November 2011.

Overland also observed that approximately 80% of the internal legal costs was initially retained in the parent company each year. Those legal costs that are originally retained in the parent company are subsequently distributed to SJI affiliates through the management service fee allocation, which uses a three-factor general allocator.[64] These internal legal costs identified above consist of SJI legal employee's direct labor costs. The General Counsel's direct labor costs made up approximately half of these costs in 2011.[65] In our interview of Ms. Merritt-Epps, she stated that most of her time is spent on general legal matters that do not affect just one affiliate; this likely for this reason that a large majority of the internal legal costs are held at the parent company. There is no cost center assigned to the legal function; therefore, all costs, internal and external, are distributed to SJI affiliates either through direct allocation or through the management service fee allocation.[66] SJI does not analyze budget to actual

[64] Response to Discovery, OC-134.
[65] Derived from Response to Discovery, OC-529.
[66] Interview with Gina Merritt-Epps, General Counsel, 3/28/13.

variances for legal costs and there is no budget to actual variance report available since the legal function does not have a cost center. Internal and external legal costs are budgeted based on the prior year's actual costs; actual current year costs are then compared to prior year's actual costs for analysis within the legal function.[67]

Performance Measurement

The SJI Legal Function has a very generic set of goals to measure the performance of the group. These include: reduce expenditures for outside legal counsel, receive a rating of 4 or better in all areas of the customer response surveys, review all contracts to ensure the Contract Administration Policy is being followed, and implementation of electronic contract review.[68]

Overland requested the balanced scorecards of both the SJI Legal Function and the Director of Legal Affairs during the audit period.[69] The Company provided the Director's balanced scorecards for 2010 and 2011. When Overland requested the departmental balanced scorecard for the legal function from 2009 to 2011, the Company provided only a copy of the 2011 balanced scorecard for the Director of Legal Affairs. When asked for further clarification as to whether the departmental scorecard was the same as the Director's for 2011, the Company stated that the legal function does not have a departmental balanced scorecard.[70]

Upon reviewing the balanced scorecard for the Director of Legal Affairs for 2010 and 2011, Overland observed a couple of deficiencies. First, there is no section showing the actual results of the Director's performance and how they relate to the targeted amounts/levels. Without this, there is no way to evaluate whether or not the legal function is achieving its goals. During our interview with the Director of Legal Affairs during the audit period, he mentioned that no specific metrics were documented, and performance of the department was discussed verbally and not otherwise documented. When Overland interviewed the General Counsel, to whom the Director of Legal Affairs reports, the General Counsel believed that the performance assessment and results were maintained with Human Resources. Neither the General Counsel nor the Director of Legal Affairs retained a copy of the performance results and assessment for 2010 or 2011. Human Resources did not have a copy of the performance results and assessment for 2010 or 2011, as they do not retain balanced scorecard documents for officers and directors. Second, only one target was defined quantitatively. The rest of the targets are ambiguous, making the decision of whether or not the target has been achieved subjective in nature.

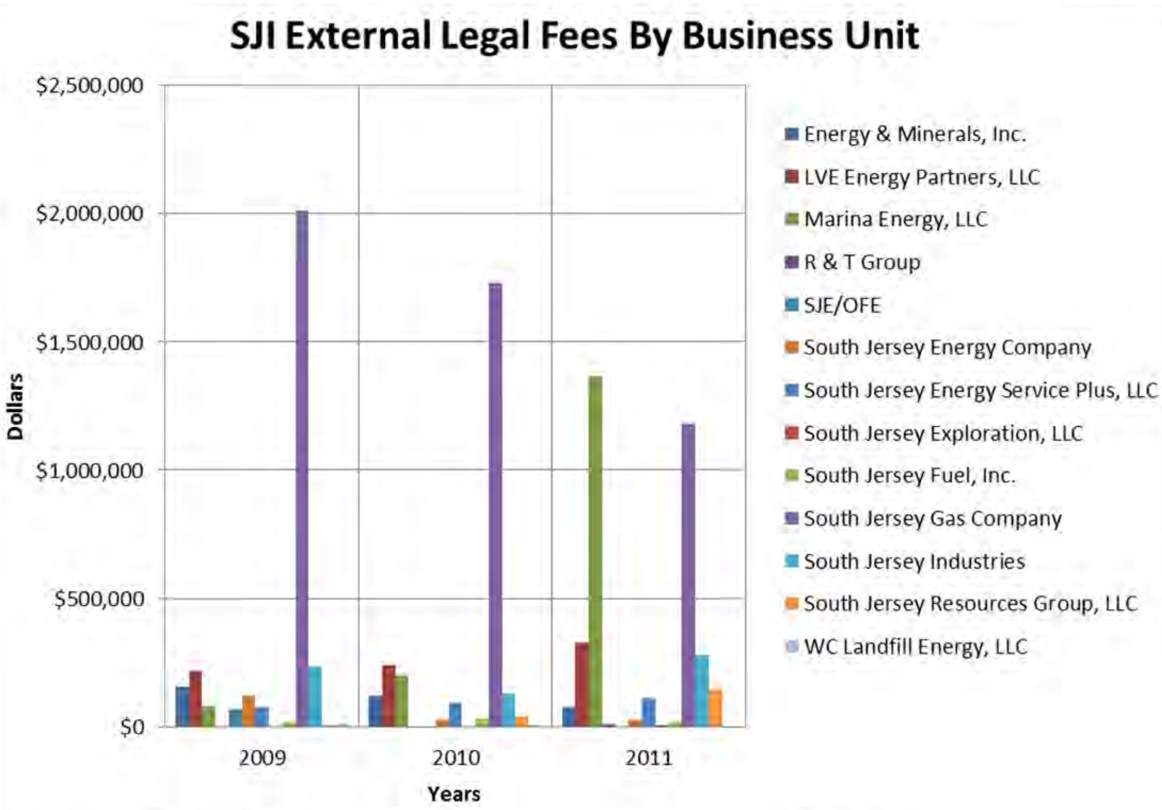
In our interview with Mr. Cocchi, he mentioned that the legal function does not utilize any benchmark studies to compare its operation to its peers.

[67] Ibid.
[68] Response to Discovery, OC-434.
[69] Response to Discovery, OC-360 and OC-434.
[70] Email correspondence with Chris Moschella, 4/10/13.

Outside Legal Services Cost Management

Significant legal matters are outsourced to external law firms based on SJI's experience with certain law firms, expertise, and the hourly rates proposed by the law firm. SJI does not subject the law firms it uses for outside counsel to a competitive bidding process. External legal fees are billed out to the affiliate and the department that incurs the legal fee. External legal fees are budgeted at the department level and the budgeting process is led by the General Counsel &Corporate Secretary. The Legal Assistant is responsible for tracking actual legal fees incurred against the budget.[71]

Table 17-18 - External Fees Paid by SJI



Source: Derived from Response to Discovery, OC-435 and confirmed with Response to Discovery, OC-530.

SJI spent $3.0 million, $2.6 million, and $3.5 million in external legal fees in 2009, 2010, and 2011, respectively.[72] As shown in the chart above, the utility (South Jersey Gas Company) incurs the largest portion of legal fees, except in the year 2011. Over the course of the audit period (2009-2011), the

[71] Interview with Steven Cocchi, Director of Rates and Revenue Requirements, 9/25/12.
[72] Derived from Response to Discovery, OC-435 and confirmed with Response to Discovery, OC-530.

utility has incurred over half of the external fees billed to SJI.[73] In 2011, Marina Energy, LLC incurred nearly $1 million in external legal fees relating to the Montclair University CHP plant, Hartford Steam plant, and the Revel project. With overall external legal costs increasing in 2011 to its highest level in the three years covered by our audit period, the increase in legal costs for Marina Energy more than accounts for the increase. Excluding Marina Energy's external legal costs, the general trend for SJI external legal costs is declining.

Overland also reviewed the amount of legal fees paid to each firm by SJI from 2009 to 2011. The data is presented in the table below.

[73] From 2009-2011, SJG incurred $4,922,680 of the $9,149,880 in outside legal fees. This was derived from the response to OC-435 and confirmed with Response to Discovery, OC-530.

Table 17-19 – SJI Legal Affairs – Outside Legal Costs by Provider

[Begin Confidential]

SJI Legal Affairs Function Outside Legal Services Costs by Provider					
Law Firms	2009	2010	2011	Total	% of Total

[End Confidential]

We found that one firm, **[Begin Confidential]** **[End Confidential]**, billed the majority of the external legal fees paid by SJI in this period. Furthermore, **[Begin Confidential]** **[End Confidential]** was the only firm to bill SJI in excess of $1 million in each year of the audit period.[74] While SJI used 26 different legal firms during the audit period, the Company heavily relied on one firm to provide required legal services. This suggests that there is a relationship between the legal firm and SJI that is not subjected to a rigorous competitive bidding process, which is inconsistent with best practices.

[74] Response to Discovery, OC-435.

Performance Improvements

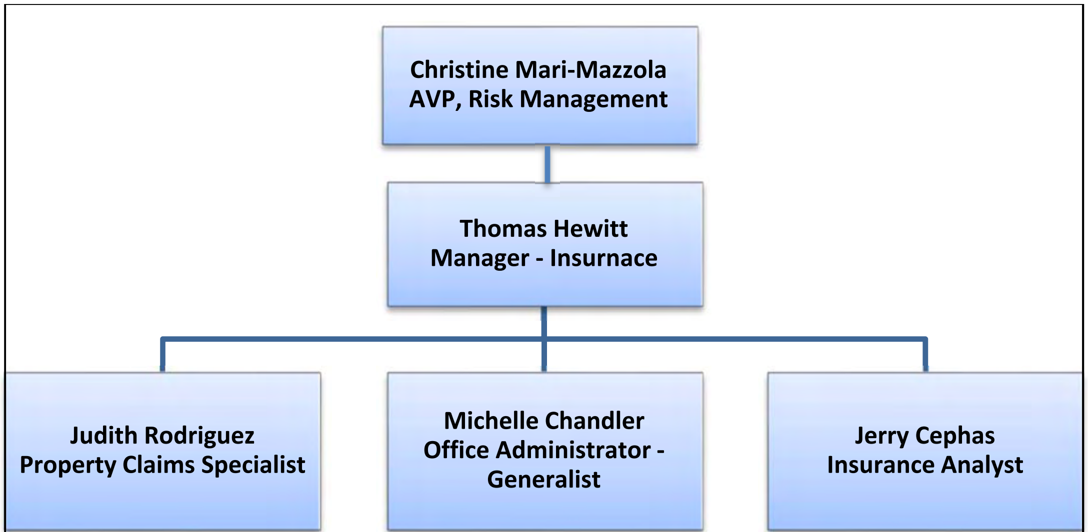
The legal function has been working on initiatives that will make better use of technology in performing contract reviews and maintaining the company's legal documents. In 2011, the legal function began to automate the contract review process. Before the implementation of an automated process, contracts were reviewed via email correspondence. SJI Legal Function worked with an outside vendor to develop software that distributes the contract details and obtains the appropriate sign-offs. This group has also initiated a process to convert all of the corporate secretary files into electronic documents. Finally, the legal function has updated the company's document retention policy to include document clean-out days.

Insurance and Claims

Insurance and Claims is a function within the Risk Management department of SJI's parent organization. As of 2013 it has four employees and is headed by Thomas Hewitt, Manager – Insurance. Mr. Hewitt has had different reporting relationships in the past few years. In 2009 and through June 2010, he reported to Sharon Pennington as the Insurance/Claims department was a component of SJI Services and Ms. Pennington was the COO of SJIS at that time. In June 2010, Insurance and Claims was moved from SJI Services to the parent company and incorporated into the Risk Management Department. From June 2010 until the end of 2012, Mr. Hewitt reported to Kenneth Lynch, AVP of Financial Reporting and Risk Management. At the beginning of 2013, Mr. Hewitt began reporting to Christine Mari-Mazzola, the current AVP of Risk Management. A current organizational chart is shown below.[75]

[75] Interview with Thomas Hewitt, Manager – Insurance, January 23, 2013.

Table 17-20 – Insurance/Claims Group Organizational Chart



Note: Jerry Cephas replaced Travis Bittenbender on 11/5/12.
Source: Response to Discovery OC-5 and interview with Thomas Hewitt, Manager – Insurance, 1/23/2013.

The Insurance and Claims group has the overall responsibility to identify, assess, and transfer risk from any of the SJI affiliates through whatever means possible including: insurance policies, contracts, indemnification provisions, etc. and to handle all third party liability claims. The department processes on average 70 to 100 claims per year, most of which result in minor rewards of $1,000 or less. The most frequently processed claims are vegetation claims and small property damage claims (i.e. damage from potholes where the utility has worked).[76]

Insurance and Claims Cost Information

Table 17-21 – SJI Services/SJI Parent Organization, Insurance Dept. Budgeted & Actual Costs

South Jersey Gas / SJI Services / SJI Parent Organization Insurance Dept. Budgeted & Actual Costs								
Description	2009		2010		2011		2012	
	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget
Insurance 10_761 (SJIS)	391,200	380,600	357,519	399,288	-	-	-	-
Insurance 30_3014 (SJI)	-	-	-	-	271,300	273,400	255,100	285,400
Insurance 2_761 (SJG)	1,775,006	1,457,968	1,882,265	1,515,926	721,633	1,585,007	1,584,916	1,643,247
Total	2,166,206	1,838,568	2,239,784	1,915,214	992,933	1,858,407	1,840,016	1,928,647
Source: Response to Discovery, OC-500 & OC-723								

[76] Ibid.

The table above shows the transition of the Insurance and Claims function from SJIS in 2010 to SJI in 2011. The actual expenses for the group did not significantly vary from the budget for SJIS and SJI. The utility saw a sharp decrease in actual insurance costs in 2011 as five significant self-insured risk claims, for which SJI had set aside reserves totaling over $1 million, were settled in favor of SJI. However, new claims in 2012 created the need to increase the reserves for self-insured claims nearly to the amounts observed in 2009 and 2010.[77]

Chapter 4 shows in Table 4-4 how costs in the Insurance and Claims organization incurred in SJIS were distributed to the operating affiliates of SJI in 2009 and 2010. Chapter 3, Table 3-16 shows the costs incurred in the Insurance and Claims organization by SJI in 2011 and how those costs were allocated to the SJI affiliates. The largest portion of the SJI insurance costs incurred in the parent organization, 86%, came from salaries and labor-related expense. The utility was the affiliate that received the largest share of parent company insurance costs, approximately 75%. As shown in the table above, substantially all of the cost of insurance outside of the compensation expenses of the Insurance/Claims group at SJI is incurred by the utility.

Insurance and Claims also incurs costs from third party service providers to assist with more challenging claims and appraisals. Below is a table showing the providers and their costs charged to the utility from 2009 to 2011.

Table 17-22 – SJG Insurance - Outside Services by Provider

South Jersey Gas SJG Insurance - Outside Services by Provider				
Vendor	**2009**	**2010**	**2011**	**Total**
Buck Horn Garden Services	600	-	-	600
BPR Claims Consultant	16,149	25,366	35,353	76,868
Nagle & Associates	11,476	7,774	9,086	28,336
O'Brien Appraisal	348	1,019	629	1,995
Total	**30,582**	**36,170**	**47,078**	**107,800**
Source: Response to Discovery, OC-672.				

BPR Claims Consultant and Nagle & Associates process bodily injury claims, property damage claims over $2,500, and other claims that require more investigation. Insurance sends out approximately 25% of its claims to BPR Claims Consultant and Nagle & Associates.[78]

Insurance Policies

Overland requested and received a listing of insurance policies at SJI that were in place as of June 1, 2011. The insurance policies at SJI are adequate, containing a wide array of insurance policies that

[77] Information obtained through follow-up inquiries via email correspondence with Chris Moschella.
[78] Interview with Thomas Hewitt, Manager – Insurance, January 23, 2013.

mitigate the company's risk relating to employees, property, environment, and the general public. The total costs for the premiums of the insurance coverages in place as of June 1, 2011 was $9,844,334, with the utility being responsible for $4,876,743 of that amount.[79] A brief summary of the major insurance policies obtained by SJI is found below.

- General Liability – SJG and SJESP are self-insured up to $250,000 per occurrence for bodily injury and property damage. The premium is allocated between the two companies based on the previous five year loss history and inflation rate. SJI decided to self-insure these companies to reduce the cost of providing first dollar coverage. Claims in excess of $250,000 are handled by a third party insurance provider. The remaining SJI affiliates receive first dollar insurance coverage on their claims. The premium for the excess general liability coverage is distributed to SJI subsidiaries based on a ratio of fixed assets, receivables, payroll and inventory.
- Auto Liability – SJG and SJESP are covered for liability only while the remaining affiliates that have vehicles have comprehensive coverage. The liability only coverage has no deductible and a coverage limit of $1 million, while the comprehensive coverage has a deductible of $500 and coverage limit of $1 million. The premium for this insurance coverage is allocated among subsidiaries based on the number of actual vehicles owned.
- Employment Practices Liability – This covers all SJI affiliates with employees against wrongful termination, harassment, and discrimination. The deductible for this coverage is $100,000 and the coverage limit is $3 million. The premium for this insurance coverage is allocated based on the number of actual number of employees for each affiliate.
- Directors and Officers Liability – This policy provides broad coverage for claims against SJI Board of directors and officers. The deductible is $300,000 for corporate indemnity and $0 for individuals. The coverage limit is $35 million ($10 million for SEC claims). The premium for this insurance coverage is allocated to subsidiaries based on the number of directors and officers sitting on each affiliate's Board(s).
- Worker's Compensation – This policy covers personal injury to employees. The deductible is $0 and the coverage limit is $1,000,000 (except in Nevada where it is $500,000). The premium for this insurance coverage is allocated based on the payroll expense for each affiliate.
- Environmental Pollution Liability – This policy covers bodily injury at the 12 manufactured gas plant sites in New Jersey. The deductible is $250,000 and the coverage limit is $25 million. This policy is directly charged to the utility.[80]

There are several other insurance policies that cover specific groups of people or assets that are not mentioned above. In general, it appears that SJI adequately tracks and documents how its business risks are mitigated through its insurance policies and how the costs for the insurance policies are distributed to SJG and other SJI subsidiaries.

In 2011, SJI performed an analysis of its insurance policies and procedures for mitigating business risks. Its Insurance Risk Analysis Report highlighted risks that were underinsured, risks that might need to be

[79] Response to Discovery, OC-592.
[80] Ibid.

insured by a third party that were self-insured at the time of the report, and risks that were uninsured where the company should obtain insurance quotes and consider purchasing a policy to mitigate. To reach the conclusions in the report, the Company reviewed benchmarking studies, consulted with outside insurance sources, reviewed trade publications, and had discussions with internal business line leaders. The recommendations that came from this report are listed below:

Obtain insurance quotes and possibly purchase policies for:

- Director & Officer "Side A" Liability
- Key Person Life & Disability
- Network Cyber & Privacy Liability

- Increase SJI Excess Liability (Umbrella) limit to $100 million
  Increase Marina Energy General Liability by $20 million for each combined heat and power (CHP) project added
- Increase SJI D&O insurance to $100 million.[81]

In our interview with the Insurance Manager, Mr. Hewitt stated that this was the first report of this type to be completed at SJI and that the Company plans to complete an Insurance Risk Analysis Report on a biannual basis. Based on the recommendations made in this report, SJI purchased Director & Officer Side "A" coverage for $15 million and an additional $25 million of umbrella insurance on June 1, 2013. As of June 2013, SJI has not purchased a Key Person Life & Disability policy or Cyber Liability policy. The Company also has not chosen to increase director and officer insurance or the umbrella policy for Marina Energy.[82]

Procedures for Acquiring New Insurance Policies

When SJI seeks to apply for a new insurance policy or renews an existing policy, Insurance employees submit the required documentation to SJI's insurance broker, Willis, who in turn sends it to several insurance carriers to provide a quote. Willis records the responses and compares the policies against each other. Once a suitable policy is chosen, it is sent to the executive lead of Risk Management, and to the CFO for approval. Once those two approvals have been obtained, the Insurance Manager binds the policy.[83]

Benchmarking

During the audit period, SJI relied on benchmarking information when determining the adequacy of its insurance coverage relative to its peers. SJI participates in the American Gas Association's (AGA) Risk Survey Report, The Risk Management Society (RIMS) benchmarking survey, and another more informal

[81] Response to Discovery, OC-670.
[82] Response to Discovery, OC-775.
[83] Interview with Thomas Hewitt, Manager – Insurance, January 23, 2013.

survey created by a subgroup of risk managers belonging to RIMS. The two tables below show the benchmarking data, comparing the utility insurance premiums and policy limits to 18 other utilities that participated in the AGA Risk Benchmarking Survey.

Table 17-23 – Comparison of SJG Insurance Premium Costs with Peers

Comparison of SJG Insurance Premium Costs with Peers 2010 Insurance Premiums (Amounts in $000s)							
Insurance Category	**SJG**	***Average***	***Median***	***Low***	***25th Percentile***	***75th Percentile***	***High***
Property							
Direct Property Damage	232.1	*3,123.5*	*909.2*	*50.6*	*459.1*	*5,195.3*	*16,021.2*
Crime/Kidnap & Ransom	13.7	*55.1*	*27.9*	*3.1*	*6.1*	*68.9*	*256.9*
Workers' Compensation							
Primary Workers' Compensation	900.9	*698.7*	*500.0*	*176.1*	*380.0*	*900.9*	*1,872.0*
Liability							
Primary General Liability	397.6	*159.0*	*138.4*	*5.0*	*55.4*	*220.0*	*397.6*
Primary Auto Liability	188.2	*149.1*	*124.1*	*17.0*	*49.2*	*202.3*	*455.0*
Umbrella/Excess Liability	570.3	*4,611.1*	*3,100.0*	*49.7*	*2,376.3*	*7,577.5*	*13,338.2*
Pollution/Environmental	157.8	*322.2*	-	-	-	*145.4*	*1,964.7*
Employment Practices	55.5	*11.7*	-	-	-	*11.0*	*55.5*
Fiduciary/Employee Benefits	121.3	*349.0*	*200.0*	*4.4*	*160.5*	*468.4*	*1,261.1*
D&O Liability	298.7	*1,294.7*	*1,075.0*	*43.4*	*574.1*	*1,377.5*	*4,490.5*
Side A Only D&O Liability	85.0	*320.3*	*325.0*	*66.5*	*146.8*	*433.1*	*736.0*
Other*	15.8	*1,034.4*	*144.8*	*15.8*	*38.4*	*1,140.8*	*3,832.3*
Totals	**3,036.7**	***11,342.5***	***7,485.5***	***214.0***	***5,363.0***	***18,306.6***	***30,715.6***
Source: Response to Discovery, OC-669, 2011 AGA Benchmarking Survey							
* Other - Employed Lawyers							

Overland could not verify the information provided by SJI[84] to the AGA Risk Benchmarking Survey for insurance premiums for: Worker's Compensation, Side A Only D&O Liability, and Other. In fact, in the 2011 Analysis of SJI Insurance Policies discussed above, SJI states that the company "does not currently purchase D&O Side A Insurance".[85] Furthermore, the data provided by SJI for the survey is inconsistent with respect to the affiliates covered by the premiums. For example, the amounts relating to primary general and umbrella/excess liability are the amounts covering all SJI affiliates, not just the utility's share. However, the primary auto liability amount is just the utility's premium cost. SJI should ensure that the data provided to the benchmarking surveys are consistent and accurate according to its Insurance Schedule, where SJI's insurance policies are tracked.

Overland notes that SJG is one of the smaller utilities in the benchmarking study, so it is expected that the premiums and coverage limits for its insurance policies would be on the lower end of the benchmark

[84] Overland used as a reference the 6-1-2010 Insurance Schedule provided in the response to discovery, OC-592.
[85] Response to Discovery, OC-670.

survey. The premiums that the utility pays for worker's compensation are above the median with respect to the other participants in this study. The reason for this is because SJI paid out insurance claims of over $800,000 in 2008, more than double the amount from 2007, causing NJ Manufacturer (the workman's compensation policy carrier) to increase the amount billed to SJI for worker's compensation fees in subsequent years. The high amount of claims in 2008 was due to an aging workforce of field workers that sustained a larger than usual amount of physical injuries (i.e. back and rotator cuff injuries).[86] Overland found that SJI had the highest premium for general liability in the survey. However, combined with the excess liability or umbrella policy, these two premium costs together are well below the 25th percentile in the survey. Overland also found that SJI had the highest employment practices premiums in the survey and pollution/environmental premiums that were above the 75th percentile. With the information provided by SJI, Overland was unable to determine the reason for the relatively high employment practice and pollution/environmental premiums.

Table 17-24 – Comparison of SJG Insurance Limits with Peers

Comparison of SJG Insurance Limits with Peers 2010 Insurance Limits (Amounts in $M)							
Insurance Category	**SJG**	***Average***	***Median***	***Low***	***25th Percentile***	***75th Percentile***	***High***
Property							
Direct Property Damage	100.0	523.3	*275.0*	*100.0*	*131.3*	*737.5*	*2,300.0*
Crime/Kidnap & Ransom	1.0	20.4	*20.0*	*1.0*	*8.1*	*23.8*	*75.0*
Workers' Compensation							
Primary Workers' Compensation	1.0	1.2	*1.0*	*0.5*	*0.8*	*1.5*	*2.0*
Liability							
Primary General Liability	1.0	3.3	*1.0*	*1.0*	*1.0*	*3.0*	*10.0*
Primary Auto Liability	1.0	1.5	*1.0*	*0.5*	*1.0*	*2.0*	*3.0*
Umbrella/Excess Liability	35.0	326.8	*275.0*	*25.0*	*211.5*	*471.3*	*800.0*
Pollution/Environmental	5.0	212.5	*137.5*	-	*38.8*	*318.8*	*800.0*
Employment Practices	3.0	101.8	*85.0*	-	*35.0*	*185.0*	*228.8*
Fiduciary/Employee Benefits	25.0	55.8	*50.0*	*25.0*	*27.5*	*75.0*	*125.0*
D&O Liability	35.0	114.9	*107.5*	*3.0*	*88.8*	*123.8*	*250.0*
Side A Only D&O Liability	10.0	67.3	*45.0*	*10.0*	*30.0*	*105.0*	*195.0*
Other*	3.0	6.3	*6.0*	*3.0*	*4.5*	*8.0*	*10.0*
Source: Response to Discovery, OC-669, 2011 AGA Benchmarking Survey * Other - Employed Lawyers							

Overland could not confirm the information provided by SJI[87] to the AGA Risk Benchmarking Survey for insurance premiums for Direct Property Damage, Pollution/Environmental, and Side A Only D&O Liability. Overland found that for every single type of insurance, SJI was either at or below the median with respect to the insurance limits on all of its policies, and at or below the 25th percentile in all but one

[86] Interview with Thomas Hewitt, Manager – Insurance, January 23, 2013.
[87] Overland used as a reference the 6-1-2010 Insurance Schedule provided in the response to discovery, OC-592.

policy type. As a smaller utility in the survey, it is reasonable for SJI to reside in the lower percentiles in the survey. However, in the above table for insurance premiums, SJI resided above the median in some policy types, yielding the potential conclusion that SJI could be overpaying for certain types of insurance when looking at premium cost versus benefits from reduced risk exposure. For example, SJI has the highest employment practices premium cost in the survey while the coverage limit ranks well below the 25th percentile. However, there are other factors to consider when comparing premium costs and coverage limits.

Insurance Department Internal Performance Metrics

Overland reviewed the balanced scorecard of the Insurance Manager to observe what measures are being tracked by the Company with respect to the Insurance/Claims function. Overall, Mr. Hewitt earned average BSC scores of **[Begin Confidential**] **[End Confidential]** in 2009, 2010, and 2011, respectively (on a scale of 1.0 to 5.0). Below is a discussion of the key objectives, measures and results from Mr. Hewitt's 2011 balanced scorecard.

- <u>Obtain favorable premium benchmarking with peers from an independent source</u> – SJI was able to achieve a total cost of risk (TCOR) rating of $6.24/$1,000 compared to the average utility TCOR rating of $10.02/$1,000. With this measure, Mr. Hewitt exceeded expectations.
- <u>Develop a quantitative analysis for all significant insurance SJI insurance policies with a recommendation of an appropriate level of coverage</u> – Mr. Hewitt completed the 2011 Analysis of SJI Insurance Policies using benchmarking data, determined where gaps in coverage's existed and made recommendations to close those gaps. Mr. Hewitt exceeded expectations on this metric.
- <u>Work with Marina and legal counsel to expedite the settlement of the Marina Pipe Claim</u> – The Marina Energy Thermal Facility (MTF) provides hot and chilled water to the Borgata Hotel and Casino in Atlantic City. An expansion joint between MTF and the Borgata ruptured. Marina and its insurance company disagree as to whether the root cause of the rupture is covered by the insurance policy. The decision has been submitted to arbitration and is expected to be resolved through binding arbitration in late 2013. Mr. Hewitt met expectations on this metric.
- <u>Develop a formalized annual risk review process designed to ensure that all insurable risks have been addressed</u> – Mr. Hewitt developed this process and incorporated it into the 2011 Analysis of SJI Insurance Policies report. Despite the report being produced on a bi-annual basis going forward, Mr. Hewitt was still considered to have met expectations on this metric.
- <u>Implement an effective and efficient process to collect current and existing contractor damage claims</u> – Mr. Hewitt worked with the SJI Legal department and an outside legal firm to aid in collecting older claims from 2005 to 2008. The target for Mr. Hewitt was to reduce the backlog of old claims by 50%. In 2011, there was a 36% reduction of older contractor damage claims.[88]

[88] Response to Discovery, OC-365.

Mr. Hewitt's balanced scorecard contains a mix of qualitative and quantitative objectives and targets. Some of the objectives appear to have challenging goals, which encourages employees to perform at their highest levels. Furthermore, Mr. Hewitt's balanced scorecard includes objectives relating to achieving targets relating to benchmarking and providing an overall review of the Insurance and Claims function's operations.

Records Management

SJI contains within SJIS a Records Management function, the purpose of which is to establish records retention guidelines "to help minimize the creation of unnecessary records in multiple copies; ensure the efficient, economical use of records in both active and inactive periods; and provide for the proper destruction of records as appropriate."[89] Marie Schaffer, Manager of Administrative Services, is responsible for records management. The Administrative Services department is discussed at the beginning of this Chapter.

Functional Responsibilities

The main tasks that Administrative Services are responsible for with respect to the Records Management function are:[90]

- Submitting and retrieving records from the records storage management company;
- Ensuring the security of the records maintained at SJI; and,
- Verifying that records maintained both on-site and off-site meet retention guidelines.

The governing document for the Records Management function at SJI is the Records Retention and Destruction Manual. The manual contains company policies and procedures as well as information regarding the record retention guidelines for applicable regulatory agencies. The manual is updated as often as necessary with the last formal revision completed prior to April 30, 2011 and made effective after a review by the Legal Department on June 24, 2011.[91] The manual explicitly requests that if any employee is aware of updates or changes that should be made to the manual, the new information should be brought to the attention of the Office of Corporate Counsel. All SJI employees have access to the Manual through the SJI intranet.[92]

Records Storage

SJI uses both on-site and off-site storage locations for maintaining physical documents of the Company. The on-site location is in the Folsom building on the first floor. This storage area is a "secure/locked room", to which only Administrative Services can provide access. This area is generally used for short-term storage needs, which the Manual defines as documents that are less than two years old. SJI uses Iron Mountain storage as its off-site document storage location. The Company uses Iron Mountain for

[89] Response to Discovery, OC-724.
[90] Response to Discovery, OC-724.
[91] Response to Discovery, OC-365 (Schaffer's BSC) and OC-724.
[92] Response to Discovery, OC-724.

long-term record storage and any overflow short-term record storage. SJI tries to limit the documents stored at Iron Mountain to those documents that are not subject to frequent retrieval. Any costs associated with retrieving stored records are directly charged to the department that owns the record.[93]

Records Management Function Performance

The company stated that there are no internal goals or objectives relating to Records Management. SJI also does not obtain any benchmarking data for the Records Management function.[94] While there is no balanced scorecard for the function, Ms. Schaffer's balanced scorecards contained objectives relating to records management in 2010 and 2011. The objectives along with their measures, targets, and results are discussed below.[95]

- <u>Comprehensive update to 1993 manual completed along with procedures for submitting/retrieving records from storage – all made available for easy reference on the network (2010)</u> – The target for this objective was to have the manual update and procedures written by the end of the third quarter in 2010. Although the update to the manual was not completed until the end of the year, the objective was considered met according to the balanced scorecard.
- <u>Release of updated Records Retention Manual and coordination of short/long term records review, cataloging, and appropriate destruction (2011)</u> – The target for this objective was to have the updated manual released by April 30, 2011 and the records review completed by September 30, 2011. Although the manual was updated prior to April 30, 2011, it was not approved by the Legal Department and released until June 2011. The review of records in storage was conducted and communicated to all SJI departments by September 30, 2011. The objective was considered met.

[93] Response to Discovery, OC-724.
[94] Response to Discovery, OC-725 and OC-726.
[95] Response to Discovery, OC-365 (Schaffer's BSC).

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18. Information Technology

Information Technology is one of the largest support services functions, affecting all of the SJI affiliates. The department resides in the SJI Services affiliate.

Summary of Findings

1. SJI uses a number of different methods for distributing IT costs from SJIS to SJI affiliates. The direct charge method is used for specific and capital intensive projects. IT specific methods of allocating costs such as: number of PCs, number of telecommunications devices, and mainframe usage are also used. Overall, SJI has minimized the used of generic allocators for distributing shared IT costs to SJI affiliates.
2. SJI is making a strong effort to upgrade the company's IT systems to take advantage of current technologies to run a more efficient business. SJI is in the process of implementing a new customer service system to replace the 30 year old system that is currently in use. SJI is also implementing an Enterprise Work and Asset Management System to replace numerous smaller systems.
3. SJI has a large number of information systems that must communicate with each other, requiring the IT department to focus a significant amount of time working to integrate all of the systems and applications together to maintain the integrity of the information that is processed and distributed from these systems.
4. In 2011 and 2012, SJIS implemented a work request system called Altiris that allows the IT help desk to create an electronic ticket and track a work request electronically from start to finish.
5. Overland did not receive any statistical or benchmarking data relating to the efficiency of resolving help desk issues.
6. SJI has recently greatly enhanced its disaster recovery and backup procedures. After purchasing space in a backup data center in Philadelphia, the Company can now retrieve data from its backup location in less than an hour.
7. **[Begin Confidential]**

   [End Confidential]
8. The rates that SJIS charges SJI affiliates for IT services are favorable when compared to rates for similar services charged by a few outside vendors selected for comparison by SJI, with the exception of Helpdesk Support.
9. SJIS obtains IT benchmarking data from Gartner surveys. During 2012, the survey shows that the IT department at SJI has a relatively low number of employees, a high number of consultants, and spends relatively more money on IT capital projects when compared to its utility peers.

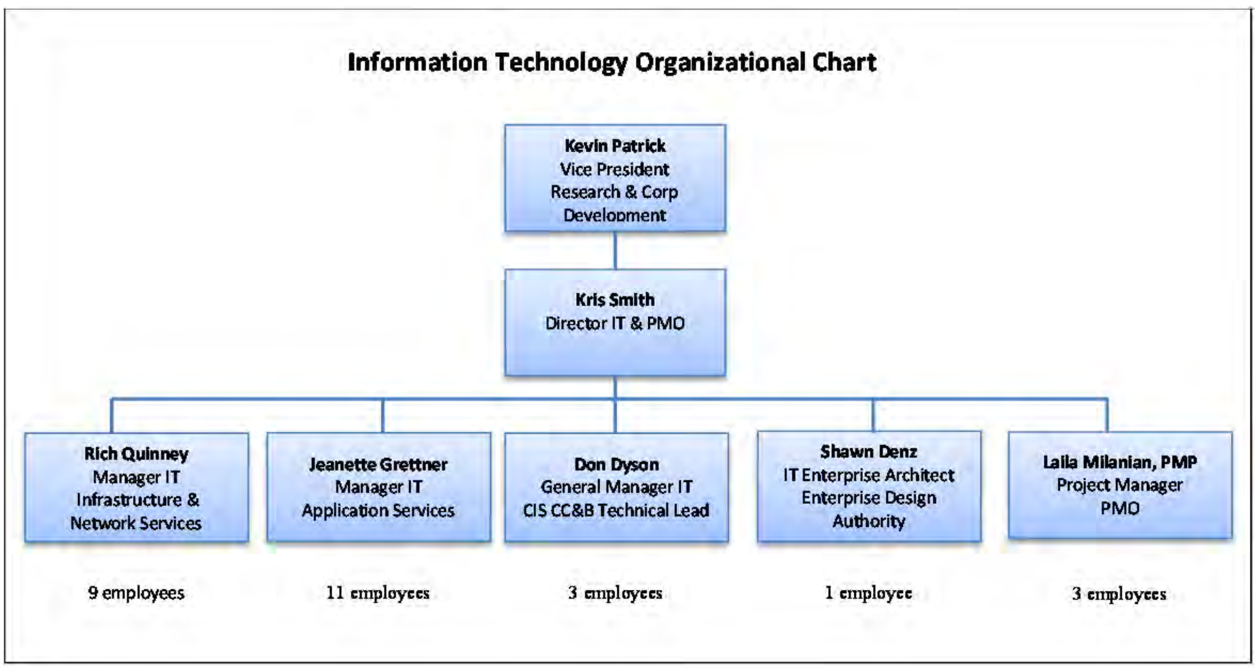
Recommendations

1. Overland recommends that the IT department obtain benchmarking data to determine how the help desk function at SJI performs against SJI's peers in the utility industry.
2. The IT Director's Balanced Scorecard should contain more performance objectives that are considered stretch objectives. These objectives will encourage the IT function to reach higher standards relative to industry peers.

Organization

The Information Technology (IT) department was made up of 24 employees as of January 2013. It oversees more than 1400 hardware devices, 750 software applications, and 6 terabytes of data (as of 2010).[1] The department is divided into five components: Infrastructure & Network Services; Application Services; CIS CC&B System; Enterprise Design Authority and Client Relations/Planning; and Project Management Office (PMO).[2]

Table 18-1 – Information Technology (IT) Hierarchy



The leader of the IT department is Kris Smith, Director of Information Technology. Mr. Smith reports directly to Kevin Patrick, Vice President, Research and Corporate Development.[3] Mr. Smith is responsible

[1] Response to Discovery, OC-678 "IT 1995-2015 Rev1".
[2] Response to Discovery, OC-674.
[3] Response to Discovery, OC-5.

for directing, overseeing, and managing the IT department and the Project Management Office. This overall responsibility includes the following specific objectives:[4]

- Provide strategic planning and technical support to SJI business lines.
- Identify opportunities where technology can assist and improve current and future business processes.
- Coordinate with SJI stakeholders all design and implementation requirements of SJI's technology mission and objectives.
- Report on the PMO status of all major project initiatives to the Executive IT Steering Committee.

The IT department is divided into five main areas as shown in the organizational chart above. Infrastructure and Network Services handles the data center, network and wireless infrastructure, telecommunications, personal computers, and disaster recovery and backup. Network Services handles the software, programming and database administration. The CIS CC&B group handles the conversion and implementation of SJI's new customer information system, Oracle Customer Care and Billing (CC&B). The IT Enterprise Architect acts as the liaison between the IT department and its stakeholders. The Project Management Office (PMO) tracks the status of IT projects and communicates the status to SJI executives via the Executive IT Steering Committee and Board of Directors as necessary. The SJI Executive IT Steering Committee's positions are filled by CEO Ed Graham's direct reports.[5] The Committee serves to oversee the implementation of large technology projects, those with an estimated cost of $250,000 or greater. The CEO has the responsibility for submitting the final approval for these projects. Shawn Denz is the Secretary of the Committee and is responsible for getting IT project approvals and serving as a liaison between the IT department and the Committee. The PMO also has responsibility for getting budget approval for IT projects, organizing a steering committee for each proposed project, and obtaining contractors to help manage the project, if necessary.[6]

IT Department Cost Information

Table 18-2 – South Jersey Gas / SJI Services, Information Technology Dept. Budgeted & Actual Costs

South Jersey Gas / SJI Services Information Technology Dept. Budgeted & Actual Costs								
Description	2009		2010		2011		2012	
	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget
Network Services 10_870 (SJIS)	815,200	846,800	1,052,543	969,745	886,150	972,537	940,400	1,021,100
Mgmt Services 10_871 (SJIS)	1,413,400	1,289,200	1,551,478	1,600,004	1,600,331	1,561,428	1,817,000	1,805,900
Computer Operations 10_873 (SJIS)	677,300	741,800	637,119	650,097	519,564	516,235	422,200	405,300
Mgmt Systems 10_871 (SJG)	206,715	155,656	158,210	160,422	359,427	188,222	698,471	527,168
Information Systems 10_872 (SJG)	127,648	151,317	160,887	187,598	604,232	628,877	783,189	743,321
Total	3,240,263	3,184,773	3,560,237	3,567,866	3,969,704	3,867,299	4,661,260	4,502,789
Source: Response to Discovery, OC-500 & OC-723								

[4] Kris Smith's SJI Bio.
[5] Response to Discovery, OC-679.
[6] Interview with Kris Smith, Director of IT, January 23, 2013.

As shown in the table above, SJI and SJG are generally effective in managing their actual IT spend when compared against the budgeted spend amounts for 2009 through 2012, with a few exceptions. The actual cost increase in cost center 2_871 is due to maintenance costs for various improvement projects involving telecommunications, networking, and software resources. The budget for this cost center is generally based on prior year expenses. The actual costs for cost center 2_872 increased from 2009 – 2012 due primarily to the transfer of licensing fees that were specific to the utility's customer care center operations from cost center 10_873. The Network Services and Management Services cost centers for SJIS had their budget and actual costs increase gradually as new employees were added for positions related to new enterprise system requirements.[7]

Chapter 4 shows, in Table 4-11, how IT costs incurred through SJIS are distributed to the operating subsidiaries of SJI. That table shows that during the 2009-2011 review period, approximately 80% of IT costs were distributed to SJG. Chapter 4 also states that the majority of the IT costs distributed from SJIS consisted of compensation for IT employees. The IT department has developed an internal system to track their time to be allocated to SJI affiliates. In addition to the costs of compensation, the IT department incurs costs from 3rd party service providers for license and maintenance fees. These vendors include:

- Dell – SJI uses Dell to purchase hardware and various computer services.
- Microsoft – SJI uses Microsoft to purchase hardware, software, and various computer services.
- Presidio – SJI has a network service contract with this company, which is considered an expert in Cisco systems.
- Utility Reduction Analysis (URA) – This company employs experts on reviewing utility and telecommunication bills and obtaining competitive rates. Along with the service fee charged by the URA, URA shares any savings on utility and telecommunications costs 50/50 with SJI.
- Magellan – This company is a reseller of data lines and acts as an intermediary between SJI and Verizon.[8]

SJIS vendor costs related to network services (cost center 870) are allocated based on the actual number of PCs used by each SJI business line. Outside management or consulting services are incurred in SJIS cost center 871 and allocated as a component of the overall management fee billing rate. Vendor costs incurred in SJIS cost center 873 relate to the operation and maintenance of the SJI mainframe computer. These costs are allocated based on a company report that determines the usage of the mainframe by each SJI affiliate. Outside services relating to a capital project are directly charged to the appropriate affiliate and charges for shared services (i.e. cellular services, telecom) are allocated as the actual charges are incurred according to usage or number of devices.[9] It appears that SJIS has minimalized the use of generic allocators for distributing share IT costs to SJI affiliates.

[7] Response to Discovery, OC-772.
[8] Ibid.
[9] Response to Discovery, OC-676.

SJI Information Systems

Significant information systems managed by the IT function include the following.

- CIS (Customer Information System) – The CIS, used primarily by SJG, is over 30 years old. In 2010 SJI completed an extensive study to determine whether it was feasible to replace the current customer service system and what system to use as a replacement. AAC Utility Partners, which conducted the study, continues to serve as the PMO for implementing the new Oracle system. PriceWaterhouseCoopers has a group of 20-25 people that make up the implementation team.[10] The current implementation target for the new system is the first quarter of 2014.[11]
- Lawson Accounting System – Lawson is used to maintain information for the general ledger, accounts receivable, human resources, purchasing and requisition, and payroll. The system is not considered an enterprise resource planning (ERP) system as additional systems are used to process information from SJI main business lines (e.g. PowerPlant is used as the asset and depreciation system.).
- Hyperion – This is the system that is used for budgeting and financial forecasting. As of January 2013, SJI was using a version of Hyperion that is two versions older than the most current version. IT plans to update to the current version during 2014.[12]
- RADAR – This is the system that houses software for the trading platform and risk management office. The system is used by all of the significant SJI affiliates. RADAR was first implemented in 2000 and last upgraded in October 2012.[13] RADAR will be replaced by the system Endur from the company Open Link for the wholesale business line by the end of 2013. There is a plan to implement this system for the retail business line in 2014.[14]
- Enterprise Work & Asset Management System (EWAMS) – This system was recently implemented by SJG and allowed the Company to eliminate over 50 stand-alone systems and create over 160 process improvements.[15] The system (Maximo) became fully operational in June 2013. The work and asset management system in place previous to Maximo was a paper-based system.[16] The Company estimates that Maximo will save the company over two million pieces of paper per year.[17]

Other less significant systems used by SJI and SJG include:

- Salesforce - A customer relationship management system.
- Hatch Mott McDonald – A geographical information system.
- Fleetboss – A GPS system for the Fleet division.

[10] Ibid.
[11] Response to Discovery, OC-675.
[12] Interview with Kris Smith, Director of IT, January 23, 2013.
[13] Response to Discovery, OC-675.
[14] Interview with Kris Smith, Director of IT, January 23, 2013.
[15] Response to Discovery, OC-162.
[16] Interview with Kris Smith, Director of IT, January 23, 2013.
[17] Response to Discovery, OC-162.

- Powerplant – An asset management system.
- CERTUS – A system that maintains internal control information.

Overland notes and confirmed with the Director of IT that SJI has many systems that must communicate with each other. The Director of IT stated that much of the time spent by the IT department relates directly to working to integrate all of the systems and applications together to maintain the integrity of the information that is processed and distributed from these systems.

The IT Help Desk

In June 2011, the IT department implemented a new work request system called Altiris. The system was intended to allow the department to electronically track a work request from start to finish. All of the calls into the help desk create a service desk ticket. The tickets are initially assigned to Level 1, 2, or 3, with the levels defined as follows:

- Level 1 – Simple IT requests (usually hardware issues).
- Level 2 – Items not resolved in Level 1; IT analyst becomes involved.
- Level 3 – Software application problems; Application analyst becomes involved.

The workflow that allowed the IT department to electronically track help desk work requests from start to finish was perfected during 2012.[18] Overland did not receive any statistical or benchmarking data relating to the efficiency of resolving help desk issues. We recommend that the IT department obtain benchmarking data to determine how the help desk function at SJI performs against SJI's peers in the utility industry.

Procedures for Acquiring New Technology

There are several different ways that the IT department stays current with new technology. IT employees perform technology scans on Internet sites and a few magazines. Some employees attend the CIO summit once or twice each year. At the summit, the employees are able to meet with vendors to discuss and demo new technologies. The IT department also receives information from vendors via email and phone calls.[19]

While SJI business lines and their leaders are responsible for initiating and obtaining the proper approvals for new technology, the IT department facilitates the review process. When a new technology is proposed at SJI, there is a nine step process that must be completed before the technology is approved for implementation. These steps are summarized below:

1. Project Description and Responsibilities;
2. Solution Information;
3. Business Outcome Review;

[18] Interview with Kris Smith, Director of IT, January 23, 2013.
[19] Ibid.

4. Resource and Skills Requirements;
5. Technology (Cost) Information;
6. Option Assessment and Recommendation;
7. Requestor Approval;
8. Affected Business Line Review; and
9. SJI Research and Corporate Development Review.

Any proposal that is greater than $250,000 must go through a Request for Proposal process and include a vendor list and timeline complete with milestones.[20]

Information Technology Security

The IT department uses a multi-tier strategy to secure access to its hardware, software and data. Internet security, intrusion prevention methods, monitoring, firewalls and data center security procedures are used to safeguard hardware, software and data. The SCADA system, used to control the flow of gas through the distribution system, has no internet facing capability, so there is no outside access to the system. There is dual level access required to access SJI applications. A username and password is required at both the entry point to the SJI directory and to enter the application itself. The IT department also employs requirements for password complexity and password expiration. Websites accessible to the public are hosted at a different data site than SJI's private applications. There is no connection between the public websites and SJI's private applications. SJI appears to have a thorough set of guidelines and procedures for safeguarding IT hardware, software, and data.[21]

Disaster Recovery and Backup

SJIS's IT department has invested significant resources and developed detailed procedures concerning disaster recovery and backing up data at SJI. The IT department has written procedures on this topic contained in the Business Continuity/Disaster Recovery (BC/DR) Manual and Plan. The IT department considers the manual a "living document" that is continuously updated. All remote SJI offices have a backup location where their data is to be stored and recovered. Only the loss of the data at the SJI headquarters in Folsom, NJ is considered a disaster in the BC/DR Plan and action steps to mitigate this disaster are documented in the Manual and Plan. The steps in the plan (for critical systems only) are tested annually and updated after each test if needed. The restoration of all tape backups of data is verified by Internal Audit for Sarbanes Oxley compliance.[22]

The method SJI uses to store backup data changed in 2011. Before the change, SJI stored data backups on tape in a Glassboro facility where the information could be recovered in 24 to 48 hours. SJI now has acquired space at a backup data center in Philadelphia Technology Park. SJI's systems now send virtual data to the backup data center on a continuous basis. This new method allows SJI to recover data from

[20] Response to Discovery, OC-679.
[21] Interview with Kris Smith, Director of IT, January 23, 2013.
[22] Response to Discovery, OC-680.

the back up servers at Philadelphia Technology Park in less than an hour. Data recovery using this method proved to be successful during the aftermath of Hurricane Sandy in October 2012.[23]

IT Internal Performance Metrics

Overland reviewed the balanced scorecard of the Director of IT to observe what measures are being tracked by the company with respect to the IT function. **[Begin Confidential]**

[End Confidential] The table below summarizes the 2011 balanced scorecard for the Director of IT.

Table 18-3 – 2011 BSC for Kris Smith, Director of IT**[Begin Confidential]**

Area	Target	Measure	Result	Weighting	Rating	Score
F						

[End Confidential]

The Director's balanced scorecard places the highest priority on controlling costs, both internal and external. It appears that the next highest priority is completing projects on time and within budget. In 2011 alone, there were 41 projects in progress with the largest two being the implementation of the

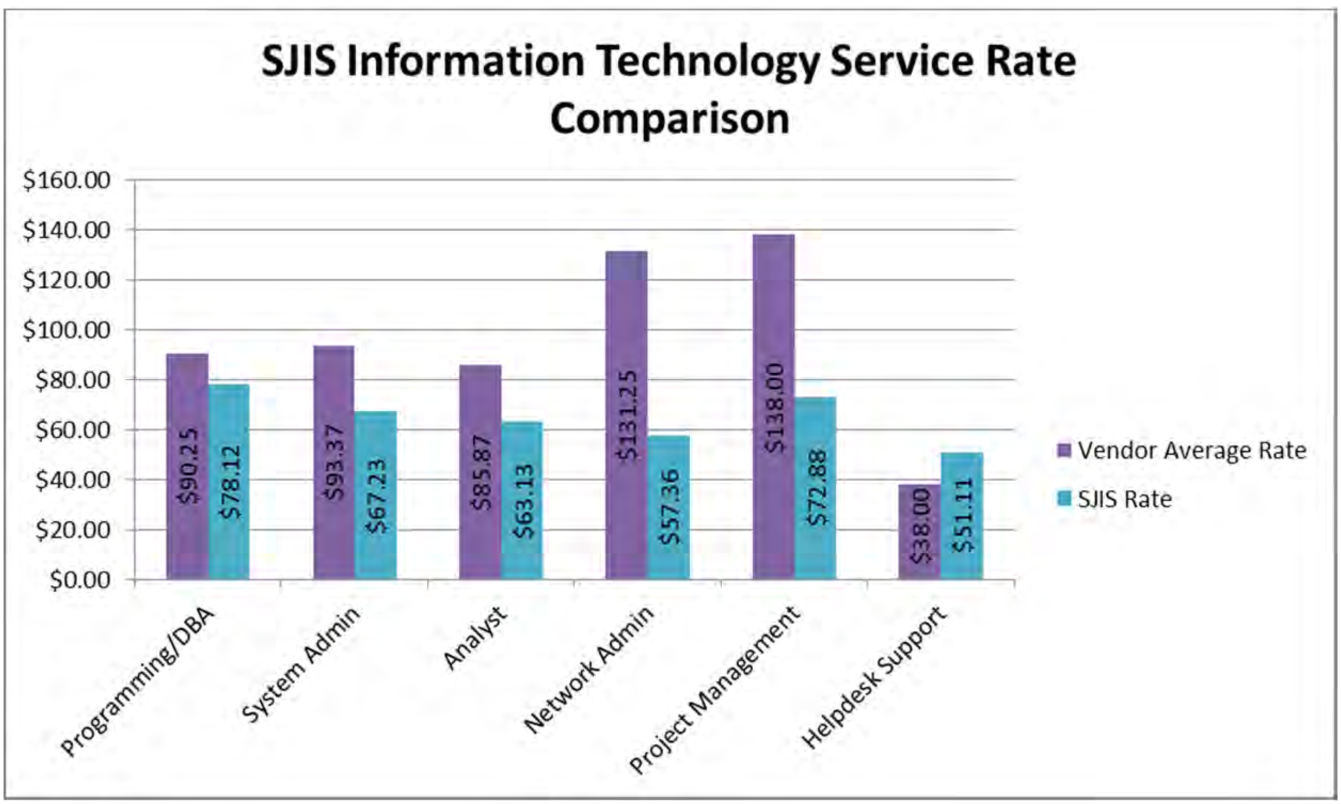
[23] Interview with Kris Smith, Director of IT, January 23, 2013.

new EWAMS and customer service system. Another important item in the balanced scorecard is that all IT staff completed at least 40 hours of training in 2011. This demonstrates that the IT department strives to achieve a high level of competency on the systems used at SJI as well as learn about future technology that could potentially benefit the Company. In the Director of IT's scorecard shown above, there are 10 quality assurance measures that the IT department was to track and improve upon in 2011. Only 6 measures were actually tracked and improved upon in 2011, according to the balanced scorecard. Overland only received documentation regarding two of these measures, response times and downtime, when requesting the metrics tracked by the IT department.[24] Overall, the scorecard provides detailed information about the objectives of the IT department and how well those objectives were achieved by its employees. Overland noted the balanced scorecards in 2009 and 2010 were similarly well-documented.

IT Benchmarking

SJIS's IT department tracks its rate of service against the rates charged by outside vendors for similar services. IT broke its services into six areas and calculated the fully allocated cost per hour of providing these services. The internal fully allocated cost was compared to three or four different vendors and a vendor average was calculated in each service area. The chart below summarizes the results.

Table 18-4 – SJIS Information Technology Service Rate Comparison



[24] Response to Discovery, OC-677.

As shown above, SJIS's service rate is lower than the vendor average in all areas except Helpdesk Support. SJI notes that there are several factors that influence the rate of service including: level of experience and workload.[25]

The SJIS group also uses information from the benchmarking company, Gartner, to compare its IT metrics to utility companies that participate in Gartner's benchmark survey. Below is a table that summarizes the metrics comparing SJIS's IT department to its peers.

Table 18-5 – Information Technology Benchmark Data

South Jersey Information Technology Benchmark Data		
Metric	**Gartner 2012 Utilities Sector**	**SJI 2012 IT**
IT FTR as a % of Total Employees	5.8%	3.3%
Insourced FTEs	80%	49%
Outsourced FTEs	20%	51%
IT Spending as % of Revenue	2.8%	2.1%
$ Spend Per Employee	$ 17,944	$ 24,686
Operational Spending	74%	21%
Capital Spending	26%	79%
Source: Response to Discovery, OC-678.		

The information in the Gartner benchmarking survey focused on employee and spending metrics. SJIS appears to have a lean IT function, showing about half of the employees in its IT department as other utilities in the survey. The reason that SJI can sustain the employee level in IT is evidenced in the next two metrics, percentage of insourced and outsourced FTEs. IT relied on approximately the same number of consultants as employees during 2012 as SJI has moved toward implementing a new customer service system, a new work and asset management system, and various other information system upgrades. The IT department's spending metrics show that the Company is heavily investing in capital projects to upgrade its technology. SJI is outspending its peers on a per employee basis even though its overall spending as a percentage of revenue is below the benchmark in this survey.

[25] Response to Discovery, OC-678.