SOUTH JERSEY INDUSTRIES INC
Form 10-Q
November 09, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark one)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **September 30, 2006**

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________________ to __________________

Commission File Number **1-6364**

SOUTH JERSEY INDUSTRIES, INC.
(Exact name of registrant as specified in its charter)

New Jersey	**22-1901645**
(State of incorporation)	(IRS employer identification no.)

1 South Jersey Plaza, Folsom, NJ 08037
(Address of principal executive offices, including zip code)

(609) 561-9000
(Registrant’s telephone number, including area code)

Common Stock	
($1.25 par value per share)	**New York Stock Exchange**
(Title of each class)	(Name of exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the

Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

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

Large accelerated filer [X]   Accelerated filer [ ] Non-accelerated filer [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

As of November 1, 2006, there were 29,279,288 shares of the registrant’s common stock outstanding.

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements — See Pages 2 through 24

SOUTH JERSEY INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(In Thousands Except for Per Share Data)

	Three Months Ended September 30,	
	2006	2005
Operating Revenues:		
Utility	$ 73,541	$ 89,053
Nonutility	59,520	67,918
Total Operating Revenues	133,061	156,971
Operating Expenses:		
Cost of Sales - Utility	50,840	66,428
Cost of Sales - Nonutility	45,774	56,002
Operations	15,596	15,332
Maintenance	1,454	1,456
Depreciation	6,646	6,052
Energy and Other Taxes	1,783	1,733
Total Operating Expenses	122,093	147,003
Operating Income	10,968	9,968
Other Income and Expense	639	(51)
Interest Charges	(7,462)	(5,326)
Income Before Income Taxes	4,145	4,591
Income Taxes	(1,830)	(2,092)
Equity in Affiliated Companies	196	183
Income from Continuing Operations	2,511	2,682
Loss from Discontinued Operations - Net	(149)	(191)
Net Income	$ 2,362	$ 2,491
Basic Earnings Per Common Share:		
Continuing Operations	$ 0.086	$ 0.095
Discontinued Operations - Net	$ (0.005)	$ (0.007)
Basic Earnings Per Common Share	$ 0.081	$ 0.088

Average Shares of Common Stock Outstanding - Basic		29,225		28,244
Diluted Earnings Per Common Share:				
Continuing Operations	$	0.086	$	0.094
Discontinued Operations - Net	$	(0.005)	$	(0.007)
Diluted Earnings Per Common Share	$	0.081	$	0.087
Average Shares of Common Stock Outstanding - Diluted		29,320		28,459
Dividends Declared per Common Share	$	0.2250	$	0.2125

The accompanying notes are an integral part of the consolidated financial statements.

SOUTH JERSEY INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
(In Thousands Except for Per Share Data)

	Nine Months Ended September 30, 2006		Nine Months Ended September 30, 2005	
Operating Revenues:				
Utility	$	438,168	$	385,980
Nonutility		215,400		253,600
Total Operating Revenues		653,568		639,580
Operating Expenses:				
Cost of Sales - Utility		318,041		262,189
Cost of Sales - Nonutility		175,314		216,258
Operations		48,005		51,661
Maintenance		4,224		4,460
Depreciation		19,384		17,895
Energy and Other Taxes		8,405		9,008
Total Operating Expenses		573,373		561,471
Operating Income		80,195		78,109
Other Income and Expense		1,434		278
Interest Charges		(20,045)		(15,553)
Income Before Income Taxes		61,584		62,834
Income Taxes		(25,684)		(26,297)
Equity in Affiliated Companies		906		593
Income from Continuing Operations		36,806		37,130
Loss from Discontinued Operations - Net		(378)		(517)
Net Income	$	36,428	$	36,613
Basic Earnings Per Common Share:				
Continuing Operations	$	1.263	$	1.326
Discontinued Operations - Net	$	(0.013)	$	(0.018)

Basic Earnings Per Common Share	$	1.250	$	1.308
Average Shares of Common Stock Outstanding - Basic		29,140		27,999
Diluted Earnings Per Common Share:				
Continuing Operations	$	1.260	$	1.315
Discontinued Operations - Net	$	(0.013)	$	(0.018)
Diluted Earnings Per Common Share	$	1.247	$	1.297
Average Shares of Common Stock Outstanding - Diluted		29,215		28,221
Dividends Declared per Common Share	$	0.6750	$	0.6375

The accompanying notes are an integral part of the consolidated financial statements.

SOUTH JERSEY INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
(In Thousands)

	Three Months Ended September 30, 2006	2005
Net Income	$ 2,362	$ 2,491
Other Comprehensive Income (Loss), Net of Tax:		
Change in Fair Value of Investments	109	100
Change in Fair Value of Derivatives - Other	(1,780)	892
Change in Fair Value of Derivatives - Energy Related	12,769	(8,503)
Other Comprehensive Income (Loss) - Net of Tax	11,098	(7,511)
Comprehensive Income (Loss)	$ 13,460	$ (5,020)

	Nine Months Ended September 30, 2006	2005
Net Income	$ 36,428	$ 36,613
Other Comprehensive Income (Loss), Net of Tax:		
Change in Fair Value of Investments	199	178
Change in Fair Value of Derivatives - Other	323	7
Change in Fair Value of Derivatives - Energy Related	16,435	(13,084)
Other Comprehensive Income (Loss) - Net of Tax	16,957	(12,899)

Comprehensive Income	$	53,385	$	23,714

The accompanying notes are an integral part of the consolidated financial statements.

SOUTH JERSEY INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In Thousands)

	Nine Months Ended September 30, 2006	2005
Cash Flows from Operating Activities:		
Income from Continuing Operations	$ 36,806	$ 37,130
Adjustments to Reconcile Income from Continuing Operations to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	20,811	20,166
Unrealized (Gain) Loss on Derivatives - Energy Related	(3,093)	1,361
Provision for Losses on Accounts Receivable	468	1,670
Stock-Based Compensation Charge	702	1,135
Revenues and Fuel Costs Deferred - Net	12,254	(8,003)
Deferred and Noncurrent Income Taxes and Credits - Net	2,683	19,282
Environmental Remediation Costs - Net	(5,485)	(2,116)
Gas Plant Cost of Removal	(1,096)	(679)
Changes in:		
Accounts Receivable	103,454	58,320
Inventories	(31,650)	(42,508)
Other Prepayments and Current Assets	(855)	(1,417)
Prepaid and Accrued Taxes - Net	(13,490)	(12,413)
Accounts Payable and Other Accrued Liabilities	(99,744)	16,437
Other Assets	(8,207)	7,280
Other Liabilities	10,691	2,504
Discontinued Operations	470	(487)
Net Cash Provided by Operating Activities	24,719	97,662
Cash Flows from Investing Activities:		
Net (Purchase of) Proceeds from Sale of Restricted Investments	(22,797)	3,993
Capital Expenditures	(58,377)	(69,624)
Other	(650)	635
Net Cash Used in Investing Activities	(81,824)	(64,996)
Cash Flows from Financing Activities:		
Net Borrowings From (Repayments of) Lines of Credit	28,300	(20,800)
Proceeds from Issuance of Long-Term Debt	41,400	10,000
Principal Repayments of Long-Term Debt	(2,405)	(22,810)

Dividends on Common Stock		(13,116)		(11,872)
Proceeds from Sale of Common Stock		4,271		16,368
Payments for Issuance of Long-Term Debt		(1,270)		(289)
Premium for Early Retirement of Long-Term Debt		-		(184)
Redemption of Preferred Stock		-		(1,690)
Net Cash Provided by (Used in) Financing Activities		57,180		(31,277)
Net Increase in Cash and Cash Equivalents		75		1,389
Cash and Cash Equivalents at Beginning of Period		4,884		5,272
Cash and Cash Equivalents at End of Period	$	4,959	$	6,661
Supplemental Disclosures of Non-Cash Investing Activities:				
Capital Expenditures unpaid as of September 30.	$	5,134	$	8,015
Proceeds from sale of Investment in Affiliate not yet received.	$	1,450	$	-

The accompanying notes are an integral part of the consolidated financial statements.

SOUTH JERSEY INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(In Thousands)

	(Unaudited) September 30, 2006	December 31, 2005
Assets		
Property, Plant and Equipment:		
Utility Plant, at original cost	$ 1,067,676	$ 1,030,028
Accumulated Depreciation	(253,021)	(241,242)
Nonutility Property and Equipment, at cost	104,999	94,623
Accumulated Depreciation	(7,721)	(6,061)
Property, Plant and Equipment - Net	911,933	877,348
Investments:		
Available-for-Sale Securities	6,030	5,642
Restricted	31,031	8,234
Investment in Affiliates	1,694	2,094
Total Investments	38,755	15,970
Current Assets:		
Cash and Cash Equivalents	4,959	4,884
Accounts Receivable	81,925	138,139
Unbilled Revenues	12,290	59,066
Provision for Uncollectibles	(5,353)	(5,871)
Natural Gas in Storage, average cost	150,973	117,542
Materials and Supplies, average cost	2,976	4,758
Deferred Income Taxes - Net	-	624
Prepaid Taxes	22,355	13,061
Derivatives - Energy Related Assets	39,278	24,408
Other Prepayments and Current Assets	6,279	5,415
Total Current Assets	315,682	362,026
Regulatory and Other Noncurrent Assets:		
Regulatory Assets	142,425	122,486
Prepaid Pension	28,341	30,075
Derivatives - Energy Related Assets	30,035	5,080
Derivatives - Other	527	-
Unamortized Debt Issuance Costs	8,028	7,147
Contract Receivables	13,408	14,766
Other	6,951	6,814

Total Regulatory and Other Noncurrent Assets		229,715		186,368
Total Assets	$	1,496,085	$	1,441,712

The accompanying notes are an integral part of the consolidated financial statements.

SOUTH JERSEY INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(In Thousands)

	(Unaudited) September 30, 2006	December 31, 2005
Capitalization and Liabilities		
Common Equity:		
Common Stock	$ 36,551	$ 36,228
Premium on Common Stock	236,834	231,861
Accumulated Other Comprehensive Income (Loss)	8,156	(8,801)
Retained Earnings	151,089	134,357
Total Common Equity	432,630	393,645
Long-Term Debt	358,078	319,066
Total Capitalization	790,708	712,711
Minority Interest	483	394
Current Liabilities:		
Notes Payable	175,600	147,300
Current Maturities of Long-Term Debt	2,347	2,364
Accounts Payable	52,294	179,023
Customer Deposits and Credit Balances	38,119	12,534
Environmental Remediation Costs	19,153	18,165
Taxes Accrued	3,575	7,456
Derivatives - Energy Related Liabilities	45,094	21,957
Deferred Income Taxes - Net	14,153	-
Deferred Contract Revenues	5,420	5,077
Dividends Payable	6,579	-
Interest Accrued	4,922	6,258
Other Current Liabilities	3,399	6,078
Total Current Liabilities	370,655	406,212
Deferred Credits and Other Noncurrent Liabilities:		
Deferred Income Taxes - Net	171,885	169,423
Investment Tax Credits	2,551	2,795
Pension and Other Postretirement Benefits	18,613	18,941

Asset Retirement Obligations	23,676	22,588
Environmental Remediation Costs	42,985	42,489
Derivatives - Energy Related Liabilities	12,086	4,895
Derivatives - Other	507	491
Regulatory Liabilities	55,230	54,002
Other	6,706	6,771
Total Deferred Credits and Other Noncurrent Liabilities	334,239	322,395
Commitments and Contingencies (Note 11)		
Total Capitalization and Liabilities	$ 1,496,085	$ 1,441,712

The accompanying notes are an integral part of the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Consolidation — The consolidated financial statements include the accounts of South Jersey Industries, Inc. (SJI), its wholly owned subsidiaries and subsidiaries in which we have a controlling interest. We eliminate all significant intercompany accounts and transactions. In our opinion, the consolidated financial statements reflect all normal and recurring adjustments needed to fairly present SJI's financial position and operating results at the dates and for the periods presented. Our businesses are subject to seasonal fluctuations and, accordingly, this interim financial information should not be the basis for estimating the full year's operating results. These financial statements should be read in conjunction with SJI's 2005 Form 10-K, annual report.

Equity Investments — Marketable equity securities that are purchased as long-term investments are classified as Available-for-Sale Securities and carried at their fair value on our consolidated balance sheets. Any unrealized gains or losses are included in Accumulated Other Comprehensive Income (Loss). SJI, through a wholly owned subsidiary, currently holds a 50% non-controlling interest in one affiliated company and accounts for the investment under the equity method. We include the operations of this affiliated company on a pre-tax basis in the statements of consolidated income under Equity in Affiliated Companies.

Estimates and Assumptions — We prepare our consolidated financial statements to conform with accounting principles generally accepted in the United States of America (GAAP). Management makes estimates and assumptions that affect the amounts reported in the consolidated financial statements and related disclosures. Therefore, actual results could differ from those estimates. Significant estimates include amounts related to regulatory accounting, energy derivatives, environmental remediation costs, pension and other postretirement benefit costs, and revenue recognition.

Regulation — South Jersey Gas Company (SJG) is subject to the rules and regulations of the New Jersey Board of Public Utilities (BPU). SJG maintains its accounts according to the BPU's prescribed Uniform System of Accounts. SJG follows the accounting for regulated enterprises prescribed by the Financial Accounting Standards Board (FASB) Statement No. 71, "Accounting for the Effects of Certain Types of Regulation." In general, Statement No. 71 allows deferral of certain costs and creation of certain obligations when it is probable that these items will be recovered from or refunded to customers in future periods.

Revenues — Gas and electric revenues are recognized in the period the commodity is delivered to customers. For SJG and South Jersey Energy Company (SJE) retail customers that are not billed at the end of the month, we record an estimate to recognize unbilled revenues for gas and electricity delivered from the date of the last meter reading to the end of the month. South Jersey Resources Group, LLC's (SJRG) gas revenues are recognized in the period the commodity is delivered. We recognize revenues related to South Jersey Energy Service Plus, LLC (SJESP) appliance service contracts seasonally over the full 12-month terms of the contracts. Revenue related to services provided on a time and materials basis is recognized on a monthly basis as the jobs are completed. Marina Energy, LLC (Marina) recognizes revenue on a monthly basis as services are provided and for on-site energy production that is delivered to its customers.

The BPU allows SJG to recover all prudently incurred gas costs through the Basic Gas Supply Service clause (BGSS). SJG collects these costs on a forecasted basis pursuant to BPU order. SJG defers over/under-recoveries of gas costs and includes them in the following year's BGSS filing. SJG pays interest on the net overcollected BGSS balances at the rate of return on rate base utilized by the BPU to set rates in its last base rate proceeding.

SJG's tariff also includes a Temperature Adjustment Clause (TAC) and a Societal Benefits Clause (SBC). Within the SBC are a Remediation Adjustment Clause (RAC), a New Jersey Clean Energy Program (NJCEP), a Universal Service Fund (USF) program, and a Consumer Education Program (CEP), which was terminated in April 2006. The TAC provides stability to SJG’s earnings and its customers’ bills by normalizing the impact of extreme winter temperatures (See Note 12 - Subsequent Events). The RAC recovers environmental remediation costs of former gas manufacturing plants and the NJCEP recovers costs associated with our energy efficiency and renewable energy programs. The USF is a statewide customer assistance program that utilizes utilities as a collection agent. The CEP recovered costs associated with providing education to the public concerning customer choice. TAC adjustments affect revenue, earnings and cash flows since colder-than-normal weather can generate credits to customers, while warmer-than-normal weather can result in additional billings. RAC adjustments affect revenue and cash flows but do not directly affect earnings because SJG defers and recovers related costs through rates over 7-year amortization periods. NJCEP, CEP and USF adjustments also affect revenue and cash flows but do not directly affect earnings, as related costs are deferred and customer credits are recovered through rates on an ongoing basis.

Accounts Receivable and Provision for Uncollectible Accounts — Accounts receivable are carried at the amount owed by customers. A provision for uncollectible accounts is established based on our collection experience and an assessment of the collectibility of specific accounts.

Property, Plant and Equipment — For regulatory purposes, utility plant is stated at original cost, which may be different than SJG’s cost if the assets were acquired from another regulated entity. Nonutility plant is stated at cost. The cost of adding, replacing and renewing property is charged to the appropriate plant account.

Depreciation — SJG depreciates utility plant on a straight-line basis over the estimated remaining lives of the various property classes. These estimates are periodically reviewed and adjusted as required after BPU approval. The composite annual rate for all depreciable utility property was approximately 2.4% in 2005 and 2.3% for the first nine months of 2006. Except for retirements outside of the normal course of business, accumulated depreciation is charged with the cost of depreciable utility property retired, less salvage. Nonutility property depreciation is computed on a straight-line basis over the estimated useful lives of the property, ranging up to 50 years. Gain or loss on the disposition of nonutility property is recognized in net income.

Capitalized Interest — SJG capitalizes interest on construction at the rate of return on rate base utilized by the BPU to set rates in its last base rate proceeding. Marina capitalizes interest on construction projects in progress based on the actual cost of borrowed funds. SJG’s amounts are included in Utility Plant and Marina’s amounts are included in Nonutility Property and Equipment on the consolidated balance sheets. Interest Charges are presented net of capitalized interest on the consolidated statements of income. SJI capitalized interest of $0.2 million and $0.4 million for the three months ended September 30, 2006 and 2005, respectively. For the nine months ended September 30, 2006 and 2005, SJI capitalized interest of $1.0 million in each period.

Impairment of Long-Lived Assets — We review the carrying amount of long-lived assets for possible impairment whenever events or changes in circumstances indicate that such amounts may not be recoverable. For the nine months ended September 30, 2006 and the year ended December 31, 2005, no significant impairments were identified.

Derivative Instruments — Certain SJI subsidiaries are involved in buying, selling, transporting and storing natural gas and buying and selling retail electricity for their own accounts as well as managing these activities for other third parties. These subsidiaries are subject to market risk due to commodity price fluctuations. To manage this risk, our companies enter into a variety of physical and financial transactions including forward contracts, swap agreements, options contracts and futures contracts.

SJI structured its subsidiaries so that SJG and SJE transact commodities on a physical basis and typically do not directly enter into positions that financially settle. SJRG performs this risk management function for these entities and enters into the types of financial transactions noted above. As part of its gas purchasing strategy, SJG uses financial contracts, through SJRG to hedge against forward price risk. The costs or benefits of these contracts are included in SJG's BGSS, subject to BPU approval. As of September 30, 2006 and December 31, 2005, SJG had $14.0 million and $(0.5) million of costs (benefits), respectively, included in its BGSS related to open financial contracts (See Regulatory Assets & Liabilities).

Management takes an active role in the risk management process and has developed policies and procedures that require specific administrative and business functions to assist in identifying, assessing and controlling various risks. Management reviews any open positions in accordance with strict policies to limit exposure to market risk.

SJI accounts for derivative instruments in accordance with FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended. We record all derivatives, whether designated in hedging relationships or not, on the consolidated balance sheets at fair value unless the derivative contracts qualify for the normal purchase and sale exemption. In general, if the derivative is designated as a fair value hedge, we recognize the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk in earnings. We currently have no fair value hedges. If the derivative is designated as a cash flow hedge, we record the effective portion of the hedge in Other Comprehensive Income (Loss) and recognize it in the income statement when the hedged item affects earnings. We recognize ineffective portions of cash flow hedges immediately in earnings. Due to the application of regulatory accounting principles under FASB Statement No. 71, derivatives related to SJG's gas purchases are recorded through the BGSS. For the three and nine months ended September 30, 2006, and 2005, the ineffective portions of the derivatives designated as cash flow hedges were not material. We formally document all relationships between hedging instruments and hedged items, as well as our risk management objectives, strategies for undertaking various hedge transactions and our methods for assessing and testing correlation and hedge ineffectiveness. All hedging instruments are linked to the hedged asset, liability, firm commitment or forecasted transaction.

We also assess whether these derivatives are highly effective in offsetting changes in cash flows or fair values of the hedged items. We discontinue hedge accounting prospectively if we decide: to discontinue the hedging relationship; determine that the anticipated transaction is no longer likely to occur; or, if we determine that a derivative is no longer highly effective as a hedge. In the event that hedge accounting is discontinued, we will continue to carry the derivative on the balance sheet at its current fair value and recognize subsequent changes in fair value in current period earnings. Unrealized gains and losses on the discontinued hedges that were previously included in Accumulated Other Comprehensive Income (Loss) will be reclassified into earnings when the forecasted transaction occurs, or when it is not probable that it will occur. During the nine months ended September 30, 2005, $1.3 million of unrealized gain on derivatives previously designated as cash flow hedges, was reclassified into Operating Revenues - Nonutility because we determined that the anticipated hedged transaction was no longer likely to occur. SJI has elected to designate certain energy-related derivative instruments as cash flow hedges, which protect against the price variability of our forecasted sales and purchases of natural gas. Based on the amount recorded in Accumulated Other Comprehensive Income (Loss) at September 30, 2006, we expect $4.4 million to be recorded as an increase in revenues in the next twelve months. As of September 30, 2006, hedges for future forecasted transactions exist into 2008.

SJRG manages its portfolio of purchases and sales, as well as natural gas in storage, using a variety of instruments that include forward contracts, swap agreements, options contracts and futures contracts. SJI measures the fair value of the contracts and records these as Derivatives — Energy Related Assets or Derivatives — Energy Related Liabilities on our consolidated balance sheets. For those derivatives not designated as hedges, we recorded the net unrealized pre-tax loss of $(0.7) million, and $(3.5) million in earnings during the three months ended September 30, 2006 and 2005, respectively, which are included with realized gains and losses in Operating Revenues — Nonutility. For the nine months ended September 30, 2006 and 2005, we recorded the net unrealized pre-tax gain of $3.1 million and a net unrealized pre-tax loss of $(1.4) million, respectively, which are included with realized gains and losses in Operating Revenues — Nonutility.

SJI presents revenues and expenses related to its energy trading activities on a net basis in Operating Revenues — Nonutility in our consolidated statements of income consistent with Emerging Issues Task Force (EITF) Issue No. 02-03, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in

Energy Trading and Risk Management Activities." The above presentation has no effect on operating income or net income.

From time to time we enter into interest rate derivatives and similar agreements to hedge exposure to increasing interest rates, and the impact of those rates on our cash flows, with respect to our variable-rate debt. We have designated and account for these interest rate derivatives as cash flow hedges. As of September 30, 2006, SJI's active interest rate swaps were as follows:

Amount	Fixed Interest Rate	Start Date	Maturity	Type	Obligor
$ 6,000,000*	4.550%	11/19/2001	12/01/2007	Taxable	Marina
$ 3,900,000	4.795%	12/01/2004	12/01/2014	Taxable	Marina
$ 8,000,000	4.775%	11/12/2004	11/12/2014	Taxable	Marina
$ 20,000,000	4.080%	11/19/2001	12/01/2011	Tax-exempt	Marina
$ 14,500,000	3.905%	03/17/2006	01/15/2026	Tax-exempt	Marina
$ 500,000	3.905%	03/17/2006	01/15/2026	Tax-exempt	Marina
$ 330,000	3.905%	03/17/2006	01/15/2026	Tax-exempt	Marina
$ 12,500,000**	3.430%	12/01/2006	02/01/2036	Tax-exempt	SJG
$ 12,500,000**	3.430%	12/01/2006	02/01/2036	Tax-exempt	SJG
$ 7,100,000	4.895%	02/01/2006	02/01/2016	Taxable	Marina

* Amount reduced to $6.0 million on 12/01/05, and further reduces to $3.0 million on 12/01/06

** SJG entered into these forward-starting swaps in anticipation of the issuance of $25.0 million of auction-rate bonds that were issued in April 2006.

The differential to be paid or received as a result of these swap agreements is accrued as interest rates change and is recognized as an adjustment to interest expense. As of September 30, 2006, the net market values of these swaps were not significant. As of December 31, 2005, the market values of these swaps were $(0.5) million which represent the amounts we would have had to pay to the counterparties if the contracts had been terminated on that date. We include this balance on the consolidated balance sheets under Derivatives — Other as of December 31, 2005. As of September 30, 2006 and 2005, we determined that the swaps were highly effective; therefore, we recorded the changes in fair value of the swaps, net of taxes, in Accumulated Other Comprehensive Income (Loss).

We determined the fair value of derivative instruments by reference to quoted market prices of listed contracts, published quotations or quotations from unrelated third parties.

Stock-Based Compensation Plans —Under the Amended and Restated 1997 Stock-Based Compensation Plan that was amended and restated by our Board of Directors and approved by our shareholders in April 2005, no more than 1,000,000 shares in the aggregate may be issued to SJI's officers, non-employee directors and other key employees. The plan will terminate on January 26, 2015, unless terminated earlier by the Board of Directors. No options were granted or outstanding during the nine months ended September 30, 2006, and 2005. No stock appreciation rights have been issued under the plan. In the first nine months of 2006, and 2005, we granted 42,983 and 38,316 restricted shares, respectively. Restricted shares vest over a 3-year period and are subject to SJI achieving certain performance targets as compared to a peer group average. The actual amount of shares that are ultimately awarded is dependent upon the final peer group average and may range from between 0% to 150% of the original share units granted.

On January 1, 2006, SJI adopted FASB Statement No. 123(R), “Share-Based Payment”, which revised FASB Statement No. 123, and superseded Accounting Principles Board (APB) Opinion No. 25, “Accounting for Stock Issued to Employees”. Statement No. 123(R) requires SJI to measure and recognize stock-based compensation expense in its financial statements based on the fair value at the date of grant for its share-based awards, which currently include restricted stock awards containing market and service conditions. In accordance with Statement No. 123(R), SJI is recognizing compensation expense over the requisite service period for: (i) awards granted on, or after, January 1, 2006 and (ii) unvested awards previously granted and outstanding as of January 1, 2006. In addition, SJI is estimating forfeitures over the requisite service period when recognizing compensation expense. These estimates can be adjusted to the extent to which actual forfeitures differ, or are expected to materially differ, from such estimates.

As permitted by Statement No. 123(R), SJI chose the modified prospective method of adoption; accordingly, financial results for the prior period presented were not retroactively adjusted to reflect the effects of this Statement. Under the modified prospective application, this Statement applies to new awards and to awards modified, repurchased, or cancelled after the required effective date. Compensation costs for the portion of awards for which the requisite service has not been rendered that are outstanding as of the required effective date shall be recognized as the requisite service is rendered based on the grant-date fair value.

The Company measures compensation expense related to restricted stock awards based on the fair value of the awards at their date of grant. Compensation expense is recognized on a straight-line basis over the requisite three-year service period for awards that ultimately vest, and is not adjusted based on the actual achievement of performance goals. The Company estimated the fair value of officers' restricted stock awards on the date of grant using a Monte Carlo simulation model.

The following table summarizes the nonvested restricted stock awards outstanding at September 30, 2006 and the assumptions used to estimate the fair value of the awards (adjusted for the June 2005 two-for-one stock split):

	Grant Date	Shares Outstanding	Fair Value Per Share	Expected Volatility	Risk-Free Interest Rate
Officers -	Jan. 2004	42,135	$20.105	16.4%	2.4%
	Jan. 2005	35,221	$25.155	15.5%	3.4%
	Jan. 2006	39,076	$27.950	16.9%	4.5%
Directors -	Dec. 2003	4,560	$19.738	-	-
	Dec. 2004	5,220	$24.955	-	-
	Dec. 2005	6,340	$29.970	-	-

Expected volatility is based on the actual daily volatility of SJI's share price over the preceding 3-year period as of the valuation date. The risk-free interest rate is based on the zero-coupon U.S. Treasury Bond, with a term equal to the three-year term of the Officers' restricted shares. As notional dividend equivalents are credited to the holders, which are reinvested during the three-year service period, no reduction to the fair value of the award is required. As the Directors' restricted stock awards contain no performance conditions and notional dividend equivalents are credited to the holder, which are reinvested during the three-year service period, the fair value of these awards are equal to the market value of shares on the date of grant.

The following table summarizes the total compensation cost for the nine months ended September 30, 2006 and 2005 (in thousands):

	2006	2005
Officers	$ 689	$ 1,427
Directors	99	75
Total Cost	$ 788	$ 1,502
Capitalized	(86)	(367)
Net Expense	$ 702	$ 1,135

As of September 30, 2006, there was $1.3 million of total unrecognized compensation cost related to nonvested share-based compensation awards granted under the restricted stock plans. That cost is expected to be recognized over a weighted average period of 1.3 years.

Prior to the adoption of Statement No. 123 (R), SJI applied Statement No. 123, as amended, which permitted the application of APB No. 25. In accordance with APB No. 25, SJI recorded compensation expense over the requisite service period for restricted stock based on the probable number of shares expected to be issued and the market value of the Company’s common stock at the end of each reporting period. As a result of SJI’s previous accounting treatment, there have been no excess tax benefits recognized since the inception of the Plans.

The change in stock-based compensation expense for the nine months ended September 30, 2006 resulting from the adoption of Statement No. 123(R) was not significant.

The following table summarizes information regarding restricted stock award activity during the nine months ended September 30, 2006:

	Officers *	Directors *
Nonvested Shares Outstanding, January 1, 2006	143,734	16,120
Granted	42,983	-
Vested**	(61,620)	-
Cancelled/Forfeited	(8,665)	-
Nonvested Shares Outstanding, September 30, 2006	116,432	16,120

* Excludes accrued dividend equivalents.
** Actual shares awarded upon vesting, including dividend equivalents and adjustments for performance measures, totaled 101,009 shares.

During the nine months ended September 30, 2006 and 2005, SJI awarded 101,009 shares at a market value of $2.9 million and 74,574 shares at a market value of $2.0 million, respectively. The Company has a policy of issuing new shares to satisfy its obligations under these plans (See Note 3); therefore, there are no cash payment requirements resulting from the normal operation of this plan. However, a change in control could result in such shares becoming nonforefeitable or immediately payable in cash.

Regulatory Assets & Liabilities — Regulatory Assets at September 30, 2006 and December 31, 2005, consisted of the following items (in thousands):

	Years Remaining as of September 30, 2006	September 30, 2006	December 31, 2005
Environmental Remediation Costs:			
Expended — Net	Various	$ 14,833	$ 9,350
Liability for Future Expenditures	Not Applicable	58,216	56,717
Income Taxes — Flowthrough Depreciation	5	4,930	5,663
Deferred Fuel Costs — Net	Various	23,445	21,237
Deferred Asset Retirement Obligation Costs	Not Applicable	20,743	19,986
Deferred Postretirement Benefit Costs	6	2,362	2,646
Societal Benefit Costs	Various	5,682	2,691
Temperature Adjustment Clause Receivable	Various	9,269	1,003
Premium for Early Retirement of Debt	Various	1,573	1,694
Other	Not Applicable	1,372	1,499

Total Regulatory Assets	$ 142,425	$ 122,486

All significant regulatory assets are separately identified above and are or will be recovered through utility rate charges. SJG is currently permitted to recover interest on its Environmental Remediation Costs and Societal Benefit Costs while the other assets are being recovered without a return on investment over the period indicated. Some of the assets included in the above caption "Other" are currently being recovered from ratepayers as approved by the BPU. Management believes the remaining deferred costs are probable of recovery from ratepayers through future utility rates.

Over/under collections of gas costs are monitored through SJG's BGSS mechanism. Net undercollected gas costs are classified as a Regulatory Asset and net overcollected gas costs are classified as a Regulatory Liability. Derivative contracts used to hedge our natural gas purchases are included in the BGSS, subject to BPU approval. The offset to the change in fair value of these contracts is recorded as a component of the regulatory asset, Deferred Fuel Costs - Net, if we are in a net undercollected position, or as a component of the regulatory liability, Deferred Gas Revenues - Net, if we are in a net overcollected position. As of September 30, 2006, costs related to derivative contracts increased Deferred Fuel Costs - Net by $14.0 million. As of December 31, 2005, benefits related to derivative contracts reduced Deferred Fuel Costs - Net by $0.5 million.

Regulatory Liabilities at September 30, 2006 and December 31, 2005 consisted of the following items (in thousands):

	September 30, 2006	December 31, 2005
Excess Plant Removal Costs	$ 48,286	$ 48,071
Overcollected State Taxes	4,151	4,025
Other	2,793	1,906
Total Regulatory Liabilities	$ 55,230	$ 54,002

Excess Plant Removal Costs represent amounts accrued in excess of actual utility plant removal costs incurred to date, which SJG has an obligation to either expend or return to ratepayers in future periods. The Overcollected State Taxes will be credited to the BGSS clause and returned to customers as a condition of a recent settlement (See Note 12-Subsequent Events). All other regulatory liabilities are subject to being returned to ratepayers in future rate proceedings.

Cash and Cash Equivalents — For purposes of reporting cash flows, highly liquid investments with original maturities of three months or less are considered cash equivalents.

New Accounting Pronouncements — In July 2006, the FASB issued Interpretation No. 48 “Uncertainty in Income Taxes” (FIN 48). This Interpretation provides guidance on the recognition and measurement of uncertain tax positions in the financial statements. The effective date of FIN 48 is January 1, 2007. Management is currently evaluating the impact that the adoption of this interpretation will have on the Company’s consolidated financial statements.

In September 2006, the FASB issued its Staff Position (FSP) on “Accounting for Planned Major Maintenance Activities”. This FSP prohibits the use of the accrue-in-advance method of accounting for planned major maintenance activities in annual and interim financial reporting periods. This FSP is effective the first fiscal year beginning after December 15, 2006. Management does not anticipate that this FSP will have a material affect on the Company’s consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, “Fair Value Measurements”, which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. This statement is effective in fiscal years beginning after November 15, 2007. Management is currently evaluating the impact that the adoption of this statement will have on the Company’s consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans”. The new statement requires a calendar year-end company with publicly traded equity securities that sponsors a postretirement benefit plan to fully recognize, as an asset or liability, the overfunded or underfunded status of its benefit plans in its 2006 year-end balance sheet and recognize changes in the funded status in the year in which the changes occur (reported in Other Comprehensive Income (Loss)). The new standard will also require a company to measure its plan assets and benefit obligations as of its year-end balance sheet date, effective for fiscal years ending after December 15, 2008. Management is currently evaluating the impact that the adoption of this statement will have on the Company’s consolidated financial statements; however, this statement does not have an impact on the computation of benefit expense recognized in the income statement.

Reclassifications — Certain amounts from prior years have been reclassified to conform to the current year presentation. In addition $6.3 million of declared dividends were removed from Dividends on Common Stock within financing activities, with an offsetting decrease in Changes in Accounts Payable and Other Accrued Liabilities within operating activities in the Statement of Cash Flows for the nine months ended September 30, 2005. These amounts did not impact previously reported revenue, net income or earnings per share and are considered immaterial to the overall presentation of our consolidated financial statements.

2. DISCONTINUED OPERATIONS, AFFILIATIONS AND CONTROLLING INTERESTS:

Discontinued Operations— In 1996, Energy & Minerals, Inc. (EMI), an SJI subsidiary, sold the common stock of The Morie Company, Inc. (Morie), its sand mining and processing subsidiary. SJI conducts tests annually to estimate the environmental remediation costs for properties owned by South Jersey Fuel, Inc. (SJF), an EMI subsidiary, from its previously operated fuel oil business. SJI reports the environmental remediation activity related to these properties as discontinued operations.

Summarized operating results of the discontinued operations for the three and nine months ended September 30, were (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Loss before Income Taxes:				
Sand Mining	$ (218)	$ (237)	$ (447)	$ (708)
Fuel Oil	(11)	(58)	(134)	(88)
Income Tax Benefits	80	104	203	279
Loss from Discontinued Operations — Net	$ (149)	$ (191)	$ (378)	$ (517)
Earnings Per Common Share from Discontinued Operations — Net:				
Basic and Diluted	$ (0.005)	$ (0.007)	$ (0.013)	$ (0.018)

Affiliations — SJI and Conectiv Solutions, LLC formed Millennium Account Services, LLC to provide meter reading services in southern New Jersey. SJE and GZA GeoEnvironmental, Inc. (GZA) formed AirLogics, LLC (AirLogics) to market a jointly developed air monitoring system designed to assist companies involved in environmental cleanup activities. On June 30, 2006, SJE sold its entire interest in AirLogics for $1.5 million, resulting in an after-tax gain of $0.2 million. We account for our investment in these affiliated companies under the equity method.

Controlling Interests — Marina and DCO Energy, LLC (DCO) formed AC Landfill Energy, LLC (ACLE) to develop and install a 1,600-kilowatt methane-to-electric power generation system at a county-owned landfill in Egg Harbor Township, NJ. Marina owns a 51% interest in ACLE and accounts for ACLE as a consolidated subsidiary. Commercial operation of the initial system began in March 2005. An additional 1,900-kilowatt system began commercial operation in August 2006. Construction on an additional 1,900-kilowatt system will begin in the fourth quarter of 2006 and is expected to be operational in the fourth quarter of 2007.

In March 2005, Marina and DCO formed WC Landfill Energy, LLC (WCLE) to develop and install a 3,800-kilowatt methane-to-electric power generation system at a county-owned landfill in White Township, NJ. Marina owns a 51% interest in WCLE and accounts for WCLE as a consolidated subsidiary. Commercial operation of the plant is targeted to begin in the fourth quarter of 2006.

3. COMMON STOCK:

SJI has 60,000,000 shares of common stock authorized. Share-related information for prior periods is reported on a retroactive basis reflecting the stock split, which was completed on June 30, 2005, throughout this Report.

The following shares were issued and outstanding:

	September 30, 2006
Beginning Balance, January 1	28,982,440
New Issues During Period:	
Dividend Reinvestment Plan	156,980
Stock-Based Compensation Plan	101,009
Ending Balance, September 30	29,240,429

We recorded the par value ($1.25 per share) of stock issued during the nine months ended September 30, 2006 in Common Stock and recorded the net excess over par value of approximately $4.9 million in Premium on Common Stock.

Earnings Per Common Share — We present basic EPS based on the weighted-average number of common shares outstanding. EPS is presented in accordance with FASB Statement No. 128, "Earnings Per Share," which establishes standards for computing and presenting basic and diluted EPS. The incremental shares required for inclusion in the denominator for the diluted EPS calculation were 94,735 and 214,427 shares for the three months, and 75,537 and 222,136 shares for the nine months ended September 30, 2006 and 2005, respectively. These shares relate to SJI's restricted stock as discussed below.

Dividend Reinvestment Plan (DRP) — Newly issued shares of common stock offered through the DRP are issued directly by SJI. As of September 30, 2006, SJI reserved 1,369,042 shares of authorized, but unissued, common stock for future issuance to the DRP.

4. LONG-TERM DEBT:

In March 2006, Marina issued $16.4 million of tax-exempt, variable-rate bonds through the New Jersey Economic Development Authority (NJEDA), which mature in March 2036. Proceeds of the bonds were used to finance the expansion of Marina's Atlantic City thermal energy plant. The interest rate on all but $1.1 million of the bonds has been effectively fixed via interest rate swaps at 3.91% until January 2026. The variable interest rate on the $1.1 million portion of the bonds that remain unhedged was 3.74% as of September 30, 2006.

In April 2006, SJG issued $25.0 million of secured tax-exempt, auction-rate debt through the NJEDA to finance infrastructure costs that qualify for tax-exempt financing. The auction rate, which resets weekly, was set at 3.40% as of September 30, 2006. In anticipation of this transaction, SJG previously entered into forward-starting interest rate swap agreements that effectively fixed the interest rate on this debt at 3.43%, commencing December 1, 2006 through January 2036. The debt was issued under SJG's medium-term note program. An additional $115.0 million of medium-term notes remains available for issuance under that program.

5. FINANCIAL INSTRUMENTS:

Restricted Investments — In accordance with the terms of Marina's and SJG's loan agreements, we were required to escrow unused proceeds pending approved construction expenditures. As of September 30, 2006, the escrowed proceeds, including interest earned totaled $18.5 million. There were no escrowed proceeds as of December 31, 2005 as the related debt was issued during 2006.

SJRG maintains a margin account with a national investment firm to support its risk management activities. As of September 30, 2006 and December 31, 2005, the balance of this account was $12.5 million and $8.2 million, respectively, due to changes in the market value of outstanding contracts.

6. SEGMENTS OF BUSINESS:

SJI operates in several different operating segments. Gas Utility Operations (SJG) consists primarily of natural gas distribution to residential, commercial and industrial customers. Wholesale Gas Operations include SJRG's activities. SJE is involved in both retail gas and retail electric activities. Retail Gas and Other Operations include natural gas acquisition and transportation service business lines. Retail Electric Operations consist of electricity acquisition and transportation to commercial and industrial customers. On-Site Energy Production consists of Marina's thermal energy facility and other energy-related projects. Appliance Service Operations includes SJESP's servicing of appliances via the sale of appliance service programs as well as on a time and materials basis, and the installation of residential and small commercial HVAC systems.

Information about SJI's operations in different operating segments for the three and nine months ended September 30 is presented below (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Operating Revenues:				
Gas Utility Operations	$ 87,714	$ 89,702	$ 469,802	$ 390,322
Wholesale Gas Operations	9,245	6,340	29,891	21,182
Retail Gas and Other Operations	26,044	33,422	119,816	148,969
Retail Electric Operations	14,263	19,099	38,928	58,643
On-Site Energy Production	7,955	7,964	19,447	18,530
Appliance Service Operations	3,611	3,457	10,961	10,650
Corporate and Services	2,910	23	9,099	1,072
Subtotal	151,742	160,007	697,944	649,368
Intersegment Sales	(18,681)	(3,036)	(44,376)	(9,788)
Total Operating Revenues	$ 133,061	$ 156,971	$ 653,568	$ 639,580
Operating Income:				
Gas Utility Operations	$ 2,907	$ 3,602	$ 55,647	$ 56,896
Wholesale Gas Operations	3,449	2,866	12,975	9,707
Retail Gas and Other Operations	65	(234)	(115)	2,056
Retail Electric Operations	1,412	253	3,494	1,114
On-Site Energy Production	2,621	3,104	6,128	6,617
Appliance Service Operations	426	688	1,676	2,476
Corporate and Services	88	(311)	390	(757)
Total Operating Income	$ 10,968	9,968	80,195	78,109
Depreciation and Amortization:				
Gas Utility Operations	$ 6,381	$ 6,339	$ 18,905	$ 18,577
Wholesale Gas Operations	2	4	7	11
Retail Gas and Other Operations	2	3	7	9
Appliance Services Operations	60	47	175	129
On-Site Energy Production	622	459	1,544	1,360
Corporate and Services	60	27	173	80
Total Depreciation and Amortization	$ 7,127	$ 6,879	$ 20,811	$ 20,166
Property Additions:				
Gas Utility Operations	$ 10,416	$ 23,543	$ 39,665	$ 53,838
Wholesale Gas Operations	-	2	3	2
Retail Gas and Other Operations	3	3	8	6
Appliance Service Operations	72	53	242	110
On-Site Energy Production	305	6,047	9,765	19,090
Corporate and Services	61	3	449	10

Total Property Additions	$ 10,857	$ 29,651	$ 50,132	$ 73,056

	September 30, 2006	December 31, 2005
Identifiable Assets:		
Gas Utility Operations	$ 1,196,422	$ 1,167,398
Wholesale Gas Operations	150,562	124,922
Retail Gas and Other Operations	38,612	50,880
Retail Electric Operations	3,238	7,751
Appliance Service Operations	15,103	13,624
On-Site Energy Production	121,344	105,822
Discontinued Operations	450	408
Subtotal	1,525,731	1,470,805
Corporate and Services	94,586	70,379
Intersegment Assets	(124,232)	(99,472)
Total Identifiable Assets	$ 1,496,085	$ 1,441,712

7. REGULATORY ACTIONS:

Base Rates — On July 7, 2004, the BPU granted SJG a base rate increase of $20.0 million effective July 8, 2004, which was predicated in part upon a 7.97% rate of return on rate base that included a 10.0% return on common equity. SJG was also permitted to recover regulatory assets contained in its petition and to reduce its composite depreciation rate from 2.9% to 2.4%.

BPU Audit — In 2004, the BPU commenced a competitive services audit and a management audit that included a focused review of SJG's gas supply and purchasing practices. The BPU is mandated by statute to conduct such audits at predetermined intervals. In February 2006, the audit reports were released by the BPU for comments. The final BPU order accepting the recommendations of the auditor with some minor revisions was signed in August 2006. The recommendations contained in these audits have no material effect on these financial statements.

Other Regulatory Matters — In December 2004, the BPU approved the statewide funding of the NJCEP of $745.0 million for the years 2005 through 2008. Of this amount, SJG will be responsible for approximately $25.4 million over the 4-year period. Amounts not yet expended have been included in the Contractual Cash Obligations table included in Note 11.

In February 2005, SJG filed notice with the BPU to provide for an $11.4 million bill credit to customers. The bill credit was implemented in March 2005. In June 2005, SJG made its annual BGSS filing with the BPU requesting a $17.1 million, or 6.3% increase in gas cost recoveries in response to increasing wholesale gas costs. In August 2005, the BPU approved SJG's requested increase, effective September 1, 2005, on an interim basis.

In October 2005, SJG filed a petition with the BPU to implement a Pipeline Integrity Management Tracker (Tracker) along with the three other natural gas distribution companies in New Jersey. The purpose of the Tracker is to recover costs to be incurred by SJG as a result of new federal regulations, which are aimed at enhancing public safety and reliability. The regulations require that utilities use a comprehensive analysis to assess, evaluate, repair and validate the integrity of certain transmission lines in the event of a leak or failure. The New Jersey utilities are requesting approval of the Tracker since the new regulations will result in ongoing incremental costs. Costs incurred to date are not considered significant. We anticipate that a large portion of the incremental cost is dependent upon overall assessment results, and therefore cannot be specifically predicted at this time.

In November 2005, SJG made its annual SBC filing, requesting a $6.1 million reduction in annual recoveries.

In November 2005, SJG filed a BGSS Motion for Emergent Rate Relief in conjunction with the other natural gas utilities in New Jersey. This filing was necessary due to substantial increases in wholesale natural gas prices across the country. In December 2005, the BPU approved an $85.7 million increase to SJG's rates, effective December 15, 2005, on an interim basis.

In December 2005, SJG made a filing proposing to implement a Conservation and Usage Adjustment (CUA) Clause, on a five-year pilot basis. The primary purpose of the CUA is to promote conservation and to base SJG's profit margin on its number of customers rather than the amount of natural gas it distributes to its customers. This structure will allow SJG to aggressively promote conservation programs without negatively impacting its financial stability. In October 2006, the BPU approved the CUA as a three year pilot program and renamed it the Conservation Incentive Program (CIP) (See Note 12).

In March 2006, the BPU approved a global settlement, effective April 1, 2006, fully resolving SJG's September 2004 SBC filing, 2003-2004 TAC filing, 2004-2005 BGSS filing and certain issues in the 2005-2006 BGSS filing. The net impact is a $4.4 million reduction to annual revenues; however, this reduction has no impact on net income as there will be a dollar-for-dollar reduction in expense. In addition, a pilot storage incentive program was approved. This program began during the second quarter of 2006 and will continue for three summer injection periods through 2008. It is designed to provide SJG with the opportunity to achieve BGSS price reductions and additional price stability. It will also provide SJG with an opportunity to share in the storage-related gains and losses, with 20% being retained by SJG, and 80% being credited to customers. Total storage-related gains for the three and nine months ended September 30, 2006 were $0.8 million and $1.6 million, respectively.

In June 2006, SJG made its annual BGSS filing with the BPU requesting a $19.7 million or 4.6% decrease in gas cost recoveries in response to decreasing wholesale gas costs and an $11.5 million benefit derived from the release of a storage facility and the liquidation of its low-cost base gas made available during the second quarter. Due to the continuing decrease in wholesale gas costs subsequent to our June 2006 filing, an agreement to utilize gas from a released storage facility for this upcoming winter, and a credit to gas costs for previously overcollected state taxes (See Notes 1 and 12), the BPU approved a $38.7 million, or 8.6%, annual decrease in gas cost recoveries in September 2006.

In July 2006, SJG made its annual USF filing, along with the state's other electric and gas utilities, proposing to increase annual statewide gas revenues to $115.3 million, an increase of $68.5 million. Under the proposal, SJG's annual USF revenues will increase to $13.0 million, which represents a $7.7 million increase in annual USF revenues.

Filings and petitions described above are still pending unless otherwise indicated.

8. PENSION & OTHER POSTRETIREMENT BENEFITS:

SJI has several defined benefit pension plans and other postretirement benefit plans. The pension plans provide annuity payments to the majority of full-time, regular employees upon retirement. Newly hired employees do not qualify for participation in the defined benefit pension plans. New hires are eligible to receive an enhanced version of SJI's defined contribution plan. Certain SJI officers also participate in a non-funded supplemental executive retirement plan (SERP), a non-qualified defined benefit pension plan. The other postretirement benefit plans provide health care and life insurance benefits to some retirees.

The BPU authorized SJG to recover costs related to postretirement benefits other than pensions under the accrual method of accounting consistent with FASB Statement No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." SJG deferred amounts accrued prior to that authorization and are amortizing them as allowed by the BPU. The unamortized balance of $2.4 million at September 30, 2006 is recoverable in rates. SJG is amortizing this amount over 15 years, which started January 1998.

Net periodic benefit cost for the three and nine months ended September 30, 2006 and 2005 related to the employee and officer pension and other postretirement benefit plans consisted of the following components (in thousands):

	Pension Benefits			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Service Cost	$ 793	$ 809	$ 2,377	$ 2,428
Interest Cost	1,804	1,686	5,411	5,056
Expected Return on Plan Assets	(2,309)	(2,142)	(6,928)	(6,427)
Amortization of Loss and Other	710	750	2,131	2,250
Net Periodic Benefit Cost	998	1,103	2,991	3,307
Capitalized Benefit Costs	(319)	(314)	(956)	(943)
Net Periodic Benefit Expense	$ 679	$ 789	$ 2,035	$ 2,364

	Other Postretirement Benefits			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Service Cost	$ 302	$ 227	$ 698	$ 681
Interest Cost	1,024	539	1,966	1,616
Expected Return on Plan Assets	(645)	(399)	(1,343)	(1,198)
Amortization of Loss and Other	291	34	351	103
Net Periodic Benefit Cost	972	401	1,672	1,202
Capitalized Benefit Costs	(398)	(124)	(594)	(373)
Net Periodic Benefit Expense	$ 574	277	$ 1,078	$ 829

Capitalized benefit costs reflected in the table above relate to SJG's construction program.

Future Benefit Payments — The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid during the following years (in thousands):

	Pension Benefits	Other Postretirement Benefits
2006	$ 5,937	$ 2,262
2007	6,028	2,490
2008	6,132	2,636
2009	6,256	2,733
2010	6,369	2,891
2011-2015	35,830	14,537

Contributions — SJI does not expect to make any contributions to its pension plan in 2006; however, changes in future investment performance and discount rates may ultimately result in a contribution during the fourth quarter. SJG has a regulatory obligation to contribute approximately $3.6 million annually to its other postretirement benefit plans' trusts, less costs incurred directly by the company.

9. RETAINED EARNINGS:

SJG is restricted as to the amount of cash dividends or other distributions that may be paid on its common stock by an order issued by the BPU in July 2004, that granted SJG an increase in base rates. Per the order, SJG is required to maintain total common equity of no less than $289.2 million. SJG's total common equity balance was $353.7 million at September 30, 2006.

Various loan agreements also contain potential restrictions regarding the amount of cash dividends or other distributions that SJG may pay on its common stock. As of September 30, 2006, SJG's loan restrictions did not affect the amount that may be distributed from either SJG's or SJI's retained earnings.

10.