

# SECURITIES AND EXCHANGE COMMISSION

## FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1994-05-13** | Period of Report: **1994-03-31**  
SEC Accession No. **0000071304-94-000016**

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### FILER

#### COMMONWEALTH ENERGY SYSTEM

CIK: **71304** | IRS No.: **041662010** | State of Incorporation: **MA** | Fiscal Year End: **1231**  
Type: **10-Q** | Act: **34** | File No.: **001-07316** | Film No.: **94528044**  
SIC: **4931** Electric & other services combined

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549-1004

FORM 10-Q

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

For the quarterly period ended March 31, 1994

OR

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-7316

COMMONWEALTH ENERGY SYSTEM

(Exact name of registrant as specified in its Declaration of Trust)

Massachusetts  
(State or other jurisdiction of  
incorporation or organization)

04-1662010  
(I.R.S. Employer  
Identification No.)

One Main Street, Cambridge, Massachusetts  
(Address of principal executive offices)

02142-9150  
(Zip Code)

Registrant's telephone number, including area code (617) 225-4000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES X NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class of Common Stock	Outstanding at May 1, 1994
Common Shares of Beneficial Interest, \$4 par value	10,398,990 shares

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PART I. - FINANCIAL INFORMATION

Item 1. Financial Statements

COMMONWEALTH ENERGY SYSTEM AND SUBSIDIARY COMPANIES

CONDENSED BALANCE SHEETS

MARCH 31, 1994 AND DECEMBER 31, 1993

ASSETS

(Unaudited)

	March 31, 1994	December 31, 1993
	(Dollars in Thousands)	
PROPERTY, PLANT AND EQUIPMENT, at original cost		
Electric	\$1 020 578	\$1 018 121
Gas	324 430	322 314
Other	58 399	58 473
	1 403 407	1 398 908
Less - Accumulated depreciation and amortization	438 513	425 483
	964 894	973 425
Add - Construction work in progress and nuclear fuel in process	14 323	11 089
	979 217	984 514
LEASED PROPERTY, net	15 951	16 150
EQUITY IN CORPORATE JOINT VENTURES		
Nuclear electric power companies (2.5% to 4.5%)	9 870	9 660
Other investments	4 017	3 889
	13 887	13 549
CURRENT ASSETS		
Cash	5 412	6 007

Accounts receivable	131 269	93 663
Unbilled revenues	35 728	43 279
Inventories, at average cost	20 948	36 102
Prepaid taxes and other	8 862	15 231
	202 219	194 282
DEFERRED CHARGES	110 272	106 668
	\$1 321 546	\$1 315 163

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COMMONWEALTH ENERGY SYSTEM AND SUBSIDIARY COMPANIES

CONDENSED BALANCE SHEETS

MARCH 31, 1994 AND DECEMBER 31, 1993

CAPITALIZATION AND LIABILITIES

(Unaudited)

	March 31, 1994	December 31, 1993
	(Dollars in Thousands)	
CAPITALIZATION		
Common share investment -		
Common shares, \$4 par value -		
Authorized - 18,000,000 shares		
Outstanding - 10,345,619 in 1994 and 10,295,077 in 1993	\$ 41 382	\$ 41 180
Amounts paid in excess of par value	96 720	94 657
Retained earnings	221 127	201 233
	359 229	337 070
Redeemable preferred shares, less current sinking fund requirements	15 420	15 480
Long-term debt, including premiums, less current sinking fund requirements and maturing debt	447 659	448 893
	822 308	801 443
CAPITAL LEASE OBLIGATIONS	14 309	14 456
CURRENT LIABILITIES		
Interim Financing -		
Notes payable to banks	19 475	71 975
Maturing long-term debt	10 000	10 000
	29 475	81 975
Other Current Liabilities -		
Current sinking fund requirements	6 793	6 793
Accounts payable	110 710	90 006
Accrued taxes	21 385	9 090

Other	37 378	37 322
	176 266	143 211
	205 741	225 186
DEFERRED CREDITS		
Accumulated deferred income taxes	159 298	156 851
Unamortized investment tax credits and other	119 890	117 227
	279 188	274 078
COMMITMENTS AND CONTINGENCIES		
	\$1 321 546	\$1 315 163

See accompanying notes.

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COMMONWEALTH ENERGY SYSTEM AND SUBSIDIARY COMPANIES

CONDENSED STATEMENTS OF INCOME

FOR THE THREE MONTHS ENDED MARCH 31, 1994 AND 1993

(Unaudited)

	Three Months Ended	
	1994	1993
	(Dollars in Thousands)	
OPERATING REVENUES		
Electric	\$171 243	\$151 061
Gas	135 549	120 860
Steam and other	6 114	4 981
	312 906	276 902
OPERATING EXPENSES		
Fuel and purchased power	102 129	83 080
Cost of gas sold	71 407	60 112
Other operation and maintenance	62 723	64 356
Depreciation	12 889	13 152
Taxes -		
Local property and other	7 888	7 873
Federal and state income	17 735	14 461
	274 771	243 034
OPERATING INCOME	38 135	33 868
OTHER INCOME	610	451
INCOME BEFORE INTEREST CHARGES	38 745	34 319
INTEREST CHARGES		

Long-term debt	9 850	8 607
Other interest charges	1 043	1 721
Allowance for borrowed funds used during construction	(99)	(72)
	10 794	10 256
NET INCOME	27 951	24 063
Dividends on preferred shares	297	312
EARNINGS APPLICABLE TO COMMON SHARES	\$ 27 654	\$ 23 751
AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	10 328 461	10 160 994
EARNINGS PER COMMON SHARE	\$2.68	\$2.34
DIVIDENDS DECLARED PER COMMON SHARE	\$ .75	\$ .73

See accompanying notes.

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COMMONWEALTH ENERGY SYSTEM AND SUBSIDIARY COMPANIES

CONDENSED STATEMENTS OF CASH FLOWS

FOR THE THREE MONTHS ENDED MARCH 31, 1994 AND 1993

(Unaudited)

	1994	1993
	(Dollars in Thousands)	
OPERATING ACTIVITIES		
Net income	\$ 27 951	\$ 24 063
Effects of non-cash items -		
Depreciation and amortization	16 678	15 670
Deferred income taxes and investment tax credits, net	478	165
Earnings from corporate joint ventures	(399)	(409)
Dividends from corporate joint ventures	62	84
Change in working capital, exclusive of cash and interim financing	24 523	14 580
All other operating items	(1 616)	(5 075)
Net cash provided by operating activities	67 677	49 078
INVESTING ACTIVITIES		
Additions to property, plant and equipment (exclusive of AFUDC)		
Electric	(4 511)	(4 190)
Gas	(4 069)	(3 303)
Other	(8)	(181)
Allowance for borrowed funds used during construction	(99)	(72)

Net cash used for investing activities	(8 687)	(7 746)
FINANCING ACTIVITIES		
Sale of common shares	2 266	1 267
Payment of dividends	(8 057)	(7 739)
Payment of short-term borrowings	(52 500)	(77 175)
Long-term debt issues	-	65 000
Long-term debt issues refunded	-	(21 300)
Sinking funds payments	(1 294)	(214)
Net cash used for financing activities	(59 585)	(40 161)
Net increase (decrease) in cash	(595)	1 171
Cash at beginning of period	6 007	1 522
Cash at end of period	\$ 5 412	\$ 2 693

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid during the period for:

Interest (net of capitalized amounts)	\$ 9 179	\$ 8 054
Income taxes	\$ 2 214	\$ 3 433

See accompanying notes.

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COMMONWEALTH ENERGY SYSTEM AND SUBSIDIARY COMPANIES  
NOTES TO CONDENSED FINANCIAL STATEMENTS

(1) Accounting Policies

Commonwealth Energy System, the parent company, is referred to in this report as the "System" and, together with its subsidiaries, is collectively referred to as "the system."

The system's significant accounting policies are described in Note 1 of Notes to Consolidated Financial Statements included in its 1993 Annual Report on Form 10-K filed with the Securities and Exchange Commission. For interim reporting purposes, the system follows these same basic accounting policies but considers each interim period as an integral part of an annual period and makes allocations of certain expenses to interim periods based upon estimates of such expenses for the year.

Regulated subsidiaries of the System have established various regulatory assets in cases where the Massachusetts Department of Public Utilities (DPU) and/or the Federal Energy Regulatory Commission (FERC) have permitted, or are expected to permit, recovery of specific costs over time. At March 31, 1994, principal regulatory assets included in deferred charges were \$21.4 million for transition costs associated with FERC Order 636, \$14.9 million for unrecovered plant and decommissioning costs for the Yankee Atomic nuclear plant, \$14.7 million for abandonment and nonconstruction costs related to the Seabrook project, \$14.2 million for post-retirement benefits costs including pensions, \$7.3 million in litigation costs associated with a settlement agreement with Boston Edison Company

relative to the Pilgrim nuclear plant and \$7.3 million related to deferred income taxes. The more significant regulatory liabilities, reflected in deferred credits, include \$17.8 million related to income taxes.

Generally, expenses which relate to more than one interim period are allocated to other periods to more appropriately match revenues and expenses. Principal items of expense which are allocated other than on the basis of passage of time are depreciation and property taxes of the gas subsidiary, Commonwealth Gas Company (Commonwealth Gas). These expenses are recorded for interim reporting purposes based upon projected gas revenue. Income tax expense is recorded using the statutory rates in effect applied to book income subject to tax for each interim period.

The unaudited financial statements for the periods ended March 31, 1994 and 1993, reflect, in the opinion of the System, all adjustments necessary to summarize fairly the results for such periods. In addition, certain prior period amounts are reclassified from time to time to conform with the presentation used in the current period's financial statements.

The results for interim periods are not necessarily indicative of results for the entire year because of seasonal variations in the consumption of energy and Commonwealth Gas' seasonal rate structure.

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#### COMMONWEALTH ENERGY SYSTEM AND SUBSIDIARY COMPANIES

### (2) Commitments and Contingencies

#### (a) Construction

The system is engaged in a continuous construction program presently estimated at \$358.3 million for the five-year period 1994 through 1998. Of that amount, \$71.9 million is estimated for 1994. The program is subject to periodic review and revision.

#### (b) Decommissioning of Nuclear Power Plants

The system, through Canal Electric Company (Canal), has a 3.52% joint-ownership interest in the Seabrook nuclear power plant. Canal and the other joint owners have established a Seabrook Nuclear Decommissioning Financing Fund to cover post operational decommissioning costs. The estimated cost to decommission the plant is \$370 million, in 1994 dollars, through March 31, 1994. Canal's share, less its share of the market value of the decommissioning trust, would amount to approximately \$12.1 million.

The system also has ownership interests in four nuclear generating facilities in New England and is obligated to pay its proportionate share of the capacity and energy costs associated with these units, which include depreciation, operations and maintenance, a return on invested capital and the estimated cost of decommissioning the nuclear plants at



the end of their estimated service lives. Pertinent information with respect to projected decommissioning costs, in 1993 dollars, resulting from life-of-the-unit contracts from these units is as follows:

	Connecticut Yankee	Maine Yankee	Vermont Yankee	Yankee Atomic*
	(Dollars in Millions)			
Equity ownership	4.50%	4.00%	2.50%	4.50%
Plant entitlement	4.50%	3.59%	2.25%	4.50%
Plant capability (MW)	560.0	870.0	496.0	-
System entitlement (MW)	25.2	31.2	11.2	-
Contract expiration date	1998	2008	2012	-
Decommissioning cost estimate (100%)	\$325.0	\$316.6	\$253.0	\$331.7
System's decommissioning cost	14.6	11.4	5.7	14.9

\* On February 26, 1992, the Board of Directors of Yankee Atomic Electric Company agreed to permanently discontinue power operation of its plant and decommission the facility. Cambridge Electric Light Company's (Cambridge) and Commonwealth Electric Company's (Commonwealth Electric) respective 2% and 2.5% investment in Yankee Atomic is approximately \$1 million. The companies' estimated decommissioning costs include their unrecovered share of all costs associated with the shutdown of the facility, recovery of its plant investment, and decommissioning and closing the plant. This amount is reflected in the accompanying Balance Sheets as a liability and a corresponding regulatory asset.

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COMMONWEALTH ENERGY SYSTEM AND SUBSIDIARY COMPANIES

(c) Environmental

The system is subject to laws and regulations administered by federal, state and local authorities relating to the quality of the environment. These laws and regulations affect, among other things, the siting and operation of electric generating and transmission facilities and can require the installation of expensive air and water pollution control equipment. These regulations have had an impact upon the System's operations in the past and will continue to have an impact upon future operations, capital costs and construction schedules of major facilities. For additional information, see "Environmental Matters" in Management's Discussion and Analysis of Financial Condition and Results of Operations.

(d) FERC Order No. 636

On April 8, 1992, the FERC issued Order No. 636 (Order 636), requiring interstate pipelines to unbundle (separate) existing gas sales contracts into separate components (gas sales, transportation and storage services). Order 636 provides mechanisms that will allow customers such as Commonwealth Gas to reduce the level of firm services from pipelines

and permits the "brokering" of excess capacity on a temporary or permanent basis. Order 636 also requires pipelines to provide transportation services which allow customers to receive the same level of service they had with bundled contracts. Pipelines were required to be operating under Order 636 by November 1, 1993.

As a result of implementing Order 636, each pipeline company is allowed to collect certain "transition costs" from their customers. Commonwealth Gas has been billed a total of approximately \$18.2 million from Tennessee Gas Pipeline Company, Algonquin Gas Transmission Company and Texas Eastern Transmission Company through March 31, 1994. It is anticipated that as much as \$45 million in transition costs could be sought by these suppliers through a series of FERC filings over the 12 to 24 month period that began on June 1, 1993. The largest element of the aforementioned transition costs results from the pipelines' need to buy out gas supply contracts entered into prior to Order 636. The total amount of such costs ultimately billed to Commonwealth Gas will vary depending on the success of the pipelines in negotiating settlements with their former suppliers, and final review by the FERC. Commonwealth Gas is actively reviewing the prudence of transition costs billed in order to minimize costs to its customers. Commonwealth Gas has recorded its estimated liability based on amounts incurred by the respective pipelines as of March 31, 1994.

As of October 29, 1993, Commonwealth Gas received preliminary DPU authorization to recover these costs, with carrying charges, through the cost of gas adjustment (CGA) over a four-year period that began in November 1993. As a result, a regulatory asset totaling \$21.4 million is reflected in deferred charges as of March 31, 1994. In addition, a related liability of \$11.8 million is reflected in deferred credits. Also, approximately \$7.9 million of the amount paid to the pipeline companies relates to gas inventory costs being allocated new storage services under Order 636. Commonwealth Gas will recover these inventory costs through the CGA.

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#### COMMONWEALTH ENERGY SYSTEM AND SUBSIDIARY COMPANIES

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

#### Financial Condition

Capital resources of the System and its subsidiaries are derived principally from retained earnings and equity funds provided through the System's Dividend Reinvestment and Common Share Purchase Plan (DRP). Supplemental interim funds are borrowed on a short-term basis and, when necessary, replaced with new equity and/or debt issues through permanent financing secured on an individual company basis. The system purchases 100% of all subsidiary common stock issues and provides, to the extent possible, a portion of the subsidiaries' short-term financing needs.

These capital resources provide the funds required for the subsidiary companies' construction programs, current operations, debt service and other capital requirements.

For the first three months of 1994, cash flows from operating activities amounted to approximately \$67.7 million and reflect net income of \$28 million and non-cash items such as depreciation (\$13.2 million), amortization (\$3.5 million) and deferred income taxes (net of investment tax credits) which amounted to \$478,000. The change in working capital since December 31, 1993, exclusive of cash and interim financing, amounted to \$24.5 million and had a significant positive effect on cash flows from operating activities, reflecting lower levels of inventory (\$15.2 million), unbilled revenues (\$7.6 million), prepaid taxes (\$4.9 million), miscellaneous current assets (\$1.5 million) coupled with higher levels of accounts payable and accrued income taxes of \$20.7 million and \$13.3 million, respectively. These were offset, in part, by a higher level of accounts receivable (\$37.6 million).

Construction expenditures for the first three months of 1994 were approximately \$8.7 million, including an allowance for funds used during construction (AFUDC) and nuclear fuel. Construction expenditures for the period, together with the preferred and common dividend requirements of the System (\$8.1 million), were funded entirely with internally generated funds. In addition to satisfying these capital requirements, the reduction in short-term borrowings of \$52.5 million was accomplished with internal funds generated from higher unit sales (due to the extreme cold weather) experienced by both the electric and gas divisions during the first quarter of this year.

#### Results of Operations

The following is a discussion of certain significant factors which have affected operating revenues, expenses and net income during the periods included in the accompanying condensed statements of income. This discussion should be read in conjunction with the Notes to Condensed Financial Statements appearing elsewhere in this report.

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#### COMMONWEALTH ENERGY SYSTEM AND SUBSIDIARY COMPANIES

A summary of the period to period changes in the principal items included in the condensed statements of income for the three months ended March 31, 1994 and 1993 is shown below:

	Three Months Ended March 31, 1994 and 1993 Increase (Decrease) (Dollars in Thousands)	
Operating Revenues - Electric	\$20 182	13.4%

Gas	14 689	12.2
Steam and other	1 133	22.7
	36 004	13.0
Operating Expenses -		
Fuel and purchased power	19 049	22.9
Cost of gas sold	11 295	18.8
Other operation and maintenance	(1 633)	(2.5)
Depreciation	(263)	(2.0)
Taxes -		
Local property and other	15	0.2
Federal and state income	3 274	22.6
	31 737	13.1
Operating Income	4 267	12.6
Other Income	159	35.3
Income Before Interest Charges	4 426	12.9
Interest Charges	538	5.2
Net Income	3 888	16.2
Dividends on preferred shares	(15)	(4.8)
Earnings Applicable to Common Shares	\$ 3 903	16.4
Unit Sales -		
Electric - Megawatthours (MWH)		
Retail	24 535	2.1
Wholesale	181 356	18.3
	205 891	9.5
Gas - Billions of British Thermal Units (BBTU)		
Firm	1 019	5.6
Interruptible	(25)	(34.7)
	994	5.5

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COMMONWEALTH ENERGY SYSTEM AND SUBSIDIARY COMPANIES

The following is a summary of electric and gas unit sales for the three-month periods indicated:

	Three Months Ended	
	March 31,	
	1994	1993
Electric Sales - MWH		
Residential	504 889	493 799
Commercial	489 396	474 578

Industrial	96 557	93 815
Other	102 170	106 285
Total retail sales	1 193 012	1 168 477
Wholesale to other systems	1 171 206	989 850
Total	2 364 218	2 158 327

Gas Sales - BBTU

Residential	11 123	10 627
Commercial	5 337	5 078
Industrial	1 683	1 585
Other	988	822
Total firm sales	19 131	18 112
Interruptible sales	47	72
Total	19 178	18 184

Electric Revenues, Fuel and Purchased Power Costs

For the first three months of 1994, electric operating revenues increased approximately \$20.2 million or 13.4% due primarily to higher fuel and purchased power costs, new retail rates for Cambridge which became effective June 1, 1993 and a 2.1% increase in retail electric unit sales.

Fuel and purchased power costs rose \$19 million or 22.9% and reflects the increase in retail unit sales and the higher cost of fuel oil at Canal's generating facility, which is the major supplier of electricity to the system. The cost of oil at Canal for the three-month period ended March 31, 1994 averaged 2.7 cents per KWH compared to 2.3 cents per KWH for the same period in 1993. Fuel and purchased power costs averaged 4.3 cents per KWH compared to 3.8 cents per KWH for the same period in 1993 and reflect the impact of Commonwealth Electric's contractual obligations to purchase higher-cost power contracted for in the 1980s when its customer base grew dramatically and forecasts predicted continued growth. The contracts, which are typically long-term power purchases from certain gas-fired independent power producing facilities, will continue to drive costs up as additional capacity comes on line. Commonwealth Electric is currently involved in the renegotiation of several existing contracts which include price restructuring, contract buy-outs and/or generating unit shutdowns that could also reduce its cost of power.

The 2.1% increase in retail electric unit sales was due primarily to higher unit sales in the residential and commercial sectors and reflects the colder than normal weather conditions experienced in our service territory during the first quarter. The 18.3% increase in wholesale sales had little, if any, impact on net income.

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COMMONWEALTH ENERGY SYSTEM AND SUBSIDIARY COMPANIES

Gas Revenues and Cost of Gas Sold

For the first three months of 1994, gas operating revenues increased

\$14.7 million or 12.2% due primarily to an increase in the cost of gas sold, higher firm unit sales and a higher level of conservation and load management costs (\$974,000). During the current three-month period, the average cost of gas increased to \$3.72 per MMBTU from \$3.31 per MMBTU for the same period of 1993 due, in part, to the billing of transition costs associated with the implementation of FERC Order No. 636. During the current three-month reporting period, firm gas unit sales increased 5.6% as each customer segment showed improvement due to the colder than normal winter.

#### Other Operating Expenses

For the first three months of 1994, other operation and maintenance decreased \$1.6 million or 2.5% due primarily to cost savings of approximately \$2 million that resulted from a second quarter 1993 work force reduction offset, in part, by a higher level of current and amortized conservation and load management costs incurred primarily at Commonwealth Gas (\$1.1 million). Other factors contributing to the overall decline include a decrease in insurance and employee benefit costs (\$485,000) and a lower provision for bad debts due to improved collections (\$115,000). Despite a higher level of depreciable plant for the current three-month period, depreciation expense decreased 2% due to an adjustment in the second quarter of 1993 to Canal's accrual rate to reflect an extension of the depreciation recovery period for Unit 1 from 1996 to 2002. Local property and other taxes increased 2.2% due primarily to higher tax rates and assessments. A higher level of pretax income and, to a lesser extent, an increase in the federal tax rate to 35% contributed to the \$3.3 million or 22.6% increase in federal and state income taxes.

#### Other Income and Interest Charges

For the first quarter of 1994, other income increased 35.3% due primarily to interest income related to a Massachusetts sales tax abatement (\$159,000) and the absence in 1994 of a loss (recorded in January 1993) in connection with the system's equity investment in Yankee Atomic Electric Company (\$74,000). The impact of these items was offset, in part, by decreases in non-operating rents (\$88,000) and accretion relating to the abandonment of Seabrook Unit 2 (\$37,000).

Total interest charges for the current quarter increased 5.2% due primarily to a higher level of long-term debt reflecting the new debt issued by Commonwealth Electric, Commonwealth Gas and Hopkinton LNG Corp. during 1993 and the interest to be refunded to the system's retail customers in connection with the aforementioned sales tax abatement. The impact of these items was offset, somewhat, by the decline in short-term interest costs reflecting a lower average level of short-term borrowings.

#### Environmental Matters

Commonwealth Gas is participating in the assessment of a number of former manufactured gas plant sites to determine if and to what extent such

## COMMONWEALTH ENERGY SYSTEM AND SUBSIDIARY COMPANIES

sites have been contaminated and whether Commonwealth Gas may be responsible for remedial actions.

The costs associated with the clean-up of these sites are recoverable in rates through the cost of gas adjustment clause pursuant to a 1990 DPU order that provides for recovery of these expenditures over a seven-year amortization period without carrying costs. Commonwealth Gas has recorded an estimated \$2.3 million liability that reflects its best estimate (based on current information) of the costs to be incurred in connection with the various activities to be undertaken at these sites. Commonwealth Gas has also recorded a regulatory asset in anticipation of recovery of these costs in rates. Commonwealth Gas is unable to predict the total cost to ultimately resolve these matters due to significant uncertainty as to the actual site condition and the extent of any associated remediation activities and the assignment of responsibility. However, it is expected that all such costs will continue to be recovered in rates as described above.

Commonwealth Gas and certain other system subsidiaries are also involved in other known or potentially contaminated sites with costs which may not be recoverable in rates and have recorded an estimated liability (and a charge to operations) of \$560,000 in total to cover the costs associated with assessment and remediation activities. These estimates will be adjusted as further investigation and assignment of responsibility occurs. As noted above, the system is unable to predict at this time the ultimate cost to resolve these matters due to the uncertainties inherent in the site investigation and remediation process.

#### Power Contracts

Cambridge and Commonwealth Electric have long-term contracts for the purchase of electricity from various sources. Generally, these contracts are for fixed periods and require that Cambridge and Commonwealth Electric pay a demand charge for their capacity entitlement in each unit and an energy charge to cover the cost of fuel. Cambridge and Commonwealth Electric collect a portion of their capacity-related purchased power costs associated with certain long-term power arrangements through their base rates. The recovery mechanism for these costs uses a per KWH factor which is calculated using historical (test-period) capacity costs and unit sales. This factor is then applied to current monthly KWH sales. When current period capacity costs and/or unit sales vary from test-period levels, Cambridge and Commonwealth Electric experience a revenue excess or shortfall. This recovery mechanism had a positive impact on net income of \$417,000 for the current quarter compared to a net loss of \$581,000 for the first quarter of 1993. All other capacity and energy-related purchased power costs are recovered through their respective Fuel Charge.

On May 2, 1994, Cambridge and Commonwealth Electric gave notice of termination of power purchase agreements with Eastern Energy Corp. (Eastern), the developer of a proposed 300 MW coal-fired plant in New Bedford, Massachusetts. In June 1989, in order to meet rising energy

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COMMONWEALTH ENERGY SYSTEM AND SUBSIDIARY COMPANIES

requirements, Cambridge and Commonwealth Electric agreed to buy 27% (33 MW and 50 MW, respectively) of the power to be produced by the proposed plant, originally scheduled to begin operation in January 1992. That date and later revised scheduled operating dates have not been achieved, and the proposed plant has still not received the necessary permits. Efforts to reshape the Eastern power purchase agreements to provide a satisfactory arrangement were unsuccessful. The companies' actions are based on Eastern's failure to meet its contractual obligations. Cambridge and Commonwealth Electric are unable to predict whether or not Eastern will contest their termination of these agreements.

Rate Stabilization Plan

Commonwealth Electric implemented a Fuel Charge (FC) rate settlement on April 1, 1994 that will stabilize its quarterly FC rate during the years 1994 through 1996 at 6.5 cents per KWH and between 6.5 cents and 6.7 cents per KWH during 1997. This rate stabilization results from the use of a cost deferral mechanism that was sponsored jointly by Commonwealth Electric and the Massachusetts Attorney General and approved by the DPU. The stabilized FC rate could save customers between 1.75% and 5% on their annual electric bills from 1994 through 1997. Deferred costs will be set up as a regulatory asset to be recovered, with carrying charges, over the subsequent six-year period beginning in 1998 under a recovery schedule to be approved by the DPU. The deferred amount, excluding carrying charges, is restricted to a maximum of \$40 million during the settlement period (1994 through 1997) and is further limited to an annual cost deferral of \$16 million which is the amount Commonwealth Electric anticipates will be deferred in 1994.

The rate stabilization mechanism is part of a long-term plan to control Commonwealth Electric retail rates. This plan will help to eliminate the disincentive for economic development resulting from a volatile and unpredictable FC rate. The stabilized FC rate will enable current and prospective customers to plan their business and personal finances in a more efficient and effective manner. In addition to the Massachusetts Attorney General, this proposal has been widely supported by various business and customer groups and other political interests.

The settlement results in Commonwealth Electric billing its customers a significantly lower rate than would have been in effect on April 1, 1994 had the DPU not approved the proposal. Commonwealth



Electric's customers would have been billed for increased costs that resulted from certain higher-priced, long-term contract obligations. Commonwealth Electric is currently involved in contract renegotiations, as mentioned previously in this discussion.

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COMMONWEALTH ENERGY SYSTEM AND SUBSIDIARY COMPANIES  
PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The system is not a party to any pending material legal proceeding.

Item 2. Changes in the Rights of the Company's Security Holders

None

Item 3. Defaults by the Company on its Senior Securities

None

Item 4. Results of Votes of Security Holders

(a) The Annual Meeting of Shareholders was held on May 5, 1994.

(b) The three nominees, Henry Dormitzer, Franklin M. Hundley and Gerald L. Wilson listed in the System's Notice of 1994 Annual Meeting, Proxy Statement and 1993 Financial Information dated April 1, 1994 were elected to the Board of Trustees of Commonwealth Energy System.

(c) As set forth in the System's Notice of 1994 Annual Meeting, Proxy Statement and 1993 Financial Information dated April 1, 1994 as Item 2, a proposal to consent to an amendment to Section 22 of the System's Declaration of Trust, which Section sets forth the conditions under which presently authorized but unissued Common Shares of the System may be issued by the Trustees without the vote or written consent of a majority of the Common Shares outstanding at the time was voted upon and approved at the 1994 Annual Shareholders' Meeting. There were 6,954,409 (67.2%) Common Shares voted for this proposal, 509,582 (4.9%) Common Shares voted against, 181,393 (1.8%) Common Shares abstained and 2,700,235 (26.1%) Common Shares were not voted. The affirmative vote of the holders of a majority of the outstanding Common Shares was required for approval of this proposal.

(d) As set forth in the System's Notice of 1994 Annual Meeting, Proxy Statement and 1993 Financial Information dated April 1, 1994 as Item 3, seeking shareholders' approval of Commonwealth Energy System and Subsidiary Companies Long-Term Incentive Compensation Plan for key employees of the System and its subsidiaries which was approved and adopted by the Board of Trustees on February 16, 1994 was voted upon and approved at the 1994 Annual Shareholders' Meeting. There were

7,728,684 (74.7%) Common Shares voted for this proposal, 736,838 (7.1%) Common Shares voted against, 204,216 (2.0%) Common Shares abstained and 1,675,881 (16.2%) Common Shares were not voted. The affirmative vote of the holders of a majority of the outstanding Common Shares was required for approval of this proposal.

(e) As set forth in the System's Notice of 1994 Annual Meeting, Proxy Statement and 1993 Financial Information dated April 1, 1994 as Item 4, a shareholder proposal, which was also presented at the 1991, 1992

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#### COMMONWEALTH ENERGY SYSTEM AND SUBSIDIARY COMPANIES

and 1993 Annual Meeting, requesting the Board of Trustees to repeal the classified board and institute annual election of trustees was voted upon and failed to pass at the 1994 Annual Shareholders' Meeting. There were 1,483,947 (14.4%) Common Shares voted for this proposal, 5,917,813 (57.2%) Common Shares voted against, 272,511 (2.6%) Common Shares abstained and 2,671,348 (25.8%) Common Shares were not voted. The affirmative vote of the holders of a majority of the outstanding Common Shares was required for approval of this proposal.

#### Item 5. Other Information

None

#### Item 6. Exhibits and Reports on Form 8-K

##### (a) Exhibits

Exhibit 4. Instruments defining the rights of security holders, including indentures.

Incorporated herein by reference:

4.4.18 Eighteenth Supplemental Indenture dated December 1, 1993 to Indenture of Trust and First Mortgage Dated as of February 1, 1949 (Exhibit 1 to Commonwealth Gas' Form 10-Q (March 1994) File No. 2-1647).

##### (b) Reports on Form 8-K

No reports on Form 8-K were filed during the three months ended March 31, 1994.

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COMMONWEALTH ENERGY SYSTEM

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

COMMONWEALTH ENERGY SYSTEM  
(Registrant)

Principal Financial Officer:

JAMES D. RAPPOLI  
James D. Rappoli,  
Financial Vice President  
and Treasurer

Principal Accounting Officer:

JOHN A. WHALEN  
John A. Whalen,  
Comptroller

Date: May 13, 1994