Agenda Date: 5/19/15
Agenda Item: 1A

# STATE OF NEW JERSEY

**Board of Public Utilities**
**44 South Clinton Avenue, 9th Floor**
**Post Office Box 350**
**Trenton, New Jersey 08625-0350**
**www.nj.gov/bpu/**

AUDITS

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| IN THE MATTER OF AN AUDIT OF THE AFFILIATED TRANSACTIONS BETWEEN SOUTH JERSEY GAS COMPANY AND ITS AFFILIATES AND A COMPREHENSIVE MANAGEMENT AUDIT OF SOUTH JERSEY GAS COMPANY PURSUANT TO N.J.S.A. 48:2-16.4, 48:3-49, 48:3-58 AND N.J.A.C. 14:3-12.1, 14:3-12-4, 14:4-3 ET SEQ. | ) | ORDER OF IMPLEMENTATION<br><br>DOCKET NO. GA11050310 |

**Party of Record:**

**Gina Merritt-Epps Esq., General Counsel/Corporate Secretary,** South Jersey Industries

BY THE BOARD:[1]

At its agenda meeting of June 15, 2011, the New Jersey Board of Public Utilities (the "Board" or "BPU") authorized the staff of the Audits Division ("Staff") to initiate an audit of the affiliated transactions between South Jersey Gas Company ("SJG" or "Company") and its affiliates, and a Management Audit of SJG. The Board also authorized Staff to send a Request for Proposals ("RFP") to the five pre-approved management consulting firms under State Term Contract T2482.

In accordance with the RFP, bid proposals were submitted to the Board's Audits Division by July 15, 2011 from Liberty Consulting Group, NorthStar Consulting Group, Overland Consulting, PMC Management Consultants, and Schumaker and Company. The bid proposals were subsequently forwarded to the Evaluation Committee for review and analysis. The Evaluation Committee consisted of staff members from the Division of Audits (2), the Division of Energy (2), and Counsel's Office (1).

At its November 30, 2011 agenda meeting, the Board approved the Committee recommendation of Overland Consulting ("Overland" or "Consultant") to perform the audits at a not-to-exceed cost of $625,000.

[1] Commissioner Upendra J. Chivukula recused himself due to a potential conflict of interest and as such took no part in the discussion or deliberation of this matter.

This assignment was conducted in two concurrent phases. Phase I concentrated on SJG's compliance with the competitive service statutes which included a review of affiliate transactions, planning, operations, and maintenance practices, procurement and purchasing, affiliate relationships, market conditions, review of previous audit recommendations, and affiliate cost allocation methodologies. Phase II included a comprehensive management audit of SJG's major organizational areas which included an examination of executive management and corporate governance, organizational structure, human resources, strategic planning, finance, cash management, accounting and property records, customer service, external relations, distribution and operations management, clean energy, support services, contractor performance, and remediation costs.

Prior to the publication of the Final Audit Report of Overland Consulting in the audit of the affiliated transactions between SJG, its parent company, South Jersey Industries ("SJI") and its affiliates, and in the management audit of the Company (referred to herein as the "Final Report"), draft versions were provided for review by Staff (including the Divisions of Audits and Energy). A draft version was also provided to SJG for its review and comment on factual discrepancies, and the need for any redactions in the Final Report to protect information claimed to be confidential or business sensitive.

On October 8, 2013, Overland submitted its Final Report. The Final Report contained 91 recommendations.

At the BPU's November 22, 2013 Agenda Meeting, Staff recommended that the Board accept Overland's Final Report for filing purposes only; authorize the release of the redacted version of the report to the public for comment, and release the confidential version of the report to appropriate parties, with the execution of a confidentiality agreement if requested by the Company. These actions were adopted by the Board.

The only other interested party in this matter is the New Jersey Division of Rate Counsel ("Rate Counsel").

On January 24, 2014, SJG filed its comments on the recommendations included in the Final Report ("SJG Response"). The Company responded to the specific recommendations made by Overland and provided further commentary on various statements made within the Final Report. The Company concurred with sixty-six recommendations, and agreed to take action to implement those accepted recommendations. The Company disagreed with eight of the recommendations, and accepted seventeen in concept with clarifications and or minor exceptions.

By letter dated January 24, 2014, Rate Counsel its comments on the recommendations included in the Final Report ("Rate Counsel Comments"). While not specifically provided in its letter, Rate Counsel's comments applied to audit recommendations 2-4, 2-5, 2-6, 2-7, 2-10, 3-1, 3-2, 3-3, and 8-1.

Below is a detailed discussion of the comments filed by the Company and Rate Counsel as they relate to specific Overland recommendations. Additionally, the position of Staff is stated with respect to each of the audit recommendations that the Company did not agree to implement.

Chapter 2 – Affiliate Overview and Analysis

**Recommendation 2-1 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.**

SJG accepts this recommendation.

**Recommendation 2-2 Appliance Services – South Jersey Energy Services Plus (SJESP) - SJESP should add the disclaimers to the front page of its website in accordance with Electric Discount and Energy Competition Act (EDECA) Standards Section 14:4-3.5(k).**

SJG accepts this recommendation.

**Recommendation 2-3 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.**

SJG accepts this recommendation.

**Recommendation 2-4 Cross Subsidization – Millennium Account Services (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.**

The Company respectfully disagrees with this recommendation as to a "termination for convenience", because compensating a contractor for costs incurred due to the Owner (SJG) terminating the contract for its (SJG's) 'convenience' is standard contracting language. Additionally, such costs would be considered part of the normal cost of doing business and be appropriately recorded as an above-the-line recoverable expense.[2]

Rate Counsel supports this recommendation in its comments and refers to it as being significant.[3] Consistent with N.J.A.C. 14:4-4.5 (h) and (g), the Company has the burden of proof to showing that the cost for services purchased from an affiliate is more advantageous than the Company providing the services itself or purchasing the services from another vendor (lower of cost or market). If there are any liquidation damages assessed on SJG under this contract, SJG has the burden of showing that even with liquidation damages, the services purchased meet the cost criteria set forth in N.J.A.C. 14:4-4.5(h). If SJG does not successfully demonstrate this to the Board, then ratepayers will not be at risk for any costs due to the liquidation of MAS. Staff

[2] SJG's Response, Audit recommendations with which the Company respectfully disagrees, dated January 24, 2014, at 2
[3] Rate Counsel's Comments, dated January 24, 2014, at 5

agrees that SJG should not bear any risk relating to a liquidation of MAS. However, Staff agrees with the Company that recovery by a contractor of any direct costs incurred due to SJG terminating the contract for its own convenience is part of the standard contracting language, and should be considered part of the normal cost of doing business.

**Recommendation 2-5 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 [ ] 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.**

SJG accepts this recommendation.

Rate Counsel supports this recommendation and refers to it as significant.[4]

**Recommendation 2-6 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.**

The Company disagrees with this recommendation, claiming that the market based bidding process, which resulted in the current agreement with MAS, fully satisfies EDECA compliance requirements, thus making additional documentation and testimony unnecessary.[5]

Rate Counsel supports Overland's recommendation that SJG file testimony identifying the net savings resulting from billing services provided by MAS. Notwithstanding, such showing still does not satisfy the Affiliate Relations requirement.

Staff agrees with Rate Counsel that the filing of testimony is necessary. Although, the Company provided data in its recently concluded base rate case proceeding supporting the pricing and terms of the current services agreement with MAS and this data demonstrated that the pricing was determined by a competitive bidding process, it must also show that it is lower than the cost

[4] Rate Counsel's Comments at 5

[5] SJG's Response, Audit recommendations with which the Company respectfully disagrees, at 2

of providing the service itself.[6] Staff recommends that this also be provided in its next base rate case.

**Recommendation 2-7 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.**

The Company disagrees with this recommendation because it is premised on the applicability of N.J.A.C. 14:4-3.5(t)(6), which requires that "transfers of services not produced, purchased or developed for sale on the open market" be priced at "the lower of fully allocated cost or fair market value." "Transfers of services" is not defined in the EDECA regulations; however, assuming that the services being provided by Millennium to SJG are a "transfer of services," the Company maintains that the services are in fact "produced, purchased or developed for sale on the open market." This is evidenced by the competitive bidding process that resulted in multiple bids from companies that provide meter reading services to the open market. Thus, SJG disagrees with the applicability of N.J.A.C. 14:4-3.5(t)(6) and the requirement that Millennium's prices be at "the lower of fully allocated cost or fair market value."[7]

Consistent with N.J.A.C. 14:4-4.5 (h) and (g), the Company has the burden to demonstrate that the cost for services purchased are more advantageous than the Company providing the services itself or purchasing the services from another vendor (lower of cost or market).

Rate Counsel's position is that the bidding process might establish the fair market price of meter reading services for SJG, but that meets only one-half of SJG's obligation with respect to MAS's pricing. The Affiliate Relations pricing standards require pricing from an affiliate to SJG to be the lower of market price or cost consistent with N.J.A.C. 14:4-4.5 (h) and (g).[8]

Staff agrees with Rate Counsel, and recommends that testimony be filed in the company's next base rate case.

**Recommendation 2-8 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.**

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[6] In the Matter of the Petition of South Jersey Gas Company for Approval of Increased Base Tariff Rates and Charges for Gas Service and Other Tariff Revisions, Decision and Order Approving Stipulations, GR13111137, Order dated September 30, 2014.
[7] SJG's Response, Audit recommendations with which the Company respectfully disagrees, at 3
[8] Rate Counsel's Comments, at 6

The Company commented that it considers this is a recommendation directed toward the BPU rather than to SJG. To the extent there are any outstanding issues from SJG's 2005 audit or matters that are contested in this current audit, SJG will fully participate in any discussions that are necessary to address those issues or recommendations.[9]

Rate Counsel did not take a position on this specific recommendation.

Staff will meet with the Company to discuss any outstanding issues from the 2005 audit. Staff recommends that the Company be required to file quarterly reports for any outstanding recommendations that have not been implemented within 60 days of the effective date of this order.

**Recommendation 2-9 EDECA Standards - SJESP Plumbing Service - South Jersey Energy Service Plus Plumbing Service should be listed as an RCBS in the SJG Compliance Plan.**

SJG accepts this recommendation.

**Recommendation 2-10 EDECA Standards - Millennium Account Services - Overland recommends that SJG list Millennium Account Services as an RCBS in SJG's Affiliate Standards Compliance Plan.**

The Company disagrees with this recommendation. The Company stated that SJG consistently and previously objected to the interpretation of the applicability of the retail competitive business segment ("RCBS") designation to Millennium, and believes it has a legally defensible position to do so. SJG still believes that Millennium does not comport with the definition of an RCBS. However, done historically, while not conceding the legal argument regarding the definition of an RCBS, SJG will, as a matter of practice, continue to treat Millennium as within the scope of the RCBS requirements.[10]

Rate Counsel commented stated that SJG failed to identify MAS as an RCBS in its most recent Affiliate Standards Compliance Plan. Second, and the most egregious, the transfer prices set for the meter reading services provided by MAS to SJG continue to be contrary to the requirements set forth for RCBSs in the Affiliate Relations Standards, specifically N.J.A.C. 14:4-3.5(0(6), because those prices do not reflect the lower of market or cost-based pricing, as required by the Affiliate Relations standards.[11]

Staff is satisfied that treating MAS as within the scope of the RCBS requirements is sufficient.

**Recommendation 2-11 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).**

[9] SJG's Response, audit recommendations suggested clarifications and or exceptions, dated January 24, 2014, at 2

[10] SJG's Response , audit recommendations with which the Company respectfully disagrees, at 3

[11] Rate Counsel's Comments at 5-6.

The Company commented that currently there are no joint advertising or marketing agreements in place with Millennium Account Services.[12]

## Chapter 3 – South Jersey Industries Cost Distributions

**Recommendation 3-1 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.**

SJG accepts this recommendation.

It is Rate Counsel's position "that it is appropriate to use and equally weighted three-part formula to allocate certain indirect costs among affiliates where there is no actual cost-causative basis for allocating such costs to the affiliates"[13].

**Recommendation 3-2 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."**

SJG accepts this recommendation.

**Recommendation 3-3 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**

[12] SJG's Response, audit recommendations suggested clarifications and or exceptions, at 2.
[13] Rate Counsel's Comments at 8.

**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.**

SJG accepts this recommendation.

Rate Counsel agrees and supports the recommendations concerning SJI cost distributions.[14]

**Chapter 4 – SJI Services and Cost Distributions to SJG**

**Recommendation 4-1 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 South Jersey Industries Services (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.**

SJG accepts this recommendation.

**Recommendation 4-2 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.**

SJG accepts this recommendation.

**Recommendation 4-3 SJI should improve Cost Allocation Manual (CAM) 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**

[14] Ibid.

**"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.**

SJG accepts this recommendation.

## <u>Chapter 6 - Executive Management and Corporate Governance</u>

**Recommendation 6-1 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.**

SJG accepts this recommendation.

**Recommendation 6-2 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.**

The Company disagrees with recommendation because that it incorrectly indicates that Directors Campbell, Hartnett-Devlin and Petrowski have outside relationships that could be viewed as a conflict of interest. Directors Campbell and Hartnett-Devlin serve on another Board which is completely unrelated to SJI. An issue related to Mr. Petrowski's former employer was vetted by the Board and the potential conflict was eliminated. The recommended disclosures could only serve to confuse a shareholder and lead to the inaccurate conclusion that service on the Board by these Directors is improper.[15]

Staff reviewed prior years proxy statements and within the Corporate Governance section of the most current 2014 proxy statement. Under the caption Certain Relationships any SCC required business relationships are disclosed.

Staff agrees with the Company that the recommended disclosures would lead to inaccurate conclusions of improper service on the Board by these Directors.

Rate Counsel did not provide specific comments on this recommendation.

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[15] SJG's Response, audit recommendations with which the Company respectfully disagrees, at 4.

**Recommendation 6-3 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.**

The Company disagrees with the recommendation providing that all directors recuse themselves from discussions or decisions involving matters in which they may have a specific outside interest and/or relationship. To highlight this duty with respect to Directors Campbell, Hartnett-Devlin and Petrowski inaccurately implies that there is a conflict or a greater potential for a conflict with respect to these directors.[16]

Rate Counsel did not provide comments on this recommendation.

Staff agrees that the Company should not have to highlight specific directors as long as all directors recuse themselves from discussions or decisions involving matters in which they may have a specific outside interest and/or relationship.

**Recommendation 6-4 We recommend that the SJI Governance Committee and the entire board consider candidates who possess accounting expertise, especially those with a Certified Public Accountant or with Chief Financial Officer 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.**

SJG accepts this recommendation.

**Recommendation 6-5 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.**

SJG accepts this recommendation.

**Recommendation 6-6 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.**

SJG accepts this recommendation.

[16] Ibid.

**Recommendation 6-7 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.**

SJG accepts this recommendation.

## Chapter 7 – Strategic Planning

**Recommendation 7-1 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.**

SJG accepts this recommendation.

**Recommendation 7-2 Overland recommends that SJI documents and retains 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.**

SJG accepts this recommendation.

**Recommendation 7-3 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).**

SJG accepts this recommendation.

## Chapter 8 – External Relations (Government Relations and Regulatory Affairs)

**Recommendation 8-1 SJG should record its share of corporate donations in below-the-line account 426.1, Donations Expense, instead of account 923, Outside Services Expense.**

SJG accepts this recommendation.

Staff agrees with Overland's recommendation that lobbying costs should be recorded below-the-line and not recoverable from ratepayers.

Rate Counsel "strongly supports Overland's recommendations to require SJG to record all costs associated with lobbying and corporate contributions in a below-the-line account so that such costs are clearly identifiable and excluded from SJG's retail revenue requirements in a rate case."[17]

[17] Rate Counsel's Comments at 9.

**Recommendation 8-2 The "government" component of Government Regulatory Affairs (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.**

The Company disagrees with the recommendation because in the Government & Regulatory Affairs Department is headed by a Director of Government & Regulatory Affairs and that individual is an SJG employee. Because of the significant relationship between the government affairs and regulatory affairs efforts, and inasmuch as regulatory affairs is primarily a utility function, SJG states that it will continue to maintain that function at the SJG level and bill out time to other SJI entities as appropriate.[18]

Staff agrees with the Company that the Director of Government & Regulatory Affairs position is primarily a utility function and should remain as a SJG employee.

Rate Counsel did not provide specific comments on this recommendation.

**Recommendation 8-3 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 Federal Energy Regulatory Commissioner (FERC) account 426.4 – Expenditures for Certain Civic, Political and Related Activities.**

The Company considers this as more of a recommendation to the BPU, than to SJG. To the extent that the BPU should decide to proceed, SJG will fully participate in any discussions that are necessary to address this issue.[19]

Staff agrees with Overland's recommendation as written.

Rate Counsel did not take a position on this specific recommendation.

## Chapter 9 – Finance

**Recommendation 9-1 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.**

SJG accepts this recommendation.

[18] SJG's Response, audit recommendations with which the Company respectfully disagrees, at 4.
[19] SJG's Response, audit recommendations suggested clarifications and or exceptions, at 2-3.

**Recommendation 9-2 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.**

SJG accepts this recommendation.

**Recommendation 9-3 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.**

The Company considers this more of a recommendation to the BPU than to SJG. To the extent that the BPU should decide to proceed, SJG will fully participate in any discussions that are necessary to address this issue.[20]

Staff from the Division of Audits and the Office of the Economist will address this issue during the implementation process.

Rate Counsel did not take a position.

**Recommendation 9-4 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.**

The Company disagrees with recommendation because SJG is a component of SJI and, as such, its dividend actions cannot be determined without some consideration of the consolidated entity. As is evident from dividend actions taken during the period of the audit, SJG's dividend policy is based upon paying its pro-rata share of SJI's dividend, while considering the need to maintain a strong balance sheet at SJG.[21]

Staff agrees with the Company that if SJG is a component of SJI, its dividend actions cannot be determined without some consideration of the consolidated entity. Rate Counsel did not provide specific comments on this recommendation.

## Chapter 9 – Risk Management

**Recommendation 9-1 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.**

SJG accepts this recommendation.

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[20] Id. at 3.
[21] SJG's Response, audit recommendations with which the Company respectfully disagrees at 4-5.

**Recommendation 9-2 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.**

SJG accepts this recommendation.

**Recommendation 9-3 SJI should more extensively use benchmarking data to compare its risk management function metrics to those of its peers.**

SJG accepts this recommendation.

<u>Chapter 10 – Accounting and Property Records</u>

**Recommendation 10-1 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.**

SJG accepts this recommendation.

**Recommendation 10-2 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.**

SJG accepts this recommendation.

**Recommendation 10-3 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.**

SJG accepts this recommendation.

**Recommendation 10-4 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.**

SJG accepts this recommendation.

<u>Chapter 11 – Gas Procurement and Supply – Gas Supply</u>

**Recommendation 11-1 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.**

SJG accepts this recommendation.

**Recommendation 11-2 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.**

SJG accepts this recommendation.

**Recommendation 11-3 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.**

SJG accepts this recommendation.

**Recommendation 11-4 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.**

SJG accepts this recommendation.

**Recommendation 11-5 The Company should annually file its FERC Compliance Manual with the NJ BPU, illustrating any changes from the previous compliance manual.**

SJG accepts this recommendation.

Chapter 11 – Gas Procurement and Supply – Gas Hedging

**Recommendation 11-1 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.**

SJG accepts this recommendation.

**Recommendation 11-2 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.**

The Company agrees to establish written performance expectations for its hedging program, and to review performance against these expectations annually with the SJG Risk Management Committee. This review will provide an evaluation of how successfully the hedging program has performed against the overall objective of commodity price stabilization.[22]

Staff agrees with the Company's position.

Rate Counsel did not provide comments.

[22] SJG's Response, audit recommendations suggested clarifications and or exceptions at 3.

**Recommendation 11-3 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.**

SJG accepts this recommendation.

**Recommendation 11-4 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.**

The Company agrees to evaluate the merits of scaling down its discretionary hedging program, and to utilize alternative hedging strategies, if appropriate, to achieve an adequate level of hedged gas supply. It is expected that the increase in hedging through the non-discretionary hedging program, as agreed to in 11H-1, along with the formalized documentation requirements for the discretionary hedging program agreed to in 11H-3, will support a potential reduction in the amount of gas hedged through the discretionary program.[23]

Staff agrees with the Company's proposal to evaluate reducing its discretionary hedging.

Rate Counsel did not provide comments.

**Recommendation 11-5 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.**

SJG accepts this recommendation.

**Recommendation 11-6 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.**

SJG accepts this recommendation.

## Chapter 12 – Gas Delivery and Operations Management

**Recommendation 12-1 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.**

The Company agrees with the intent of this recommendation. Safety goals to be included in this category will be directly related to adhering to the various compliance programs (e.g. Leak Surveys, Valve & Regulator Checks, etc.). These compliance programs established to help maintain a safe and reliable distribution pipeline system.[24]

Staff agrees with the Company's position.

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[23] Ibid.
[24] Id. at 3-4.

Rate Counsel did not provide comments.

**Recommendation 12-2 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.**

The Company accepts this recommendation, except that low level nonhazardous leaks under new pavement (municipal moratorium) will be rechecked by procedure, but not scheduled for repair until the street opening moratorium is lifted.[25]

Staff believes that the Company's position is reasonable.

Rate Counsel did not provide comments.

**Recommendation 12-3 SJG should integrate industry benchmark statistics into its performance targeting and should set performance targets at a "stretch" (aspirational) level.**

SJG accepts this recommendation.

<u>Chapter 13 – Contractor Performance and Damage Prevention</u>

**Recommendation 13-1 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.**

SJG accepts this recommendation.

**Recommendation 13-2 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.**

The Company accepts this recommendation. However, the period for such analyses should be based upon conditions that may warrant varying cycles of review, such as the timing of labor and contractor agreements.[26]

The Company accepts this recommendation and shall submit the first analysis within twelve months of this order.

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[25] <u>Id.</u> at 4
[26] <u>Ibid.</u>

Staff agrees that any subsequent analysis may be based on conditions that may warrant varying cycles of review, such as the timing of labor and contractor agreements.

Rate Counsel did not provide comments.

**Recommendation 13-3 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 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).**

SJG accepts this recommendation.

**Chapter 14 – Customer Service and Meter Operations**

**Recommendation 14-1 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.**

SJG accepts this recommendation.

**Recommendation 14-2 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.**

SJG accepts this recommendation.

**Recommendation 14-3 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.**

SJG accepts this recommendation.

**Recommendation 14-4 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.**

SJG accepts this recommendation.

**Recommendation 14-5 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.**

SJG accepts this recommendation.

Chapter 15 – Human Resources

Organization and Staffing

**Recommendation 15-1 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.**

The Company accepts this recommendation. However, SJI will obtain benchmark reports every other year since SJI considers this the most cost effective use of resources.[27]

Staff agrees that the Company's proposal adequately addresses this recommendation to update the benchmark reports.

Rate Counsel did not provide comments.

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[27] Ibid.

Workforce Management

**Recommendation 15-1 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.**

SJG accepted this recommendation.

Compensation

**Recommendation 15-1 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.**

The Company agrees with the intent of this recommendation. SJI sets performance goals based upon anticipated business conditions, although what may have been viewed as a stretch goal in the beginning of 2012, turned out differently at the end of 2012.[28]

Staff agrees with the Company's position.

Rate Counsel did not provide comments.

**Recommendation 15-2 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.**

SJG accepts this recommendation.

Training and Development

**Recommendation 15-1 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.**

SJG accepts this recommendation.

**Recommendation 15-2 Overland recommends that mid-year reviews of employee performance be completed in their entirety, and formally documented, and retained electronically.**

SJG accepts this recommendation.

[28] Ibid.(as 15-3)

## Benchmarking

**Recommendation 15-1 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.**

SJG accepts this recommendation.

## Labor Relations

**Recommendation 15-1 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.**

SJG accepts this recommendation.

## Chapter 16 – Remediation Costs

**Recommendation 16-1 The SJI Audit Committee should continue to perform annual reviews of the MGP Site remediation budget until all sites have been sufficiently repaired.**

SJG accepts this recommendation.

## Chapter 17 – Support Services

### Materials Procurement & Management

**Recommendation 17-1 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.**

SJG accepts this recommendation.

**Recommendation 17-2 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.**

SJG accepts this recommendation.

**Recommendation 17-3 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.**

SJG accepts this recommendation.

**Recommendation 17-4 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.**

SJG accepts this recommendation.

**Recommendation 17-5 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]3%[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.**

SJG accepts this recommendation.

## Fleet Management

**Recommendation 17-1 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.**

SJG accepts this recommendation.

**Recommendation 17-2 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.**

SJG accepts this recommendation.

## Facilities Management

**Recommendation 17-1 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.**

SJG accepts this recommendation.

**Recommendation 17-2 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.**

The Company agrees with the intent of this recommendation. SJG facilities costs for the Folsom HQ will be isolated from operating centers. Operating centers will be combined for cost tracking to remain consistent with the most cost efficient approach to facilities service contracts.[29]

Staff agrees with the Company's position.

Rate Counsel did not provide comments.

**Recommendation 17-3 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.**

SJG accepts this recommendation.

**Recommendation 17-4 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.**

SJG accepts this recommendation.

## Legal

**Recommendation 17-1 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.**

The Company agrees with the intent of recommendations 17-1, but noted that Legal Affairs is an integral part of the Office of General Counsel, not a separate or independent function or group. Based on the information provided to staff when asked for clarification of its position, the Company informed staff that SJI will not be establishing a separate cost center for Legal. SJI

[29] Id. at 4-5.

has the ability now to evaluate legal costs through reviews of specific vendors (legal firms) without having to establish a cost center. This extra administrative step will not add value.[30]

Staff agrees with the Company's position.

Rate Counsel did not provide comments.

**Recommendation 17-2 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.**

The Company agrees with the intent of recommendation 17-2.[31] When Staff asked for clarification, the Company informed staff that SJG accepts this recommendation.

**Recommendation 17-3 The Legal Affairs function (or the leader of the function) should have a BSC that is updated and completed on a yearly basis.**

The Company agrees with the intent of recommendation 17-3.[32] When staff asked for clarification of its position, the Company informed staff that SJG accepts this recommendation.

**Recommendation 17-4 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.**

The Company agrees with the intent of recommendation 17-4.[33] When staff asked for clarification of its position, the Company informed staff that SJG accepts this recommendation.

**Recommendation 17-5 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.**

The Company agrees with the intent of recommendation 17-5. However, it noted that Legal Affairs is an integral part of the Office of General Counsel, not a separate or independent function or group.[34] Based upon the information provided to staff when asked for clarification of its position, the Company informed staff that it reviews each case for the use of outside counsel on its own merits. Where an existing relationship exists that provides valuable benefits either through experience or expertise within the issue, it bypasses bidding. Under appropriate circumstances, the Company utilizes competitive bidding for outside counsel.

Staff agrees with the Company's position.

Rate Counsel did not provide comments.

[30] Id. at 5
[31] Id. at 5
[32] Id. at 5.
[33] Id. at 5.
[34] Id. at 5.

**Insurance/Claims**

**Recommendation 17-1 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.**

SJG accepts this recommendation.

**Chapter 18 – Information Technology**

**Recommendation 18-1 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.**

SJG accepts this recommendation

**Recommendation 18-2 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.**

SJG accepts this recommendation.

**DISCUSSION AND FINDINGS**

As noted above, there are ninety-one recommendations in Overland's Final Report for improvement in the management and operations of SJG. As also noted above, with respect to six of the recommendations – 2-4, 2-10, 6-2, 6-3, 8-2 and 9-4 -- Staff agrees with the Company, and does not recommend implementation by the Company at this time. Staff recommends implementation of the remaining 85 recommendations, subject to the specific modifications described above.

After review of the Final Report and the comments of the Company and Rate Counsel, and of the Staff positions, the Board agrees with Staff's recommendations. Therefore, upon careful review of the Final Report recommendations and the comments received, the Board **HEREBY ORDERS** the Company to implement the 85 recommendations, as modified above.

Additionally, the Board **HEREBY DIRECTS** SJG, with the assistance of the Division of Audits, to formulate detailed implementation plans for any of the 85 recommendations, as modified above, within 60 days from the date of this Order. SJG shall implement all recommendations as soon as possible but not later than one year from the date of this Order.

Furthermore, the Board **HEREBY DIRECTS** SJG to file quarterly reports with the Division of Audits, by the fifteenth day of the month following the conclusion of each calendar quarter, regarding the status of all recommendations. The Division of Audits shall monitor, evaluate, and modify, as necessary, the implementation of the recommendations.

The recommendations of the Final Report shall not be dispositive of issues raised in any other proceedings before this Board.

DATED:

May 19, 2015

BOARD OF PUBLIC UTILITIES
BY:

RICHARD S. MROZ
PRESIDENT

JOSEPH L. FIORDALISO
COMMISSIONER

MARY-ANNA HOLDEN
COMMISSIONER

DIANNE SOLOMON
COMMISSIONER

ATTEST:

IRENE KIM ASBURY
SECRETARY

**I HEREBY CERTIFY that the within document is a true copy of the original in the files of the Board of Public Utilities**

In the Matter of An Audit of the Affiliated Transactions between South Jersey Gas Company and its Affiliates and a Comprehensive Management Audit of South Jersey Gas Company Pursuant to N.J.S.A. 48:2-16.4, 48:3-49, 48:3-58 and N.J.A.C. 14:3-12.1, 14:3-12-4, 14:4-3 et seq.
Docket No. GA11050310

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