



2014 ANNUAL REPORT



NEW JERSEY NATURAL GAS
2014 ANNUAL REPORT

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GLOSSARY OF KEY TERMS

AFUDC	Allowance for Funds Used During Construction
AIP	Accelerated Infrastructure Program
ARO	Asset Retirement Obligations
ASC	Accounting Standards Codification
ASU	Accounting Standards Update
Bcf	Billion Cubic Feet
BGSS	Basic Gas Supply Service
BPU	New Jersey Board of Public Utilities
CIP	Conservation Incentive Program
CME	Chicago Mercantile Exchange
The Company	New Jersey Natural Gas Company
CR&R	Commercial Realty & Resources Corp.
Credit Facility	The \$250 million unsecured committed credit facility expiring in May 2019
CWIP	Construction Work In Progress
EDA Bonds	Collectively, Series 2011A, Series 2011B and Series 2011C Bonds issued by the New Jersey Economic Development Authority
EDECA	Electric Discount and Energy Competition Act
FASB	Financial Accounting Standards Board
FCM	Futures Commission Merchant
FERC	Federal Energy Regulatory Commission
HCCTR	Health Care Cost Trend Rate
ICE	Intercontinental Exchange
Iroquois	Iroquois Gas Transmission L.P.
IRS	Internal Revenue Service
ISDA	The International Swaps and Derivatives Association
ITC	Investment Tax Credit
JPMC Facility	NJNG's \$100 million, four-year credit facility with JPMorgan Chase Bank, N.A. expiring in August 2015 and terminated on September 26, 2014
LIBOR	London Inter-Bank Offered Rate
LNG	Liquefied Natural Gas
Loan Agreement	Loan Agreement between the EDA and the Company
MGP	Manufactured Gas Plant
Moody's	Moody's Investors Service, Inc.
NAESB	The North American Energy Standards Board
New Mortgage Indenture	The Amended and Restated Indenture of Mortgage, Deed of Trust and Security Agreement between NJNG and U.S. Bank National Association dated as of September 1, 2014
NGV	Natural Gas Vehicles
NJ RISE	New Jersey Reinvestment in System Enhancement
NJCEP	New Jersey's Clean Energy Program
NJDEP	New Jersey Department of Environmental Protection
NJR	New Jersey Resources Corporation
NJR Service	NJR Service Corporation

GLOSSARY OF KEY TERMS (cont.)

NJRCEV	NJR Clean Energy Ventures Corporation
NJRES	NJR Energy Services Company
NJRHS	NJR Home Services Company
NYMEX	New York Mercantile Exchange
O&M	Operation and Maintenance
Old Mortgage Indenture	Indenture of Mortgage and Deed of Trust between NJNG and The Bank of New York Mellon Trust Company, N.A., dated April 1, 1952, as amended
OPEB	Other Postemployment Benefit Plans
PEP	Pension Equalization Plan
PIM	Pipeline Integrity Management
RA	Remediation Adjustment
S&P	Standard & Poor's Financial Services, LLC
SAFE	Safety Acceleration and Facility Enhancement
SAVEGREEN	The SAVEGREEN Project®
Savings Plan	Employees' Retirement Savings Plan
SBC	Societal Benefits Charge
Steckman Ridge	Collectively, Steckman Ridge GP, LLC and Steckman Ridge, LP
Superstorm Sandy	Post-Tropical Cyclone Sandy
TEFA	Transitional Energy Facilities Assessment
Trustee	U.S. Bank National Association
U.S.	The United States of America
USF	Universal Service Fund
Wells Fargo	Wells Fargo Municipal Capital Strategies, LLC

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
New Jersey Natural Gas Company

We have audited the accompanying financial statements of New Jersey Natural Gas Company (the "Company"), which comprise the balance sheets as of September 30, 2014 and 2013, and the related statements of operations, common stock equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

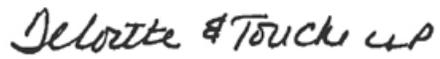
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of New Jersey Natural Gas Company as of September 30, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A rectangular box containing the handwritten signature "Deloitte & Touche LLP" in black ink.

December 17, 2014

New Jersey Natural Gas Company

STATEMENTS OF OPERATIONS

(Thousands)

Fiscal years ended September 30,	2014	2013
OPERATING REVENUES	\$ 819,415	\$ 787,987
OPERATING EXPENSES		
Gas purchases	402,552	414,594
Operation and maintenance	124,717	113,174
Regulatory rider expenses	72,164	48,417
Depreciation and amortization	40,540	37,999
Energy and other taxes	52,013	52,410
Total operating expenses	691,986	666,594
OPERATING INCOME	127,429	121,393
Other income	2,832	2,847
Interest charges, net of capitalized interest	16,683	14,995
INCOME BEFORE INCOME TAXES	113,578	109,245
Income tax provision	39,374	35,399
NET INCOME	\$ 74,204	\$ 73,846

See Notes to Financial Statements

New Jersey Natural Gas Company

STATEMENTS OF CASH FLOWS

(Thousands)

Fiscal years ended September 30,	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 74,204	\$ 73,846
Adjustments to reconcile net income to cash flows from operating activities:		
Depreciation and amortization	40,540	37,999
Allowance for funds used during construction	(1,562)	(2,037)
Amortization of deferred charges	463	763
Allowance for bad debt expense	2,266	2,446
Deferred income taxes	(1,531)	29,817
Manufactured gas plant remediation costs	(4,396)	(6,166)
Cost of removal – asset retirement obligation	(1,153)	(1,697)
Contributions to postemployment benefit plans	(4,858)	(25,930)
Changes in:		
Components of working capital	44,540	(9,815)
Other noncurrent assets	17,125	8,677
Other noncurrent liabilities	3,453	(1,542)
Cash flows from operating activities	169,091	106,361
CASH FLOWS (USED IN) INVESTING ACTIVITIES		
Expenditures for		
Utility plant	(128,254)	(110,482)
Cost of removal	(24,312)	(26,601)
Withdrawal from restricted cash construction fund	88	56
Cash flows (used in) investing activities	(152,478)	(137,027)
CASH FLOWS (USED IN) FROM FINANCING ACTIVITIES		
Payments of common stock dividends to parent	(53,024)	(49,979)
Tax benefit from stock options exercised	131	52
Proceeds from long-term debt	125,000	50,000
Payments of long-term debt	(82,336)	(8,916)
Proceeds from short-term debt, net of payments	(15,600)	33,600
Proceeds from sale-leaseback transaction	7,576	7,076
Cash flows (used in) from financing activities	(18,253)	31,833
Change in cash and cash equivalents	(1,640)	1,167
Cash and cash equivalents at beginning of period	1,912	745
Cash and cash equivalents at end of period	\$ 272	\$ 1,912
CHANGES IN COMPONENTS OF WORKING CAPITAL		
Receivables	\$ (314)	\$ (12,188)
Inventories	24,881	33,954
Recovery of gas costs	13,015	6,100
Accounts payable and other	8,416	1,513
Gas purchases payable	(9,452)	6,264
Prepaid and accrued taxes, net	16,666	(14,694)
Customers' credit balances and deposits	(2,034)	(24,112)
Restricted broker margin accounts	(844)	1,500
Other current assets	(5,811)	(8,152)
Other current liabilities	17	—
Total	\$ 44,540	\$ (9,815)
SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION		
Cash paid for		
Interest (net of amounts capitalized)	\$ 15,052	\$ 12,498
Income taxes	\$ 23,732	\$ 22,257
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING ACTIVITIES		
Accrued capital expenditures	\$ 4,433	\$ 259

See Notes to Financial Statements

BALANCE SHEETS

ASSETS

(Thousands)

September 30,	2014	2013
PROPERTY, PLANT AND EQUIPMENT		
Utility plant, at cost	\$ 1,791,009	\$ 1,681,585
Construction work in progress	139,624	114,961
Total property, plant and equipment	1,930,633	1,796,546
Accumulated depreciation and amortization	(409,135)	(383,895)
Property, plant and equipment, net	1,521,498	1,412,651
CURRENT ASSETS		
Cash and cash equivalents	272	1,912
Customer accounts receivable:		
Billed	41,281	43,045
Unbilled	7,231	7,429
Allowance for doubtful accounts	(5,277)	(5,287)
Regulatory assets	26,862	34,372
Gas in storage, at average cost	86,266	104,979
Materials and supplies, at average cost	6,839	13,007
Prepaid taxes	23,015	40,300
Derivatives, at fair value	2,525	3,502
Broker margin account	1,057	213
Deferred taxes	1,277	—
Other	16,860	10,050
Total current assets	208,208	253,522
NONCURRENT ASSETS		
Regulatory assets	377,575	402,202
Derivatives, at fair value	82	121
Other	36,321	33,313
Total noncurrent assets	413,978	435,636
Total assets	\$ 2,143,684	\$ 2,101,809

See Notes to Financial Statements

CAPITALIZATION AND LIABILITIES

(Thousands, except for share data)

September 30,	2014	2013
CAPITALIZATION		
Common stock, \$5 par value; authorized 4,750,000 shares; outstanding 3,214,923 shares	\$ 16,075	\$ 16,075
Premium on common stock	11,269	11,269
Contribution from parent and other	359,230	359,099
Retained earnings	332,650	311,470
Common stock equity	719,224	697,913
Long-term debt	473,209	362,886
Total capitalization	1,192,433	1,060,799
CURRENT LIABILITIES		
Current maturities of long-term debt	9,505	68,643
Short-term debt	153,000	168,600
Gas purchases payable	21,292	30,744
Accounts payable and other	50,129	39,239
Deferred and accrued taxes	81	9,276
Regulatory liabilities	6,072	1,456
New Jersey clean energy program	14,285	14,532
Derivatives, at fair value	2,205	2,045
Customers' credit balances and deposits	22,222	24,256
Total current liabilities	278,791	358,791
NONCURRENT LIABILITIES		
Deferred income taxes	341,690	333,046
Deferred investment tax credits	5,262	5,584
Derivatives, at fair value	25	140
Manufactured gas plant remediation	177,000	183,600
Postemployment benefit liability	51,035	47,278
Regulatory liabilities	61,326	79,647
Asset retirement obligation	30,495	28,711
Other	5,627	4,213
Total noncurrent liabilities	672,460	682,219
Total capitalization and liabilities	\$ 2,143,684	\$ 2,101,809

See Notes to Financial Statements

New Jersey Natural Gas Company

STATEMENTS OF COMMON STOCK EQUITY

<i>(Thousands)</i>	Number of Shares	Common Stock	Premium on Common Stock	Contribution from Parent and Other	Retained Earnings	Total
Balance at September 30, 2012	3,215	\$ 16,075	\$ 11,269	\$ 359,047	\$ 287,603	\$ 673,994
Net income					73,846	73,846
Tax benefit from stock plans				52		52
Cash dividend declared					(49,979)	(49,979)
Balance at September 30, 2013	3,215	16,075	11,269	359,099	311,470	697,913
Net income					74,204	74,204
Tax benefit from stock plans				131		131
Cash dividend declared					(53,024)	(53,024)
Balance at September 30, 2014	3,215	\$ 16,075	\$ 11,269	\$ 359,230	\$ 332,650	\$ 719,224

See Notes to Financial Statements

New Jersey Natural Gas Company

1. NATURE OF THE BUSINESS

New Jersey Natural Gas is a local natural gas distribution company that provides regulated retail natural gas service to approximately 504,300 residential and commercial customers in central and northern New Jersey, and participates in the off-system sales and capacity release markets. The Company is the regulated utility subsidiary of NJR and is subject to rate regulation by the BPU. The Company owns approximately 7,060 miles of distribution main, 7,168 miles of service main, 226 miles of transmission main and approximately 526,000 meters. Mains are primarily located under public roads. Where mains are located under private property, the Company has obtained easements from the owners of record.

Additionally, the Company owns and operates two LNG storage plants in Stafford Township, Ocean County; and Howell Township, Monmouth County. The two LNG plants have an aggregate estimated maximum capacity of approximately 170,000 dths per day and 1 Bcf of total capacity. These facilities are used for peaking natural gas supply and emergencies.

The Company owns four service centers located in Rockaway Township, Morris County; Atlantic Highlands and Wall Township, Monmouth County; and Lakewood, Ocean County. These service centers house storerooms, garages, gas distribution and administrative offices. The Company leases its headquarters and customer service facilities in Wall Township, Monmouth County, a customer service office in Asbury Park, Monmouth County and a service center in Manahawkin, Ocean County. These customer service offices support customer contact, marketing, economic development and other functions.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Regulatory Assets & Liabilities

Under cost-based regulation, regulated utility enterprises generally are permitted to recover their operating expenses and earn a reasonable rate of return on their utility investment.

The Company maintains its accounts in accordance with the FERC Uniform System of Accounts as prescribed by the BPU and in accordance with the *Regulated Operations* Topic of the FASB ASC. As a result of the impact of the ratemaking process and regulatory actions of the BPU, the Company is required to recognize the economic effects of rate regulation. Accordingly, the Company capitalizes or defers certain costs that are expected to be recovered from its customers as regulatory assets and recognizes certain obligations representing probable future expenditures as regulatory liabilities on the Balance Sheets. See *Note 3. Regulation*, for a more detailed description of the Company's regulatory assets and liabilities.

Gas in Storage

Gas in storage is reflected at average cost on the Balance Sheets, and represents natural gas and liquefied natural gas that will be utilized in the ordinary course of business. The Company had 21.3 Bcf and 20.4 Bcf of gas in storage as of September 30, 2014 and 2013, respectively.

New Jersey Natural Gas Company

Demand Fees

For the purpose of securing adequate storage and pipeline capacity, the Company enters into storage and pipeline capacity contracts, which require the payment of certain demand charges to maintain the ability to access such natural gas storage or pipeline capacity, during a fixed time period, which generally ranges from one to 10 years. Demand charges are based on established rates as regulated by FERC. These demand charges represent commitments to pay storage providers or pipeline companies for the right to store and transport natural gas utilizing their respective assets.

Demand fees of \$92 million and \$92.1 million for fiscal years ended September 30, 2014 and 2013, respectively, which are net of fees received for capacity release, are included in its weighted average cost of gas. The demand charges are expensed as a component of gas purchases in the Statements of Operations based on BGSS sales and recovered as part of its gas commodity component of its BGSS tariff.

Derivative Instruments

Derivative instruments associated with natural gas commodity contracts are recorded in accordance with the *Derivatives and Hedging* Topic of the ASC 815, under which the Company records the fair value of derivatives, held as assets and liabilities. The Company's derivatives used to economically hedge its natural gas purchasing activities are recoverable through its BGSS, a component of its tariff. Accordingly, the offset to the change in fair value of these derivatives is recorded as a Regulatory asset or liability on the Balance Sheets.

See *Note 4. Derivative Instruments* for additional details regarding natural gas transacting activities.

Fair values of exchange-traded instruments, including futures, swaps and certain options, are based on actively quoted market prices. Fair values are subject to change in the near term and reflect management's best estimate based on various factors. In establishing the fair value of commodity contracts that do not have quoted prices, such as physical contracts, over-the-counter options and swaps and certain embedded derivatives, management uses available market data and pricing models to estimate fair values. Estimating fair values of instruments that do not have quoted market prices requires management's judgment in determining amounts that could reasonably be expected to be received from, or paid to, a third party in settlement of the instruments. These amounts could be materially different from amounts that might be realized in an actual sale transaction.

Revenues

Revenues from the sale of natural gas to customers of the Company are recognized in the period that gas is delivered and consumed by customers, including an estimate for unbilled revenue.

The Company records unbilled revenue for natural gas services. Natural gas sales to individual customers are based on meter readings, which are performed on a systematic basis throughout the month. At the end of each month, the amount of natural gas delivered to each customer after the last meter reading through the end of the respective accounting period is estimated, and the Company recognizes unbilled revenues related to these amounts. The unbilled revenue estimates are based on estimated customer usage by customer type, weather effects, unaccounted-for gas and the most current tariff rates.

New Jersey Natural Gas Company

Gas Purchases

The Company's tariff includes a component for BGSS, which is designed to allow the Company to recover the cost of natural gas through rates charged to its customers and is typically revised on an annual basis. As part of computing its BGSS rate, the Company projects its cost of natural gas, net of supplier refunds, the impact of hedging activities and credits from non-firm sales and transportation activities. The Company subsequently recovers or credits the difference, if any, of actual costs compared with those included in current rates. Any underrecoveries or overrecoveries are either credited to customers or deferred and, subject to BPU approval, reflected in the BGSS rates in subsequent years.

Income Taxes

The Company computes income taxes using the asset and liability method, whereby deferred income taxes are generally determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. See *Note 9. Income Taxes*.

ITCs have been deferred and are being amortized as a reduction to the tax provision over the average lives of the related equipment in accordance with regulatory treatment.

Capitalized and Deferred Interest

The Company's base rates include the ability to recover the cost of debt and equity associated with AFUDC and CWIP. Incremental cost of equity is recoverable only during periods when the Company's short-term debt balances are lower than its CWIP.

Capitalized amounts associated with the debt and equity components of the Company's AFUDC, are recorded in utility plant on the Balance Sheets. Corresponding amounts for the debt component is recognized in interest expense and in other income for the equity component on the Statements of Operations and include the following for the fiscal years ended September 30:

<i>(Thousands)</i>	2014	2013
AFUDC:		
Debt	\$ 1,057	\$ 921
Equity	1,562	2,037
Total	\$ 2,619	\$ 2,958
Weighted average interest rate	3.30%	1.05%

Pursuant to a BPU order, the Company is permitted to recover carrying costs on uncollected balances related to SBC program costs, which include NJCEP, RA and USF expenditures. See *Note 3. Regulation*. The SBC interest rate changes each September based on the August 31 seven-year constant maturity Treasury rate plus 60 basis points. The rate was 2.65 percent and 2.84 percent for the fiscal years ended September 30, 2014 and 2013, respectively. Accordingly, other income included \$586,000 and \$653,000 for the fiscal years ended September 30, 2014 and 2013, respectively.

New Jersey Natural Gas Company

Sales Tax Accounting

Sales tax and TEFA are collected from customers and presented in both operating revenues and operating expenses on the Statements of Operations for the fiscal years ended September 30, as follows:

<i>(Thousands)</i>	2014	2013
Sales tax	\$ 46,008	\$ 43,039
TEFA ⁽¹⁾	1,431	4,998
Total	\$ 47,440	\$ 48,047

(1) TEFA was phased out in January 2014.

Cash and Cash Equivalents

Cash and cash equivalents consists of cash on deposit and temporary investments with maturities of three months or less, and excludes restricted cash of \$1 million and \$1.1 million as of September 30, 2014 and 2013, respectively, related to escrow balances for utility plant projects, which is recorded in other current and noncurrent assets on the Balance Sheets, respectively.

Property Plant and Equipment

Regulated property, plant and equipment is stated at original cost. Costs include direct labor, materials and third-party construction contractor costs, AFUDC and certain indirect costs related to equipment and employees engaged in construction. Upon retirement, the cost of depreciable regulated property, plus removal costs less salvage, is charged to accumulated depreciation with no gain or loss recorded.

Depreciation is computed on a straight-line basis over the useful life of the assets for financial statement purposes and using rates based on the estimated average lives of the various classes of depreciable property for the Company. The composite rate of depreciation used was 2.44 percent of average depreciable property in fiscal 2014 and 2.43 percent in fiscal 2013.

Property, plant and equipment was comprised of the following as of September 30, 2014 and 2013:

<i>(Thousands)</i>	Estimated Useful Lives	2014	2013
Property Classifications			
Distribution facilities	38 to 74 years	\$ 1,567,648	\$ 1,421,885
Transmission facilities	35 to 56 years	281,488	273,853
Storage facilities	34 to 47 years	41,669	41,687
All other property	5 to 35 years	39,828	59,121
Total property, plant and equipment		1,930,633	1,796,546
Accumulated depreciation and amortization		(409,135)	(383,895)
Property, plant and equipment, net		\$ 1,521,498	\$ 1,412,651

Impairment of Long-Lived Assets

The Company reviews the carrying amount of an asset for possible impairment whenever events or changes in circumstances indicate that such amount may not be recoverable.

No impairments were identified for the fiscal years ended September 30, 2014 and 2013.

New Jersey Natural Gas Company

Customer Accounts Receivable and Allowance for Doubtful Accounts

The Company's receivables consist of natural gas sales and transportation services billed to residential, commercial, industrial and other customers. The Company evaluates its accounts receivable and, to the extent customer account balances are outstanding for more than 60 days, establishes an allowance for doubtful accounts. The allowance is based on a combination of factors including historical collection experience and trends, aging of receivables, general economic conditions in the company's distribution or sales territories, and customer specific information. The Company writes-off customers' accounts once it is determined they are uncollectible.

Loans Receivable

The Company provides interest-free loans, with terms ranging from two to 10 years, to customers that elect to purchase and install certain energy efficient equipment in accordance with its BPU approved SAVEGREEN program. The loans are recognized at net present value on the Balance Sheets. Refer to *Note 5. Fair Value* for a discussion of the Company's fair value measurement policies and level disclosures. The Company has recorded \$3.9 million and \$1.9 million in other current assets and \$27.3 million and \$14.3 million in other noncurrent assets as of September 30, 2014 and September 30, 2013, respectively, on the Balance Sheets, related to the loans.

The Company's policy is to establish an allowance for doubtful accounts when loan balances are outstanding for more than 60 days. During fiscal 2014 and 2013 there was no allowance for doubtful accounts established related to loans receivable.

Asset Retirement Obligations

The Company recognizes a liability for its AROs based on the fair value of the liability when incurred, which is generally upon acquisition, construction, development and/or through the normal operation of the asset. Concurrently, the Company also capitalizes an asset retirement cost by increasing the carrying amount of the related asset by the same amount as the liability. In periods subsequent to the initial measurement, the Company is required to recognize changes in the liability resulting from the passage of time (accretion) or due to revisions to either timing or the amount of the originally estimated cash flows to settle the conditional ARO.

Pension and Postemployment Plans

The Company has two noncontributory defined pension plans covering eligible employees, including officers. Benefits are based on each employee's years of service and compensation. The Company's funding policy is to contribute annually to these plans at least the minimum amount required under the Employee Retirement Income Security Act of 1974, as amended, and not more than can be deducted for federal income tax purposes. Plan assets consist of equity securities, fixed-income securities and short-term investments. In fiscal 2014 and 2013, the Company had no minimum funding requirements. The Company made no discretionary contributions to the pension plans in fiscal 2014, and contributed \$20 million to the plans in fiscal 2013.

The Company also provides two primarily noncontributory medical and life insurance plans for eligible retirees and dependents. Medical benefits, which make up the largest component of the plans, are based upon an age and years-of-service vesting schedule and other plan provisions. Funding of these benefits is made primarily into Voluntary Employee Beneficiary Association trust funds. The Company contributed \$5 million and \$6 million in aggregate to these plans in fiscal 2014 and 2013, respectively.

New Jersey Natural Gas Company

Recent Updates to the Accounting Standards Codification

Balance Sheet Offsetting

In December 2011, the FASB issued ASU No. 2011-11, an amendment to ASC 210, *Balance Sheet*, requiring additional disclosures about the nature of an entity's rights of setoff and related master netting arrangements. ASU 2013-01, issued in January 2013, further clarified that the amended guidance was applicable to certain financial and derivative instruments. The Company applied the provisions of the amended guidance retrospectively effective October 1, 2013. The guidance did not impact the Company's financial position, results of operations or cash flows, however, it required additional disclosures that are included in *Note 4. Derivative Instruments*.

Income Taxes

In July 2013, the FASB issued ASU No. 2013-11, an amendment to ASC 740, *Income Taxes*, which clarifies financial statement presentation for unrecognized tax benefits. The ASU requires that an unrecognized tax benefit, or portion thereof, shall be presented in the balance sheet as a reduction to a deferred tax asset for a net operating loss carryforward, similar tax loss or a tax credit carryforward. To the extent such a deferred tax asset is not available or the company does not intend to use it to settle any additional taxes that would result from the disallowance of a tax position, the related unrecognized tax benefit will be presented as a liability in the financial statements. The amended guidance will become effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The Company currently does not have unrecognized tax benefits recorded on its balance sheet and does not expect any impact to its financial position upon adoption during its first quarter of fiscal 2015.

Discontinued Operations

In April 2014, the FASB issued ASU No. 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. The new guidance changes the definition and reporting of discontinued operations to include only those disposals that represent a strategic shift and that have a major effect on an entity's operations and financial results. The new guidance, which also requires additional disclosures, becomes effective for annual periods beginning on or after December 15, 2014 and interim periods within those years. The Company does not expect an impact to its financial position, results of operations and cash flows upon adoption.

Revenue

In May 2014, the FASB issued ASU No. 2014-09, and added Topic 606, *Revenue from Contracts with Customers*, to the ASC. ASC 606 supersedes ASC 605, *Revenue Recognition*, as well as most industry-specific guidance, and prescribes a single, comprehensive revenue recognition model designed to improve financial reporting comparability across entities, industries, jurisdictions and capital markets. The new guidance will become effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. Upon adoption, the guidance will be applied on a full or modified retrospective basis. The Company is currently evaluating the provisions of ASC 606 to understand the impact, if any, to its financial position, results of operations and cash flows upon adoption.

New Jersey Natural Gas Company

Use of Estimates

The preparation of financial statements in conformity with Generally Accepted Accounting Principles of the United States requires the Company to make estimates that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosure of contingencies during the reporting period. On a monthly basis, the Company evaluates its estimates, including those related to the calculation of the fair value of derivative instruments, debt, unbilled revenues, allowance for doubtful accounts, provisions for depreciation and amortization, regulatory assets and liabilities, income taxes, pensions and other postemployment benefits, contingencies related to environmental matters and litigation. AROs are evaluated as often as needed. The Company's estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources.

The Company has legal, regulatory and environmental proceedings during the normal course of business that can result in loss contingencies. When evaluating the potential for a loss, the Company will establish a reserve if a loss is probable and can be reasonably estimated, in which case it is the Company's policy to accrue the full amount of such estimates. Where the information is sufficient only to establish a range of probable liability, and no point within the range is more likely than any other, it is the Company's policy to accrue the lower end of the range. In the normal course of business, estimated amounts are subsequently adjusted to actual results that may differ from estimates.

Subsequent Events

To the best of our knowledge and belief, no other material events have occurred subsequent to September 30, 2014, through December 17, 2014, the date the financial statements were issued that require consideration as adjustments to or disclosures in the aforementioned financial statements, except as disclosed in *Note 3. Regulation*.

3. REGULATION

The EDECA is the legal framework for New Jersey's public utility and wholesale energy landscape. The Company is required, pursuant to a written order by the BPU under EDECA, to open its residential markets to competition from third-party natural gas suppliers. Customers can choose the supplier of their natural gas commodity in the Company's service territory.

As required by EDECA, the Company's rates are segregated into two primary components, the commodity portion, which represents the wholesale cost of natural gas, including the cost for interstate pipeline capacity to transport the gas to the Company's service territory, and the delivery portion, which represents the transportation of the commodity portion through the Company's gas distribution system to the end-use customer. The Company does not earn utility gross margin on the commodity portion of its natural gas sales. The Company earns utility gross margin through the delivery of natural gas to its customers, regardless of whether it or a third-party supplier provides the wholesale natural gas commodity.

Under EDECA, the BPU is required to audit the state's energy utilities every two years. The primary purpose of the audit is to ensure that utilities and their affiliates offering unregulated retail services do not have an unfair competitive advantage over nonaffiliated providers of similar retail services. A combined competitive services and management audit of the Company commenced in August 2013. A draft management audit report was accepted by the BPU on July 23, 2014, for public comment and is waiting for final approval.

New Jersey Natural Gas Company

The Company is subject to cost-based regulation, therefore, it is permitted to recover authorized operating expenses and earn a reasonable return on its utility investment based on the BPU's approval, in accordance with accounting guidance applicable to regulated operations. The impact of the ratemaking process and decisions authorized by the BPU allows the Company to capitalize or defer certain costs that are expected to be recovered from its customers as regulatory assets and to recognize certain obligations representing amounts that are probable future expenditures as regulatory liabilities.

As recovery of regulatory assets is subject to BPU approval, if there are any changes in regulatory positions that indicate recovery is not probable, the related cost would be charged to income in the period of such determination.

Regulatory assets and liabilities included on the Balance Sheets as of September 30, are comprised of the following:

<i>(Thousands)</i>	2014	2013
Regulatory assets-current		
Underrecovered gas costs	\$ 12,577	\$ 953
Conservation Incentive Program	—	18,887
New Jersey Clean Energy Program	14,285	14,532
Total current	\$ 26,862	\$ 34,372
Regulatory assets-noncurrent		
Environmental remediation costs		
Expended, net of recoveries	\$ 30,916	\$ 46,968
Liability for future expenditures	177,000	183,600
Deferred income and other taxes	9,968	10,718
Derivatives, net	—	19
SAVEGREEN	29,180	30,004
Postemployment and other benefit costs	108,507	101,415
Deferred Superstorm Sandy costs	15,207	14,822
Other noncurrent assets	6,797	14,656
Total noncurrent	\$ 377,575	\$ 402,202
Regulatory liability-current		
Conservation Incentive Program	\$ 5,752	\$ —
Derivatives, net	\$ 320	\$ 1,456
Total current	\$ 6,072	\$ 1,456
Regulatory liabilities-noncurrent		
Cost of removal obligation	\$ 61,163	\$ 79,315
Derivatives, net	57	—
Other noncurrent liabilities	106	332
Total noncurrent	\$ 61,326	\$ 79,647

The Company's recovery of costs is facilitated through its base tariff rates, BGSS and other regulatory tariff riders. The Company is required to make an annual filing to the BPU by June 1 of each year for review of its BGSS, CIP and various other programs and related rates. Annual rate changes are requested to be effective at the beginning of the following fiscal year. In addition, the Company is also permitted to request approval of certain rate or program changes on an interim basis. All rate and program changes are subject to proper notification and BPU review and approval.

New Jersey Natural Gas Company

Gas Costs

The Company recovers its cost of gas through the BGSS rate component of its customers' bills. The Company's cost of gas includes the purchased cost of the natural gas commodity, fees paid to pipelines and storage facilities, adjustments as a result of BGSS incentive programs, and hedging transactions. Under-recovered gas costs represent a regulatory asset that generally occurs during periods when the Company's BGSS rates are lower than actual costs and requests amounts to be recovered from customers in the future. Conversely, over-recovered gas costs represent a regulatory liability that generally occurs when the Company's BGSS rates are higher than actual costs and requests approval to be returned to customers including interest, when applicable, in accordance with the Company's approved BGSS tariff.

Conservation Incentive Program

The CIP permits the Company to recover utility gross margin variations related to customer usage resulting from customer conservation efforts and allows the Company to mitigate the impact of weather on its gross margin. Such utility gross margin variations are recovered in the year following the end of the CIP usage year, without interest, and are subject to additional conditions, including an earnings test and an evaluation of BGSS related savings.

New Jersey Clean Energy Program

The NJCEP is a statewide program that encourages energy efficiency and renewable energy. Funding amounts are determined by the BPU's Office of Clean Energy and all New Jersey utilities are required to share in the annual funding obligation. The current NJCEP program is for the State of New Jersey's fiscal year ending June 2015. The Company recovers the costs associated with its portion of the NJCEP obligation, including interest, through its SBC rate rider over a one-year period.

Environmental Remediation Costs

The Company is responsible for the cleanup of certain former gas manufacturing facilities. Actual expenditures are recovered from customers, with interest, over seven year rolling periods, through a RA rate rider. Recovery for the Company's estimated future liability will be requested and/or recovered when actual expenditures are incurred. See *Note 10. Commitments and Contingencies*.

Deferred Income Taxes

In 1993, the Company adopted the provisions of ASC 740, *Income Taxes*, which changed the method used to determine deferred tax assets and liabilities. Upon adoption, the Company recognized a transition adjustment and corresponding regulatory asset representing the difference between the Company's existing deferred tax amounts compared with the deferred tax amounts calculated in accordance with the change in method prescribed by ASC 740. The Company recovers the regulatory asset associated with these tax impacts through future base rates, without interest.

Derivatives

Derivatives are utilized by the Company to manage the price risk associated with its natural gas purchasing activities and to participate in certain BGSS incentive programs. The gains and losses associated with the Company's derivatives are recoverable through its BGSS, as noted above, without interest. See *Note 4. Derivatives*.

New Jersey Natural Gas Company

SAVEGREEN

The Company administers certain programs that supplement the state's NJCEP and that allows the Company to promote clean energy to its residential and commercial customers, as described further below. The Company will recover related expenditures and a weighted average cost of capital through a tariff rider, as approved by the BPU, over a two to 10-year period depending upon the specific program incentive.

Postemployment and Other Benefit Costs

Postemployment and Other Benefit Costs represents the Company's underfunded postemployment benefit obligations that the Company began recognizing in fiscal 2006, as a result of changes in the accounting provisions of ASC 715, *Compensation and Benefits*, as well as a fiscal 2010 tax charge resulting from a change in the deductibility of federal subsidies associated with Medicare D, both of which are deferred as regulatory assets and are recoverable, without interest, in base tariff rates. See *Note 10. Employee Benefit Plans*.

Deferred Superstorm Sandy Costs

In October 2012, portions of the Company's distribution system incurred significant damage as a result of Superstorm Sandy. The Company filed a petition with the BPU in November 2012 requesting deferral accounting for uninsured incremental O&M costs associated with its restoration efforts, which was approved in May 2013. On October 22, 2014, the BPU approved, as prudent and reasonable, the deferred O&M storm costs to be recovered in the Company's next base rate case including the appropriate recovery period for such deferred expenses, to be filed no later than November 15, 2015.

Other Regulatory Assets

Other regulatory assets consists primarily of deferred costs associated with certain components of the Company's SBC, as discussed further below, and the Company's compliance with federal and state mandated PIM provisions. The Company's related costs to maintain the operational integrity of its distribution and transmission main are recoverable, subject to BPU review and approval, in its next base rate case. The Company is limited to recording a regulatory asset associated with PIM that does not exceed \$700,000 per year. In addition, to the extent that project costs are lower than the approved PIM annual expense of \$1.4 million, the Company will record a regulatory liability that will be refundable as a credit to customers' gas costs when the net cumulative liability exceeds \$1 million. As of September 30, 2014, the Company has recorded \$3.8 million of PIM in other regulatory assets.

Cost of Removal Obligation

The Company accrues and collects for cost of removal in base tariff rates on its utility property, without interest. A regulatory liability represents the current collections in excess of actual expenditures, which the Company will return to customers over approximately 48 years, through a reduction in the depreciation expense component of the Company's base tariff rates, as approved by the BPU in the Company's October 2008 base rate case.

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The following is a description of regulatory proceedings during fiscal 2013 and 2014:

BGSS and CIP

BGSS rates are normally revised on an annual basis. In addition, to manage the fluctuations in wholesale natural gas costs, the Company has the ability to make two interim filings during each fiscal year to increase residential and small commercial customer BGSS rates on a self-implementing and provisional basis. The Company is also permitted to refund or credit back a portion of the commodity costs to customers when the natural gas commodity costs decrease in comparison to amounts projected or to amounts previously collected from customers. Commodity prices were relatively stable during fiscal 2014 and 2013, therefore, no refunds or bill credits were issued to BGSS customers.

Concurrent with the annual BGSS filing, the Company files for an annual review of its CIP. In March 2013, the Company and South Jersey Gas Company filed a joint petition with the BPU requesting the continuation of the CIP with certain modifications. On May 21, 2014, the BPU approved the continuation of the CIP program with no expiration date; however, it will be subject to review in a future rate filing in 2017. The Company's annual BGSS and CIP filings are summarized as follows:

- June 2012 BGSS/CIP filing — The Company proposed to maintain its BGSS rate. In addition, the Company requested approval to decrease the CIP rate for residential non-heating customers and increase the CIP rates for residential heating and commercial customers, which increased an average residential heat customer's bill by 2.4 percent, effective October 2012. In May 2013, the BPU approved the changes on a final basis. In May 2013, the Company notified the BPU that it was going to reduce its BGSS rate resulting in a 5.2 percent decrease to an average residential heat customer's bill, effective June 1, 2013.
- June 2013 BGSS/CIP filing — The Company proposed to maintain its BGSS rate. In addition, the Company proposed a 1 percent reduction to an average residential heat customer's bill related to the CIP factor. The CIP rate reduction was provisionally approved by the BPU on October 16, 2013, to be effective November 1, 2013. On November 21, 2013, the Company notified the BPU of its intent to reduce its BGSS rate, effective December 1, 2013, resulting in a 6 percent decrease to the average residential heat customer's bill. On July 23, 2014, the BPU approved these rates on a final basis.
- June 2014 BGSS/CIP filing — The Company proposed to maintain its BGSS rate. In addition, the Company proposed a 4.3 percent reduction to an average residential heat customer's bill related to the CIP factor for fiscal 2015. On September 30, 2014, the BPU provisionally approved these rates to be effective October 1, 2014.
- On October 1, 2014, the Company implemented a decrease to its BGSS price for residential sales and general service small sales customers resulting in a 5 percent decrease to the average residential heat customer's bill.

Infrastructure Programs

The Company has significant annual capital expenditures associated with the management of its natural gas distribution and transmission system, including new utility plant for customer growth and its associated PIM and infrastructure programs.

New Jersey Natural Gas Company

The Company has implemented BPU-approved infrastructure projects that are designed to enhance the reliability of the Company's gas distribution system, including AIP and SAFE. The AIP projects, which totaled approximately \$148.7 million, were constructed and gas was introduced to the system from 2009 through October 2012. In May 2013, a base rate change was approved by the BPU that permits the Company to recover a total of approximately \$15.3 million annually. Depending on the infrastructure project, recoveries include a weighted average cost of capital of 7.76 percent or 7.12 percent with a return on equity of 10.3 percent.

In October 2012, the BPU approved the Company's petition to implement the SAFE program, investing up to \$130 million, exclusive of AFUDC, over a four-year period to replace portions of the Company's gas distribution unprotected steel and cast iron infrastructure in order to improve the safety and reliability of the gas distribution system. The approved SAFE Program includes the deferral of infrastructure costs subject to review in the Company's next base rate case to be filed no later than November 15, 2015, the deferral of depreciation expense on SAFE investments and recognizes an overall rate of return on infrastructure investments of 6.9 percent, including a return on equity of 9.75 percent. The deferred cost recovery will include accruals for both debt and equity components of AFUDC while construction is completed but not yet in service. In accordance with ASC 980, *Regulated Operations*, when SAFE construction projects are placed in service, the Company will accrue an AFUDC debt rate. For ratemaking purposes, subsequent to projects being placed into service, the Company will continue to earn an AFUDC rate of 6.9 percent per year until such time that the Company receives approval for recovery of all costs through base rates.

In June 2012, the BPU approved a pilot program for the Company to invest up to \$10 million to build NGV refueling stations in Monmouth, Ocean and Morris counties. On April 23, 2014, the BPU approved the Company's request to include a cost recovery filing to the BPU within the Company's next base rate case to be filed no later than November 15, 2015. In addition, the BPU approved a deferred accounting methodology related to the NGV investment costs consistent with the Company's SAFE Program. The NGV program was authorized by the BPU to earn an overall weighted average cost of capital of 7.1 percent, including a return on equity of 10.3 percent. A portion of the proceeds from the utilization of the NGV equipment, along with any available federal and state incentives, will be credited back to ratepayers to help offset the cost of this investment. As of September 30, 2014, the Company has begun development on three NGV stations with a total investment of approximately \$5.8 million to date.

On September 3, 2013, the Company filed a petition seeking approval of NJ RISE, which consists of six capital investment projects estimated to cost \$102.5 million over a five-year period, excluding AFUDC, for gas distribution storm hardening and mitigation projects, along with incremental O&M expenses. The submission was made in response to a March 2013 BPU order, initiating a proceeding to investigate prudent, cost efficient and effective opportunities to protect New Jersey's utility infrastructure from future major storm events. These system enhancements are intended to minimize service impacts during extreme weather events to customers that live in the most storm prone areas of the Company's service territory. In the filing, the Company seeks to recover the capital costs associated with NJ RISE through an annual adjustment to its base rate. On July 23, 2014, the BPU issued an order approving a Stipulation of Settlement related to the NJ RISE capital infrastructure program that requires the Company to submit a filing in May 2015 to recover costs through July 31, 2015, associated with NJ RISE. Those costs will be recovered through an adjustment to base rates as of November 1, 2015. Additional cost recovery will be included in the Company's next base rate case scheduled to be filed no later than November 15, 2015.

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BGSS Incentive Programs

The Company is eligible to receive financial incentives for reducing BGSS costs through a series of utility gross margin-sharing programs that include off-system sales, capacity release, storage incentive and Financial Risk Management programs. In August 2011, the BPU approved an extension of the Company's BGSS incentive programs for four years through October 31, 2015, maintaining the existing margin-sharing percentages. This agreement also permits the Company to annually propose a process to evaluate and discuss alternative incentive programs, should performance of the existing incentives or market conditions warrant re-evaluation.

SAVEGREEN

SAVEGREEN conducts home energy audits and provides various grants, incentives and financing alternatives, which are designed to encourage the installation of high efficiency heating and cooling equipment and other energy efficiency upgrades to promote energy efficiency incentives to its residential and commercial customers while stimulating state and local economies through the creation of jobs. Depending on the specific initiative, the Company recovers costs associated with the programs over a two to 10-year period through a tariff rider mechanism. As of September 30, 2014, the BPU has approved total SAVEGREEN expenditures of \$85 million related to grants and rebates, of which, the Company has spent a total of \$52.8 million and approved \$93.1 million related to customer financing incentives, of which, the Company has provided interest-free loans in the amount of \$38.8 million.

SAVEGREEN investments and costs are filed with the BPU on an annual basis and include the following:

- June 2012 SAVEGREEN filing — In June 2013, the BPU approved the Company's 2012 request to extend and expand SAVEGREEN through June 2015, with certain modifications, resulting in a planned investment of more than \$85 million, which includes \$17.3 million of investments in grants and rebates, and includes a weighted average cost of capital of 6.9 percent. In addition, the BPU approved a tariff rider rate increase of approximately 1.7 percent to recover costs and investments related to SAVEGREEN over a two to 10-year period, which represents an annual recovery of approximately \$12.4 million.

In June 2014, the Company submitted a rate filing for the recovery of SAVEGREEN costs, which proposes to maintain the existing rate.

In December 2014, the Company filed a petition with the BPU to extend SAVEGREEN through June 30, 2018, with minor modifications.

Societal Benefits Clause

The SBC is comprised of three primary riders that allow the Company to recover costs associated with USF, which is a permanent statewide program for all natural gas and electric utilities for the benefit of income-eligible customers, MGP remediation, and the NJCEP. The Company has submitted the following filings to the BPU, which includes a report of program expenditures incurred each program year:

- February 2012 SBC filing — The Company requested, and received, BPU approval of its MGP expenditures incurred through June 2011, which continued its existing overall SBC rate and recovery that was approved by the BPU, effective November 2011.

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- June 2012 USF filing — The Company filed to reduce the USF recovery rate resulting in a .1 percent decrease for the average residential heat customer's bill. The rate was approved by the BPU, effective October 2012.
- June 2013 USF filing — The Company filed to reduce the USF recovery rate resulting in a .5 percent decrease for the average residential heat customer's bill effective October 1, 2013. The rate was approved by the BPU in September 2013.
- July 2013 SBC filing — The Company requested approval of its MGP expenditures incurred through June 2013, as well as a .2 percent reduction to the average residential heat customer's bill related to the SBC RA factor to recover \$18.7 million annually, and a 1.9 percent increase related to its NJCEP factor. The rates were approved by the BPU on a provisional basis, effective December 1, 2013, and on a final basis in July 2014.
- June 2014 USF filing — The Company filed to to increase the statewide USF rate, resulting in a .4 percent increase to the average residential heat customer's bill effective October 1, 2014. The rate was approved by the BPU in September 2014.
- September 2014 SBC filing — The Company requested approval of its MGP expenditures incurred through June 2014, as well as a 3 percent reduction to the average residential heat customer's bill, to recover \$8.5 million annually related to the SBC RA factor and \$16.3 million related to the NJCEP factor.
- Additionally, in November 2012, the BPU approved the Company's funding obligations for NJCEP for the period from January 2013 to June 2013, of approximately \$9.8 million. In June 2013, the BPU approved the Company's funding obligations for July 2013 to June 2014, of approximately \$15.6 million. In June 2014, the BPU approved the Company's funding obligations for July 2014 to June 2015, of approximately \$15.6 million. Accordingly, the Company recorded the obligation and corresponding regulatory asset on the Balance Sheets.

Other Regulatory Initiatives

In November 2012, the Company filed a petition with the BPU requesting deferred accounting for uninsured incremental O&M costs associated with Superstorm Sandy, which was subsequently approved in May 2013. In March 2013, the BPU issued an Order establishing a generic proceeding to review the prudence of costs incurred by New Jersey utility companies in response to major storm events in 2011 and 2012. In July 2013, the Company filed its detailed report including unreimbursed, uninsured incremental storm restoration costs and capital expenditures. As of September 30, 2014, the Company has deferred \$15.2 million of these costs as a regulatory asset. On October 22, 2014, the BPU approved, as prudent and reasonable, the deferred O&M storm costs to be recovered in the Company's next base rate case to be filed no later than November 15, 2015.

In December 2012, the Company filed a petition with the BPU requesting approval of a municipal consent in the Borough of Sayreville, New Jersey to provide natural gas distribution service to Red Oak Power, LLC, an electric generating facility. The municipal consent was approved by the BPU in September 2013. In December 2013, the BPU approved a gas service agreement between TAQA GEN-X, LLC and the Company that allows the Company to provide transportation service to Red Oak Power, LLC, through September 2022. Construction to connect to the plant commenced during the fourth quarter of fiscal 2014,

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and is anticipated to cost approximately \$1 million, which will be reimbursed by Red Oak Power, LLC. Service is expected to begin in the first half of fiscal 2015.

On April 23, 2014, the BPU approved a petition filed by the Company requesting authorization over a three-year period to issue up to \$300 million of medium-term notes with a maturity of not more than 30 years, renew its revolving credit facility expiring August 2014 for up to five years, enter into interest rate risk management transactions related to debt securities and redeem, refinance or defease any of the Company's outstanding long-term debt securities.

4. DERIVATIVE INSTRUMENTS

The Company is subject to commodity price risk due to fluctuations in the market price of natural gas. To manage this risk, the Company enters into a variety of derivative instruments including, but not limited to, futures contracts, physical forward contracts, financial options and swaps to economically hedge the commodity price risk associated with its existing and anticipated commitments to purchase and sell natural gas. Accordingly, all of the financial derivative instruments are recorded at fair value on the Balance Sheets. For a more detailed discussion of the Company's fair value measurement policies and level disclosures associated with derivative instruments, see *Note 5. Fair Value*.

Changes in fair value of the Company's derivative instruments, however, are recorded as a component of regulatory assets or liabilities on the Balance Sheets, as the Company has received regulatory approval to defer and to recover these amounts through future BGSS rates as an increase or decrease to the cost of natural gas in the Company's tariff.

The Company elects normal purchase/normal sale accounting treatment on all physical commodity contracts. These contracts are accounted for on an accrual basis. Accordingly, physical purchases are recognized in regulatory assets or liabilities on the Balance Sheets when the contract settles and the natural gas is delivered and amortized in current period earnings based on the current BPU BGSS factor.

Fair Value of Derivatives

The following table reflects the fair value of the Company's derivative assets and liabilities recognized on the Balance Sheets as of September 30:

	Balance Sheet Location	Fair Value			
		2014		2013	
(Thousands)		Asset Derivatives	Liability Derivatives	Asset Derivatives	Liability Derivatives
Financial commodity contracts	Derivatives - current	\$ 2,525	\$ 2,205	\$ 3,502	\$ 2,045
	Derivatives - noncurrent	82	25	121	140
Total fair value of derivatives		\$ 2,607	\$ 2,230	\$ 3,623	\$ 2,185

Offsetting of Derivatives

The Company transacts under master netting arrangements or similar agreements that allow it to offset derivative assets and liabilities with the same counterparty, however the Company's policy is to present its derivative assets and liabilities on a gross basis in the Balance Sheets.

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The following table summarizes the reported gross amounts, the amounts that the Company has the right to offset but elects not to, financial collateral, as well as the net amounts the Company could present in the Balance Sheets but elects not to.

<i>(Thousands)</i>	Amounts Presented in Balance Sheets ⁽¹⁾	Offsetting Derivative Instruments ⁽²⁾	Financial Collateral Received/Pledged ⁽³⁾	Net Amounts ⁽⁴⁾
As of September 30, 2014:				
Derivative assets:				
Financial commodity contracts	\$ 2,607	\$ (2,230)	\$ (377)	\$ —
Derivative liabilities:				
Financial commodity contracts	\$ 2,230	\$ (2,230)	\$ —	\$ —
As of September 30, 2013:				
Derivative assets:				
Financial commodity contracts	\$ 3,623	\$ (2,185)	\$ 214	\$ 1,652
Derivative liabilities:				
Financial commodity contracts	\$ 2,185	\$ (2,185)	\$ —	\$ —

- (1) Derivative assets and liabilities are presented on a gross basis in the balance sheet as the Company does not elect balance sheet offsetting under ASC 210-20.
- (2) Offsetting derivative instruments include: transactions with NAESB netting election, transactions held by FCMs with net margining and transactions with ISDA netting.
- (3) Financial collateral includes cash balances at FCMs as well as cash received from or pledged to other counterparties.
- (4) Net amounts represent presentation of derivative assets and liabilities if the Company were to elect balance sheet offsetting under ASC 210-20.

The Company had gains associated with financial derivatives that totaled \$10.1 million and \$1.8 million for the fiscal years ended September 30, 2014 and 2013, respectively. These derivatives are part of the Company's risk management activities that relate to its natural gas purchases and BGSS incentive programs. As these transactions are entered into pursuant to and recoverable through regulatory riders, any changes in the value of the Company's financial derivatives are deferred in regulatory assets or liabilities resulting in no impact to earnings.

The Company had outstanding long derivatives of 17.3 Bcf and 22.6 Bcf as of September 30, 2014 and 2013, respectively.

Broker Margin

Generally, exchange-traded futures contracts require posted collateral, referred to as margin, usually in the form of cash. The amount of margin required is comprised of a fixed initial amount based on exchange requirements and a variable amount based on a daily mark-to-market. The Company's broker margin account balances as of September 30, 2014 and 2013, are \$1.1 million and \$213,000, respectively.

Wholesale Credit Risk

The Company is exposed to credit risk as a result of their wholesale marketing activities. As a result of the inherent volatility in the prices of natural gas commodities and derivatives, the market value of contractual positions with individual counterparties could exceed established credit limits or collateral provided by those counterparties. If a counterparty failed to perform the obligations under its contract (e.g., failed to deliver or pay for natural gas), then the Company could sustain a loss.

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The Company monitors and manages the credit risk of its wholesale marketing operations through credit policies and procedures that management believes reduce overall credit risk. These policies include a review and evaluation of current and prospective counterparties' financial statements and/or credit ratings, daily monitoring of counterparties' credit limits and exposure, daily communication with traders regarding credit status and the use of credit mitigation measures, such as collateral requirements and netting agreements. Examples of collateral include letters of credit and cash received for either prepayment or margin deposit. Collateral may be requested due to the Company's election not to extend credit or because exposure exceeds defined thresholds. Most of the Company's wholesale marketing contracts contain standard netting provisions. These contracts include those governed by the ISDA and the NAESB. The netting provisions refer to payment netting, whereby receivables and payables with the same counterparty are offset and the resulting net amount is paid to the party to which it is due.

Internally-rated exposure applies to counterparties that are not rated by S&P or Moody's. In these cases, the company's or guarantor's financial statements are reviewed, and similar methodologies and ratios used by S&P and/or Moody's are applied to arrive at a substitute rating. Gross credit exposure is defined as the unrealized fair value of physical and financial derivative commodity contracts plus any outstanding wholesale receivable for the value of natural gas delivered and/or financial derivative commodity contract that has settled for which payment has not yet been received. The amounts presented below have not been reduced by any collateral received or netting and exclude accounts receivable for retail natural gas sales and services.

The following is a summary of gross credit exposures grouped by investment and noninvestment grade counterparties, as of September 30, 2014.

<i>(Thousands)</i>	Gross Credit Exposure
Investment grade	\$ 4,762
Noninvestment grade	491
Internally rated investment grade	78
Internally rated noninvestment grade	95
Total	\$ 5,426

Conversely, certain of the Company's derivative instruments are linked to agreements containing provisions that would require cash collateral payments from the Company if certain events occur. These provisions vary based upon the terms in individual counterparty agreements and can result in cash payments if the Company's credit rating were to fall below its current level. The Company's credit rating, with respect to S&P, reflects the overall corporate credit profile. Specifically, most, but not all, of these additional payments will be triggered if the Company's debt is downgraded by the major credit agencies, regardless of investment grade status. As well, some of these agreements include threshold amounts that would result in additional collateral payments if the values of derivative liabilities were to exceed the maximum values provided for in relevant counterparty agreements. Other provisions include payment features that are not specifically linked to ratings, but are based on certain financial metrics.

Collateral amounts associated with any of these conditions, are determined based on a sliding scale and are contingent upon the degree to which the Company's credit rating and/or financial metrics deteriorate, and the extent to which liability amounts exceed applicable threshold limits. There was no aggregate fair value of derivative instruments with credit-risk-related contingent features that were in a liability position on September 30, 2014 and 2013. If all the thresholds related to the credit-risk-related contingent features underlying these agreements had been invoked on September 30, 2014 and 2013, the Company would not have been required to post any additional collateral to its counterparties. These amounts differ from the

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respective net derivative liabilities reflected on the Balance Sheets because the agreements also include clauses, commonly known as “Rights of Offset,” that would permit the Company to offset its derivative assets against its derivative liabilities for determining additional collateral to be posted.

5. FAIR VALUE

Fair Value of Assets and Liabilities

The fair value of cash and cash equivalents, commercial paper and borrowings under revolving credit facilities are estimated to equal their carrying amounts due to the short maturity of those instruments. The estimated fair value of long-term debt, including current maturities and excluding capital leases, as applicable as of September 30, are as follows:

<i>(Thousands)</i>	2014	2013
Carrying value	\$ 432,845	\$ 379,845
Fair market value	\$ 453,773	\$ 397,175

The Company utilizes a discounted cash flow method to determine the fair value of its debt. Inputs include observable municipal and corporate yields, as appropriate, for the maturity of the specific issue and NJR's credit rating. As of September 30, 2014 and 2013, the Company discloses its debt within Level 2 of the fair value hierarchy.

Fair Value Hierarchy

The Company applies fair value measurement guidance to its financial assets and liabilities, as appropriate, which include financial derivatives. In addition, authoritative accounting literature prescribes the use of a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value based on the source of the data used to develop the price inputs. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority to inputs that are based on unobservable market data and include the following:

- Level 1 Unadjusted quoted prices for identical assets or liabilities in active markets. The Company's Level 1 assets and liabilities include exchange traded futures contracts, listed equities, and money market funds. Exchange traded futures contracts include all energy contracts traded on the NYMEX/CME and ICE that the Company refers internally to as basis swaps, fixed swaps and futures that are cleared through a FCM.
- Level 2 Other significant observable inputs such as interest rates or price data, including both commodity and basis pricing that is observed either directly or indirectly from publications or pricing services. Level 2 financial derivatives consist of transactions with non-FCM counterparties (basis swaps, fixed swaps and/or options).
- Level 3 Inputs derived from a significant amount of unobservable market data; these include the Company's best estimate of fair value and are derived primarily through the use of internal valuation methodologies.

The Company's financial derivatives portfolios consist mainly of futures and swaps. The Company primarily uses the market approach and its policy is to use actively quoted market prices when available.

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The principal market for its derivative transactions is the natural gas wholesale market, therefore, the primary source for its price inputs is the CME/NYMEX exchange.

When the Company determines fair values, measurements are adjusted, as needed, for credit risk associated with its counterparties, as well as its own credit risk. The Company determines these adjustments by using historical default probabilities that correspond to the applicable S&P issuer ratings, while also taking into consideration collateral and netting arrangements that serve to mitigate risk.

Assets and liabilities measured at fair value on a recurring basis are summarized as follows:

<i>(Thousands)</i>	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
As of September 30, 2014:				
Assets:				
Financial derivative contracts - natural gas	\$ 2,607	\$ —	\$ —	\$ 2,607
Total assets at fair value	\$ 2,607	\$ —	\$ —	\$ 2,607
Liabilities:				
Financial derivative contracts - natural gas	\$ 2,230	\$ —	\$ —	\$ 2,230
Total liabilities at fair value	\$ 2,230	\$ —	\$ —	\$ 2,230
As of September 30, 2013:				
Assets:				
Financial derivative contracts - natural gas	\$ 3,623	\$ —	\$ —	\$ 3,623
Total assets at fair value	\$ 3,623	\$ —	\$ —	\$ 3,623
Liabilities:				
Financial derivative contracts - natural gas	\$ 2,185	\$ —	\$ —	\$ 2,185
Total liabilities at fair value	\$ 2,185	\$ —	\$ —	\$ 2,185

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6. DEBT

The following table presents the long-term debt of the Company as of September 30:

<i>(Thousands)</i>			2014	2013
Long-Term Debt				
First mortgage bonds:		Maturity date:		
5.00%	Series HH	December 1, 2038	—	12,000
4.50%	Series II	August 1, 2023	10,300	10,300
4.60%	Series JJ	August 1, 2024	10,500	10,500
4.90%	Series KK	October 1, 2040	15,000	15,000
5.60%	Series LL	May 15, 2018	125,000	125,000
Variable	Series MM	September 1, 2027	9,545	9,545
Variable	Series NN	August 1, 2035	41,000	41,000
Variable	Series OO	August 1, 2041	46,500	46,500
3.15%	Series PP	April 15, 2028	50,000	50,000
4.77%	Unsecured senior notes	March 15, 2014	—	60,000
3.58%	Series QQ	March 13, 2024	70,000	—
4.61%	Series RR	March 13, 2044	55,000	—
Capital lease obligation-Buildings		June 1, 2021	18,726	20,381
Capital lease obligation-Meters		Various dates	31,143	31,261
Capital lease obligation-Equipment		December 1, 2013	—	42
Less: Current maturities of long-term debt			(9,505)	(68,643)
Total long-term debt			\$ 473,209	\$ 362,886

Annual long-term debt redemption requirements, excluding capital leases, as of September 30, are as follows (in millions):

September 30,	Redemption
2015	\$ —
2016	\$ —
2017	\$ —
2018	\$ 125.0
2019	\$ —
Thereafter	\$ 307.8

First Mortgage Bonds

The Company and Trustee, entered into the New Mortgage Indenture, dated September 1, 2014, which secures all of the outstanding First Mortgage Bonds issued under the Old Mortgage Indenture. The New Mortgage Indenture provides a direct first mortgage lien upon substantially all of the operating properties and franchises of the Company (other than excepted property, such as cash on hand, choses-in-action, securities, rent, natural gas meters and certain materials, supplies, appliances and vehicles), subject only to certain permitted encumbrances. The New Mortgage Indenture contains provisions subjecting after-acquired property (other than excepted property and subject to pre-existing liens, if any, at the time of acquisition) to the lien thereof.

New Jersey Natural Gas Company

The Company's New Mortgage Indenture no longer contains a restriction on the ability of the Company to pay dividends. New Jersey Administrative Code 14:4-4.7 states that a public utility cannot issue dividends if its equity to total capitalization ratio falls below 30 percent without regulatory approval. As of September 30, 2014, the Company equity to total capitalization ratio is 50.9 percent and has the ability to issue up to \$841.2 million of First Mortgage Bonds under the terms of the New Mortgage Indenture.

In August 2011, the Company completed a refunding of its outstanding Auction-Rate Securities whereby the EDA issued three series of Variable Rate Demand Notes with a total principal amount of \$97 million with maturity dates ranging from September 2027 to August 2041. The Company and the EDA entered into a Loan Agreement securing the payment of principal and interest on the notes by the Company with a pledge of \$97 million principal amount of First Mortgage Bonds issued by the Company.

This agreement was amended and restated effective September 1, 2014, to accommodate a new variable interest rate mode. In connection with the change in interest rate mode, the Company entered into a Continuing Covenant Agreement dated as of September 24, 2014, with Wells Fargo, pursuant to which Wells Fargo agreed to buy the EDA Bonds. Each series of EDA Bonds is expected to accrue interest for five years at a variable rate determined monthly, which rate is initially calculated as .55 percent plus 70 percent of one month LIBOR, subject to earlier redemption or conversion to another interest rate mode. The EDA Bonds are not subject to optional tender while they bear interest at a LIBOR index rate. Any remaining unamortized extinguished debt costs, will be amortized over the life of the new EDA Bonds in accordance with ASC 980, Regulated Operations, therefore, there was no impact to income upon extinguishment.

The rates on these types of investments are generally correlated with the Securities Industry and Financial Markets Association Municipal Swap Index and will initially accrue interest at a daily rate, with a maximum rate of 12 percent per annum. As of September 30, 2014, the interest rate on the EDA Bonds was .66 percent.

On April 15, 2013, the Company issued \$50 million of 3.15 percent senior secured notes due April 15, 2028, in the private placement market pursuant to a note purchase agreement entered into on February 8, 2013. Interest is payable semi-annually. The proceeds were used to refinance short-term debt and will fund capital expenditure requirements.

On March 13, 2014, the Company issued \$70 million of 3.58 percent senior notes due March 13, 2024, and \$55 million of 4.61 percent senior notes due March 13, 2044, secured by First Mortgage Bonds in the private placement market pursuant to a note purchase agreement entered into on February 7, 2014. The proceeds were used to pay down short-term debt and redeem the Company's \$60 million, 4.77 percent private placement bonds on March 15, 2014.

On May 27, 2014, the Company redeemed the \$12 million, 5 percent Series HH bonds, which were callable as of December 1, 2013.

Sale-Leasebacks

The Company's lease agreement for its headquarters building has a 25.5-year term that expires in June 2021, subject to an option by the Company to renew the lease for additional five-year terms a maximum of four times. The present value of the agreement's minimum lease payments is reflected as both a capital lease asset and a capital lease obligation, which are included in utility plant and long-term debt, respectively, on the Balance Sheets.

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The Company received \$7.6 million and \$7.1 million for fiscal 2014 and 2013, respectively, in connection with the sale-leaseback of its natural gas meters. The Company records a capital lease obligation that is paid over the term of the lease and has the option to purchase the meters back at fair value upon expiration of the lease. During fiscal 2014 and 2013, the Company exercised early purchase options with respect to meter leases by making final principal payments of \$956,000 and \$752,000, respectively. This sale-leaseback program is expected to continue on an annual basis.

Contractual commitments for capital lease payments, as of the fiscal years ended September 30, are as follows (in millions):

<i>(Millions)</i>	Lease Payments
2015	\$11.9
2016	12.1
2017	11.0
2018	9.1
2019	6.3
Thereafter	7.6
Subtotal	58.0
Less: interest component	(8.1)
Total	\$49.9

Short-term Debt

A summary of the Company's credit facilities, which require commitment fees on the unused amounts, as of September 30, are as follows:

<i>(Thousands)</i>	2014	2013
Bank credit facility dedicated to EDA Bonds ^{(1) (2)}	\$ —	\$ 100,000
Bank revolving credit facilities ⁽¹⁾	\$ 250,000	\$ 250,000
Commercial paper outstanding at end of period	\$ 153,000	\$ 168,600
Weighted average interest rate at end of period	0.12%	0.13%
Amount available at end of period ⁽³⁾	\$ 96,269	\$ 81,400

(1) Committed credit facilities, which require commitment fees on the unused amounts.

(2) There were no borrowings outstanding as of September 30, 2014 and 2013, respectively.

(3) Letters of credit outstanding total \$731,000 and \$266,000 as of September 30, 2014 and 2013, respectively, which reduce amount available.

The Company had a \$250 million unsecured committed credit facility, which was due to expire in August 2014. On May 15, 2014, the Company replaced the facility with a new \$250 million, five-year, revolving, unsecured credit facility expiring in May 2019. The new Credit Facility permits the borrowing of revolving loans and swing loans, as well as the issuance of letters of credit. It also permits an increase to the facility, from time to time, with the existing or new lenders, in a minimum of \$15 million increments up to a maximum of \$50 million at the lending banks' discretion. As of September 30, 2014, the unused amount available under the Credit Facility, including amounts allocated to the backstop under the commercial paper program and the issuance of letters of credit, was \$153 million.

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As of September 30, 2014, the Company has two letters of credit outstanding for \$731,000. The Company's letters of credit are used for collateral for remediation projects and expire on August 11, 2015. These letters of credit reduce the amount available under the Company's committed credit facility by the same amount. The Company does not anticipate that these letters of credit will be drawn upon by the counterparty, and will be renewed as necessary.

The Company entered into the JPMC Facility, which was a \$100 million four-year credit facility that was due to expire in August 2015, to provide liquidity support in the event of a failed remarketing of the EDA Bonds and to ensure payment of principal and interest. The JPMC Facility was terminated on September 26, 2014 as a result of the change in the interest rate mode on the EDA bonds.

7. EMPLOYEE BENEFIT PLANS

Pension and Other Postemployment Benefit Plans

The Company has two trustee, noncontributory defined benefit retirement plans covering eligible regular represented and nonrepresented employees with more than one year of service. Defined benefit plan benefits are based on years of service and average compensation during the highest sixty consecutive months of employment. The Company also provides postemployment medical and life insurance benefits to employees who meet certain eligibility requirements.

All non-represented employees hired on or after October 1, 2009, and represented employees hired on or after January 1, 2012, are covered by an enhanced defined contribution plan instead of the defined benefit plan. Participation in the postemployment medical and life insurance plan was also frozen to new employees as of the same dates.

The Company also maintains an unfunded nonqualified PEP that was established to provide employees with the full level of benefits as stated in the qualified plan without reductions due to various limitations imposed by the provisions of federal income tax laws and regulations. There were no plan assets in the nonqualified plan due to the nature of the plan.

During the fourth quarter of fiscal 2014, the Company implemented a voluntary early retirement program to certain employees and recognized an expense of approximately \$1.7 million, including pension and postemployment benefit costs of \$1.2 million related to special termination benefits, and \$533,000 related to other severance benefits.

The Company's funding policy for its pension plans is to contribute at least the minimum amount required by the Employee Retirement Income Security Act of 1974, as amended. In fiscal 2014 and 2013, the Company had no minimum funding requirements. The Company made no discretionary contributions to the pension plans in fiscal 2014, and contributed \$20 million in fiscal 2013. The Company elected to make this discretionary tax-deductible contribution to improve the funded status of the pension plans. The Company does not expect to be required to make additional contributions to fund the pension plans over the next three fiscal years based on current actuarial assumptions; however, funding requirements are uncertain and can depend significantly on changes in actuarial assumptions, returns on plan assets and changes in the demographics of eligible employees and covered dependents. In addition, as in the past, the Company may elect to make contributions in excess of the minimum required amount to the plans.

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There are no Federal requirements to pre-fund OPEB benefits. However, the Company is required to fund certain amounts due to regulatory agreements with the BPU. The Company contributed \$5 million and \$6 million, respectively, in fiscal 2014 and 2013 and estimates that it will contribute between \$4 million to \$6 million over the next five years. Additional contributions may be required based on market conditions and changes to assumptions.

The following summarizes the changes in the funded status of the plans and the related liabilities recognized on the Balance Sheets as of September 30:

<i>(Thousands)</i>	Pension ⁽¹⁾		OPEB	
	2014	2013	2014	2013
Change in Benefit Obligation				
Benefit obligation at beginning of year	\$ 146,050	\$ 154,265	\$ 94,777	\$ 101,794
Service cost	4,125	4,564	2,704	3,184
Interest cost	7,381	6,521	4,809	4,322
Plan participants' contributions	39	41	38	32
Special termination benefits	978	—	195	—
Actuarial loss (gain)	15,325	(14,515)	4,720	(12,077)
Benefits paid, net of retiree subsidies received	(8,749)	(4,826)	(2,115)	(2,478)
Benefit obligation at end of year	\$ 165,149	\$ 146,050	\$ 105,128	\$ 94,777
Change in plan assets				
Fair value of plan assets at beginning of year	\$ 153,923	\$ 123,875	\$ 48,877	\$ 40,485
Actual return on plan assets	17,624	14,784	4,551	5,047
Employer contributions	49	20,049	4,950	5,977
Benefits paid, net of plan participants' contributions	(8,710)	(4,785)	(2,186)	(2,632)
Fair value of plan assets at end of year	\$ 162,886	\$ 153,923	\$ 56,192	\$ 48,877
Funded status	\$ (2,263)	\$ 7,873	\$ (48,936)	\$ (45,900)
Amounts recognized on the Balance Sheets				
Postemployment employee benefit (liability) asset				
Current	\$ (48)	\$ (47)	\$ (116)	\$ (100)
Non-current	(2,215)	7,920	(48,820)	(45,800)
Total	\$ (2,263)	\$ 7,873	\$ (48,936)	\$ (45,900)

(1) Includes the Company's PEP.

The Company recognizes a liability for its underfunded benefit plans as required by the *Compensation - Retirement Benefits* Topic of the ASC 715, and records the offset to regulatory assets for the portion of liability relating to its regulated utility and to accumulated other comprehensive income for the portion of the liability related to its non-regulated operations.

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The following table summarizes the amounts recognized in regulatory assets as of September 30:

	Pension	OPEB
Balance at September 30, 2012 ⁽¹⁾	\$ 80,449	\$ 58,799
Amounts arising during the period:		
Net actuarial (gain)	(17,961)	(13,523)
Amounts amortized to net periodic costs:		
Net actuarial (loss)	(5,719)	(3,743)
Prior service (cost) credit	(105)	301
Net transition obligation	—	(22)
Balance at September 30, 2013	\$ 56,664	\$ 41,812
Amounts arising during the period:		
Net actuarial loss	10,563	4,277
Amounts amortized to net periodic costs:		
Net actuarial (loss)	(5,326)	(2,607)
Prior service (cost) credit	(107)	303
Net transition obligation	—	(11)
Balance at September 30, 2014	\$ 61,794	\$ 43,774

(1) Balance represents amounts recognized in accordance with ASC 715 and excludes \$308,000 associated with a regulatory asset approved by the BPU for fiscal 2012.

The amounts in regulatory assets and accumulated other comprehensive income not yet recognized as components of net periodic benefit cost as of September 30 are:

<i>(Thousands)</i>	Pension		OPEB	
	2014	2013	2014	2013
Net actuarial loss	\$ 60,797	\$ 55,559	\$ 45,809	\$ 44,140
Prior service cost (credit)	997	1,105	(2,035)	(2,339)
Net transition obligation	—	—	—	11
Total	\$ 61,794	\$ 56,664	\$ 43,774	\$ 41,812

Amounts included in regulatory assets expected to be recognized as components of net periodic benefit cost in fiscal 2015 are as follows:

<i>(Thousands)</i>	Pension	OPEB
Net actuarial loss	\$ 5,305	\$ 2,911
Prior service cost (credit)	108	(311)
Total	\$ 5,413	\$ 2,600

The accumulated benefit obligation for the pension plans, including PEP exceeded the fair value of plan assets. The projected benefit and accumulated benefit obligations and the fair value of plan assets as of September 30, are as follows:

<i>(Thousands)</i>	Pension	
	2014	2013
Projected benefit obligation	\$ 165,149	\$ 146,050
Accumulated benefit obligation	\$ 144,695	\$ 130,422
Fair value of plan assets	\$ 162,886	\$ 153,923

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The components of the net periodic cost for pension benefits, including the Company's PEP and OPEB costs (principally health care and life insurance) for employees and covered dependents for fiscal years ended September 30, are as follows:

<i>(Thousands)</i>	Pension		OPEB	
	2014	2013	2014	2013
Service cost	\$ 4,125	\$ 4,564	\$ 2,704	\$ 3,184
Interest cost	7,381	6,521	4,809	4,322
Expected return on plan assets	(11,885)	(11,338)	(4,109)	(3,601)
Recognized actuarial loss	4,348	5,719	2,607	3,743
Prior service cost (credit) amortization	107	105	(303)	(301)
Recognized net initial obligation	—	—	11	22
Net periodic benefit cost	\$ 4,076	\$ 5,571	\$ 5,719	\$ 7,369
Special termination benefit	\$ 978	\$ —	\$ 195	\$ —
Net periodic benefit cost recognized as expense	\$ 5,054	\$ 5,571	\$ 5,914	\$ 7,369

The weighted average assumptions used to determine benefit costs during the fiscal year and obligations as of September 30, are as follows:

	Pension		OPEB	
	2014	2013	2014	2013
Benefit costs:				
Discount rate	5.15%	4.30%	5.15%	4.30%
Expected asset return	8.25%	8.50%	8.25%	8.50%
Compensation increase	3.25%	3.25%	3.50%	3.25%
Obligations:				
Discount rate	4.55%	5.15%	4.55%	5.15%
Compensation increase	3.25/3.50% ⁽¹⁾	3.25%	3.50%	3.25%

(1) Percentages for represented and nonrepresented plans, respectively.

In selecting an assumed discount rate, the Company uses a modeling process that involves selecting a portfolio of high-quality corporate debt issuances (AA- or better) whose cash flows (via coupons or maturities) match the timing and amount of the Company's expected future benefit payments. The Company considers the results of this modeling process, as well as overall rates of return on high-quality corporate bonds and changes in such rates over time, to determine its assumed discount rate.

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Information relating to the assumed HCCTR used to determine expected OPEB benefits as of September 30, and the effect of a one percent change in the rate, are as follows:

<i>(\$ in thousands)</i>	2014	2013
HCCTR	7.1%	7.3%
Ultimate HCCTR	4.8%	4.8%
Year ultimate HCCTR reached	2022	2022
Effect of a 1 percentage point increase in the HCCTR on:		
<i>Year-end benefit obligation</i>	\$ 17,333	\$ 15,170
<i>Total service and interest cost</i>	\$ 1,450	\$ 1,624
Effect of a 1 percentage point decrease in the HCCTR on:		
<i>Year-end benefit obligation</i>	\$ (13,987)	\$ (12,318)
<i>Total service and interest costs</i>	\$ (1,149)	\$ (1,263)

The Company's investment objective is a long-term real rate of return on assets before permissible expenses that is approximately 6 percent greater than the assumed rate of inflation as measured by the consumer price index. The expected long-term rate of return is based on the asset categories in which the Company invests and the current expectations and historical performance for these categories.

The mix and targeted allocation of the pension and OPEB plans' assets are as follows:

Asset Allocation	2015 Target Allocation	Assets at September 30,	
		2014	2013
U.S. equity securities	40%	39%	42%
International equity securities	20	20	22
Fixed income	40	41	36
Total	100%	100%	100%

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid during the following years:

<i>(Thousands)</i>	Pension	OPEB
2015	\$ 5,626	\$ 3,289
2016	\$ 6,231	\$ 3,891
2017	\$ 6,566	\$ 4,300
2018	\$ 7,093	\$ 4,709
2019	\$ 7,546	\$ 5,132
2020 - 2024	\$ 45,993	\$ 32,102

The Company's OPEB plans provide prescription drug benefits that are actuarially equivalent to those provided by Medicare Part D. Therefore, under the Medicare Prescription Drug, Improvement and Modernization Act of 2003 the Company qualifies for federal subsidies.

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The estimated subsidy payments are:

Fiscal Year	Estimated Subsidy Payment (Thousands)
2015	\$ 195
2016	\$ 215
2017	\$ 235
2018	\$ 255
2019	\$ 276
2020 - 2024	\$ 1,812

Pension and OPEB assets held in the master trust, measured at fair value, as of September 30, are summarized as follows:

(Thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)			
	Pension		OPEB	
Assets	2014	2013	2014	2013
Money market funds	\$ 38	\$ 2	\$ 1,139	\$ 1,134
Registered Investment Companies-				
Equity Funds				
Large Cap Index Fund	54,147	53,584	18,851	16,195
Extended Market Index Fund	9,601	11,328	3,686	3,397
International Stock	32,194	32,895	10,179	9,896
Fixed Income Funds				
Emerging Markets	7,718	6,729	2,763	2,133
Core Fixed Income	—	—	6,440	11,524
Opportunistic Income	—	—	3,910	—
Ultra Short Duration	—	—	3,714	—
High Yield Bond Fund	16,203	15,259	5,510	4,598
Long Duration Fund	42,985	34,126	—	—
Total assets at fair value	\$ 162,886	\$ 153,923	\$ 56,192	\$ 48,877

The plan had no Level 2 or Level 3 fair value measurements during the two fiscal years and there have been no changes in valuation methodologies as of September 30, 2014. The following is a description of the valuation methodologies used for assets measured at fair value:

Money Market funds: Represents bank balances and money market funds that are valued based on the net asset value of shares held at year end.

Registered Investment Companies: Equity and fixed income funds valued at the net asset value of shares held by the plan at year end as reported on the active market on which the individual securities are traded.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation

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methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Defined Contribution Plan

The Company offers a Savings Plan to eligible employees. As of January 1, 2014, the Company matches 60 percent of participants' contributions up to 6 percent of base compensation. The Company's non-represented employees hired on or after October 1, 2009, and represented employees hired on or after January 1, 2012, are eligible for an employer special contribution of between 3 percent and 4 percent of base compensation, depending on years of service, into the Savings Plan on their behalf. The amount expensed and contributed for the matching provision of the Savings Plan was \$1.4 million in fiscal 2014 and \$1.2 million in fiscal 2013. The amount contributed for the employer special contribution of the Savings Plan was \$62,000 and \$20,000 in fiscal 2014 and 2013, respectively.

8. ASSET RETIREMENT OBLIGATIONS

The Company recognizes AROs related to the costs associated with cutting and capping its main and service gas distribution pipelines, which are required by New Jersey law when taking such gas distribution pipeline out of service.

The following is an analysis of the change in the ARO liability for the fiscal years ended September 30:

<i>(Thousands)</i>	2014	2013
Balance at October 1	\$ 28,711	\$ 27,983
Accretion	2,012	1,892
Additions	925	533
Retirements	(1,153)	(1,697)
Balance at period end	\$ 30,495	\$ 28,711

Accretion amounts are deferred as a regulatory asset and netted against regulatory liabilities, for presentation purposes, on the Balance Sheets.

Accretion for the next five years is estimated to be as follows:

<i>(Thousands)</i>	Estimated Accretion
Fiscal Years Ended September 30,	
2015	\$ 2,075
2016	2,139
2017	2,194
2018	2,248
2019	2,303
Total	\$ 10,959

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9. INCOME TAXES

A reconciliation of the United States federal statutory rate of 35 percent to the effective rate from operations for the fiscal years ended September 30, 2014 and 2013 are as follows:

<i>(Thousands)</i>	2014	2013
Statutory income tax expense	\$ 39,752	\$ 38,236
Change resulting from:		
State income taxes	4,904	4,122
Depreciation and cost of removal	(4,437)	(5,769)
Investment tax credits	(321)	(322)
Other	(524)	(868)
Income tax provision	\$ 39,374	\$ 35,399
Effective income tax rate	34.7%	32.4%

The income tax provision (benefit) from operations consists of the following:

<i>(Thousands)</i>	2014	2013
Current		
Federal	\$ 34,724	\$ 3,479
State	5,429	1,416
Deferred		
Federal	(3,073)	25,899
State	2,615	4,927
Investment tax credits	(321)	(322)
Income tax provision	\$ 39,374	\$ 35,399

The temporary differences, which give rise to deferred tax assets and (liabilities), consist of the following:

<i>(Thousands)</i>	2014	2013
Deferred tax assets		
Investment tax credits	\$ 2,841	\$ 3,012
Incentive compensation	3,141	1,365
Conservation incentive plan	2,312	—
Other	6,639	5,964
Total deferred tax assets	\$ 14,933	\$ 10,341
Deferred tax liabilities		
Property related items	\$ (305,828)	\$ (286,220)
Remediation costs	(12,429)	(18,881)
Post employment benefits	(23,832)	(26,507)
Conservation incentive plan	—	(7,611)
Under-recovered gas costs	(5,056)	(383)
Other	(8,201)	(12,361)
Total deferred tax liabilities	\$ (355,346)	\$ (351,963)
Total net deferred tax liabilities	\$ (340,413)	\$ (341,622)

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The Company's federal income tax returns through fiscal 2010 have either been reviewed by the IRS, or the related statute of limitations has expired and all matters have been settled. The IRS is currently examining fiscal 2011 through fiscal 2013.

The State of New Jersey has completed its sales and use tax examinations through March 31, 2010, and its corporate business tax examinations through September 30, 2008. All periods subsequent to those ended September 30, 2009, are statutorily open to examination.

The Company evaluates its tax positions to determine the appropriate accounting and recognition of potential future obligations associated with unrecognized tax benefits. As of September 30, 2014 and 2013, based on its analysis, the Company determined that there was no need to recognize any liabilities associated with uncertain tax positions.

In September 2013, the U.S. Department of the Treasury and the IRS released final regulations that provide guidance on applying Section 263(a) of the Internal Revenue Code to amounts paid to acquire, produce, or improve tangible property, as well as rules for materials and supplies. Implementation of these final regulations in September 2013 had no material impact on the Company's results of operations, financial condition or cash flow.

10. COMMITMENTS AND CONTINGENT LIABILITIES

Cash Commitments

The Company has entered into long-term contracts, expiring at various dates through October 2032, for the supply, storage and delivery of natural gas. These contracts include current annual fixed charges of approximately \$78.3 million at current contract rates and volumes, which are recoverable through BGSS.

Commitments as of September 30, 2014, for natural gas purchases and future demand fees for the next five fiscal year periods are as follows:

<i>(Thousands)</i>	2015	2016	2017	2018	2019	Thereafter
Natural gas purchases	\$ 100,218	\$ 5,328	\$ 34	\$ —	\$ —	\$ —
Storage demand fees	24,045	17,865	10,883	9,299	9,299	4,649
Pipeline demand fees	54,293	44,372	41,001	85,558	87,367	860,211
Total⁽¹⁾	\$ 178,556	\$ 67,565	\$ 51,918	\$ 94,857	\$ 96,666	\$ 864,860

(1) Does not include amounts related to intercompany asset management agreements with NJRES.

As of September 30, 2014, the Company's future minimum lease payments under various operating leases will not be more than \$1,172,000 annually for the next five years and \$224,000 in the aggregate for all years thereafter.

Guarantees

The Company previously entered into agreements to lease vehicles, generally over a five-year term, that qualified as operating leases. These agreements contain provisions that could require the Company to make additional cash payments at the end of the term for a portion of the residual value of the vehicles. As of September 30, 2014, the present value of the liability recognized on the Balance Sheets is \$571,000. In the event performance under the guarantee is required, the Company's maximum future payment would be \$756,000.

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Legal Proceedings

Manufactured Gas Plant Remediation

The Company is responsible for the remedial cleanup of five MGP sites, dating back to gas operations in the late 1800s and early 1900s that contain contaminated residues from former gas manufacturing operations. The Company is currently involved in administrative proceedings with the NJDEP, as well as participating in various studies and investigations by outside consultants, to determine the nature and extent of any such contaminated residues and to develop appropriate programs of remedial action, where warranted, under Administrative Consent Orders or Memoranda of Agreement with the NJDEP.

The Company may recover its remediation expenditures, including carrying costs, over rolling seven-year periods pursuant to a RA approved by the BPU. In February 2012, the Company filed its 2011 SBC filing, requesting approval of its MGP expenditures incurred through June 30, 2011, which would continue its existing overall SBC rate and recovery at approximately \$20 million. In July 2013, the Company requested approval of its MGP expenditures incurred through June 2013 as well as a reduction in the RA factor to \$18.7 million annually. The petition was provisionally approved by the BPU on November 22, 2013, with rates effective December 1, 2013, and was approved on a final basis in July 2014. In September 2014, the Company requested approval of its MGP expenditures incurred through June 2014 to recover \$8.5 million annually related to the SBC RA factor. As of September 30, 2014, \$30.9 million of previously incurred remediation costs, net of recoveries from customers and insurance proceeds, are included in regulatory assets on the Balance Sheets.

The Company periodically, and at least annually, performs an environmental review of the MGP sites, including a review of potential liability for investigation and remedial action. The Company estimated at the time of the most recent review that total future expenditures to remediate and monitor the five MGP sites for which it is responsible, including potential liabilities for Natural Resource Damages that might be brought by the NJDEP for alleged injury to groundwater or other natural resources concerning these sites, will range from approximately \$151.3 million to \$249.8 million. The Company's estimate of these liabilities is based upon known facts, existing technology and enacted laws and regulations in place when the review was completed. Where it is probable that costs will be incurred, and the information is sufficient to establish a range of possible liability, the Company accrues the most likely amount in the range. If no point within the range is more likely than the other, it is the Company's policy to accrue the lower end of the range. Accordingly, as of September 30, 2014, the Company recorded an MGP remediation liability and a corresponding regulatory asset of \$177 million on the Balance Sheets, based on the most likely amount. The actual costs to be incurred by the Company are dependent upon several factors, including final determination of remedial action, changing technologies and governmental regulations, the ultimate ability of other responsible parties to pay and any insurance recoveries.

The Company will continue to seek recovery of MGP-related costs through the RA. However, because recovery of such costs is subject to BPU approval, there can be no assurance as to the ultimate recovery through the RA or the impact on the Company's results of operations, financial position or cash flows, which could be material. If any future regulatory position indicates that the recovery of such costs is not probable, the related non-recoverable costs would be charged to income in the period of such determination.

New Jersey Natural Gas Company

General

The Company is party to various other claims, legal actions and complaints arising in the ordinary course of business. In the Company's opinion, the ultimate disposition of these matters will not have a material effect on its financial condition, results of operations or cash flows.

11. RELATED PARTY TRANSACTIONS

The Company participates in various transactions with NJR and other subsidiaries of NJR in the ordinary course of business. These transactions result in either charges or credits to operation and maintenance expense in the Statements of Operations.

The following table summarizes charges from NJR and NJR Service during fiscal 2014 and 2013. Charges from NJR were for various services, including executive management and corporate governance. Charges from NJR Service were primarily related to financial and administrative, legal, human resources, corporate communications, taxation, internal audit and technology services.

<i>(Thousands)</i>	2014	2013
NJR	\$ 5,726	\$ 7,521
NJR Service	21,896	19,902
Total	\$ 27,622	\$ 27,423

The following table summarizes charges from the Company to NJRHS, NJRES, NJR, NJRCEV and CR&R during fiscal 2014 and 2013. Charges to NJRHS were for services related to billing, customer inquiry, payment processing, vehicle fleet maintenance and operating expenses. Charges to NJRES were for administrative services and operating expenses. Charges to NJR were for operating expenses. Charges to NJRCEV were for services related to billing and payment processing and operating expenses. Charges to CR&R were for operating expenses.

<i>(Thousands)</i>	2014	2013
NJRHS	\$ 4,580	\$ 3,994
NJRES	600	568
NJR	512	496
NJRCEV	476	425
CR&R	21	21
Total	\$ 6,189	\$ 5,504

The following table reflects the receivable (payable) the Company had with NJR and other subsidiaries of NJR at September 30, 2014 and 2013, which are included in accounts payable and other on the Balance Sheets:

<i>(Thousands)</i>	2014	2013
NJR	\$ (657)	\$ (1,589)
NJRES	94	16
NJRHS	(640)	(1,040)
CR&R	17	17
NJR Service	(2,529)	(1,200)
NJRCEV	117	68
Total	\$ (3,598)	\$ (3,728)

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In January 2010, the Company entered into a 10-year agreement effective April 1, 2010, for 3 Bcf of firm storage capacity with Steckman Ridge. Under the terms of the agreement, the Company incurs demand fees, at market rates, of approximately \$9.3 million annually. These fees are recoverable through the Company's BGSS mechanism and are included in regulatory assets. Additionally, the Company has transportation capacity with Iroquois that expires by January 31, 2019. Demand fees associated with both Steckman Ridge and Iroquois were \$10 million and \$9.2 million during the fiscal years ended September 30, 2014 and 2013, respectively. As of September 30, 2014 and 2013, the Company had fees payable to Steckman Ridge in the amount of \$775,000 for both fiscal years. The Company had net fees payable to Iroquois of \$48,000 and \$61,000 as of September 30, 2014 and 2013, respectively.

The Company and NJRES have entered into various asset management agreements. Under the terms of these agreements, the Company releases certain transportation and storage contracts to NJRES for the entire term of the agreements. As of September 30, 2014, the Company and NJRES had four asset management agreements with expiration dates ranging from October 2014 through March 2016. The Company also sold natural gas in storage at cost to NJRES. In return, the Company has the option to purchase index priced gas and storage inventory gas from NJRES at the Company's citygate and other delivery locations to maintain operational reliability. During the fiscal years ended September 30, 2014 and 2013, the Company purchased natural gas from NJRES in the amount of \$72.8 million and \$5 million, respectively.

In the fourth quarter of fiscal 2014, the Company entered into a precedent agreement for transportation capacity of 180,000 dths per day with PennEast Pipeline Company, LLC, a with an estimated service date of November 1, 2017.