nationalgrid

National Grid Generation LLC and Subsidiaries

Consolidated Financial Statements

For the years ended December 31, 2019 and 2018

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

To the Board of Managers of
National Grid Generation LLC

We have audited the accompanying consolidated financial statements of National Grid Generation LLC and Subsidiaries (the "Company"), which comprise the consolidated balance sheets and statements of capitalization as of December 31, 2019 and 2018, and the related consolidated statements of income, changes in member's equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of National Grid Generation LLC and Subsidiaries as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

February 28, 2020

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(in thousands of dollars)

	Twelve Months Ended December 31,	
	2019	2018
Operating revenues	**$ 479,531**	$ 475,829
Operating expenses:		
Operations and maintenance	**170,947**	171,242
Depreciation	**54,757**	53,804
Other taxes	**202,408**	200,108
Total operating expenses	**428,112**	425,154
Operating income	**51,419**	50,675
Other income and (deductions):		
Interest on long-term debt	**(1,219)**	(1,199)
Other interest, including affiliate interest	**(6,750)**	10,133
Other income, net	**7,021**	3,181
Total other (deductions) income, net	**(948)**	12,115
Income before income taxes	**50,471**	62,790
Income tax expense	**15,147**	1,187
Net income	**$ 35,324**	$ 61,603

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands of dollars)

	Twelve Months Ended December 31,	
	2019	2018
Operating activities:		
Net income	**$ 35,324**	$ 61,603
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	**54,757**	53,804
Deferred income tax	**956**	2,303
(Income) loss from equity investments, net of dividends received	**(979)**	207
Decommissioning charges, net of payments	**956**	560
Changes in operating assets and liabilities:		
Accounts receivable and other receivable, net, and unbilled revenues	**3,148**	4,732
Accounts receivable from/payable to affiliates, net	**(1,187)**	-
Inventory	**(1,078)**	(373)
Emission credits and emission credits reserve	**(81)**	(432)
Prepaid and accrued taxes	**7,428**	3,083
Accounts payable and other liabilities	**5,057**	(21,325)
Other, net	**61**	(9,967)
Net cash provided by operating activities	**104,362**	94,195
Investing activities:		
Capital expenditures	**(43,009)**	(55,902)
Intercompany money pool	**(42,701)**	1,066
Investment in joint venture	**(889)**	(21,489)
Other	**107**	-
Net cash used in investing activities	**(86,492)**	(76,325)
Financing activities:		
Payments on long-term debt	**(17,870)**	(17,870)
Net cash used in financing activities	**(17,870)**	(17,870)
Net increase in cash, cash equivalents, restricted cash and special deposits	**-**	-
Cash, cash equivalents, restricted cash and special deposits, beginning of period	**-**	-
Cash, cash equivalents, restricted cash and special deposits, end of period	**$ -**	$ -
Supplemental disclosures:		
Interest paid	**$ (6,524)**	$ (7,060)
Income taxes paid	**(4,430)**	(9,202)
Significant non-cash items:		
Capital-related accruals included in accounts payable	**3,767**	1,575
Parent tax loss allocation	-	5,482
National Grid Ventures divestiture	**(26,734)**	-

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands of dollars)

	December 31, 2019	December 31, 2018
ASSETS		
Current assets:		
Accounts receivable, net of allowance	**$ 57**	$ 676
Accounts receivable from affiliates	**2,395**	3,632
Intercompany moneypool asset	**73,911**	31,210
Unbilled revenues	**3,531**	6,139
Inventory	**63,580**	55,069
Other current assets	**475**	2,299
Total current assets	**143,949**	99,025
Investment in affiliates	**-**	22,051
Property, plant and equipment, net	**668,387**	676,461
Noncurrent assets:		
Other noncurrent assets	**10,031**	11,702
Total noncurrent assets	**10,031**	11,702
Total assets	**$ 822,367**	$ 809,239

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands of dollars)

	December 31, 2019	December 31, 2018
LIABILITIES AND CAPITALIZATION		
Current liabilities:		
Accounts payable	$ **62,666**	$ 55,824
Accounts payable to affiliates	**20,327**	14,507
Current portion of long-term debt	**17,870**	17,870
Taxes accrued	**73,751**	73,748
Interest accrued - current	**764**	854
Current portion of emission credit reserve	**7,009**	6,624
Other current liabilities	**6,544**	5,682
Total current liabilities	**188,931**	175,109
Noncurrent liabilities:		
Asset retirement obligations	**17,955**	17,541
Deferred income tax liabilities, net	**95,238**	93,582
Emission credit reserve	**13,674**	6,707
Other noncurrent liabilities	**19,955**	20,406
Total noncurrent liabilities	**146,822**	138,236
Capitalization:		
Member's equity	**282,819**	274,229
Long-term debt	**203,795**	221,665
Total capitalization	**486,614**	495,894
Total liabilities and capitalization	$ **822,367**	$ 809,239

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CAPITALIZATION
(in thousands of dollars)

	Interest Rate	Maturity Date	December 31, 2019	December 31, 2018
Total member's equity			**$ 282,819**	$ 274,229
Long-term debt:				
Pollution Control Revenue Bonds - Series 1999A	Variable	October 1, 2028	**41,125**	41,125
Electric Facilities Revenue Bonds - Series 1997A	Variable	December 1, 2027	**24,880**	24,880
			66,005	66,005
Promissory Notes to National Grid North America Inc.	3.13-3.25%	June 2027 - April 2028	**155,660**	173,530
Total Debt			**221,665**	239,535
Current portion of long-term debt			**17,870**	17,870
Total long-term debt			**203,795**	221,665
Total capitalization			**$ 486,614**	$ 495,894

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN MEMBER'S EQUITY
(in thousands of dollars)

	Additional Paid-in Capital	Retained Earnings	Total
Balance as of December 31, 2017	**$ 151,306**	**$ 55,864**	**$ 207,170**
Net income	-	61,603	61,603
Parent tax loss allocation	5,482	-	5,482
Share based compensation	(26)	-	(26)
Balance as of December 31, 2018	**$ 156,762**	**$ 117,467**	**$ 274,229**
Net income	-	35,324	35,324
Equity distribution	(26,734)	-	(26,734)
Balance as of December 31, 2019	**$ 130,028**	**$ 152,791**	**$ 282,819**

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

National Grid Generation LLC (together with its subsidiaries referred to as "the Company") is a New York limited liability company that owns and operates 50 electric generation units with approximately 3,800 megawatts ("MWs") of electric generation capacity located in Long Island. The Company, together with its wholly-owned subsidiaries, National Grid Glenwood Energy Center, LLC ("Glenwood") and National Grid Port Jefferson Energy Center LLC ("Port Jefferson"), sell capacity, energy conversion, and ancillary services to the Long Island Power Authority ("LIPA"). See Note 3, "Equity Investments," for further information on the Company's non-consolidated subsidiaries.

The Company is a wholly-owned subsidiary of National Grid USA ("NGUSA" or the "Parent"), a public utility holding company with regulated subsidiaries engaged in the generation of electricity and the transmission, distribution, and sale of both natural gas and electricity. NGUSA is a direct wholly-owned subsidiary of National Grid North America Inc. ("NGNA") and an indirect wholly-owned subsidiary of National Grid plc, a public limited company incorporated under the laws of England and Wales.

The Company earns all of its revenue from contracts with LIPA based upon an agreement with LIPA (the "Amended and Restated Power Supply Agreement" or "A&R PSA"), which provides for the sale of all capacity and requested energy from its oil and gas-fired generating facilities. In addition, Glenwood and Port Jefferson have 25-year Power Purchase Agreements ("PPAs") with LIPA to provide capacity, energy, and ancillary services to LIPA and each plant is designed to produce 80 MWs of electricity.

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP").

The Company has evaluated subsequent events and transactions through February 28, 2020, the date of issuance of these consolidated financial statements, and concluded that there were no events or transactions that require adjustment to, or disclosure in, the consolidated financial statements as of and for the year ended December 31, 2019.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

In preparing consolidated financial statements that conform to U.S. GAAP, the Company must make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses, and the disclosure of contingent assets and liabilities included in the consolidated financial statements. Actual results could differ from those estimates.

Revenue Recognition

Revenues are recognized for sales of capacity and energy to LIPA under terms of the A&R PSA, with rates approved by the Federal Energy Regulatory Commission ("FERC"). See Note 11, "Leases," for additional information on the A&R PSA. The Company records unbilled revenues for the estimated amount of energy delivered from the bill date to the end of the accounting period.

Other Taxes

The Company collects taxes and fees from LIPA such as sales taxes, other taxes, surcharges, and fees that are levied by state or local governments on the sale or distribution of electricity. The Company accounts for taxes that are imposed on customers (such as sales taxes) on a net basis (excluded from revenues).

The Company's policy is to accrue for property taxes on a calendar year basis, taking into account the assessment period. The Company had accrued for property taxes of $48.6 million and $49.1 million as of December 31, 2019 and 2018, respectively.

Income Taxes

Federal and state income taxes have been computed utilizing the asset and liability approach that requires the recognition of deferred tax assets and liabilities for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the consolidated financial statement carrying amounts and the tax basis of existing assets and liabilities. Deferred income taxes also reflect the tax effect of net operating losses, capital losses, and general business credit carryforwards. The Company assesses the available positive and negative evidence to estimate whether sufficient future taxable income of the appropriate tax character will be generated to realize the benefits of existing deferred tax assets. When the evaluation of the evidence indicates that the Company will not be able to realize the benefits of existing deferred tax assets, a valuation allowance is recorded to reduce existing deferred tax assets to the net realizable amount.

The effects of tax positions are recognized in the consolidated financial statements when it is more likely than not that the position taken, or expected to be taken, in a tax return will be sustained upon examination by taxing authorities based on the technical merits of the position. The financial effect of changes in tax laws or rates is accounted for in the period of enactment. Deferred investment tax credits are amortized over the useful life of the underlying property.

NGNA files consolidated federal tax returns including all of the activities of its subsidiaries. Each subsidiary determines its tax provision based on the separate return method, modified by benefits-for-loss allocation pursuant to a tax sharing agreement between NGNA and its subsidiaries. The benefits of consolidated tax losses and credits are allocated to the NGNA subsidiaries giving rise to such benefits in determining each subsidiary's tax expense in the year that the loss or credit arises. In a year that a consolidated loss or credit carryforward is utilized, the tax benefit utilized in consolidation is paid proportionately to the subsidiaries that gave rise to the benefit regardless of whether that subsidiary would have utilized the benefit. The tax sharing agreement also requires NGNA to allocate its parent tax losses, excluding deductions from acquisition indebtedness, to each subsidiary in the consolidated federal tax return with taxable income. The allocation of NGNA's parent tax losses to its subsidiaries is accounted for as a capital contribution and is performed in conjunction with the annual intercompany cash settlement process following the filing of the federal tax return.

Accounts Receivable and Allowance for Doubtful Accounts

The Company recognizes an allowance for doubtful accounts to record accounts receivable at estimated net realizable value. The allowance is determined taking into account historical collection and write-off experience and management's assessment of collectability from LIPA. The collectability of receivables is continuously assessed, and, if circumstances change, the allowance is adjusted accordingly. Receivable balances are written off against the allowance for doubtful accounts when the balances are deemed to be uncollectible, which is reflected in the Company's operations and maintenance expense

Inventory

Inventory is comprised of materials and supplies and carbon dioxide emission credits. Materials and supplies are stated at weighted average cost, which represents net realizable value, and are expensed or capitalized as used. The Company wrote off $0.1 million in obsolete inventory for both the years ended December 31, 2019 and 2018, respectively. The Company's carbon dioxide emission credits are valued at the lower of weighted average cost or net realizable value and are held primarily for consumption or may be sold to third-party purchasers.

The Company had materials and supplies of $40.8 million and $39.8 million as of December 31, 2019 and 2018, respectively.

As of December 31, 2019 and 2018, the Company recorded emission allowance credits of $22.7 million and $15.3 million and a compliance reserve of $20.7 million and $13.3 million, respectively.

As per the Regional Greenhouse Gas Initiative, the Company is required to maintain carbon dioxide emission credits for emissions which are emitted over a three-year compliance period. After the end of each interim control period, which is each of the first two calendar years of a three-year compliance period, the Company is required to surrender 50% of its emission credits for the control period, which is recognized as a reduction to inventory and the emission credit reserve on the accompanying consolidated balance sheet. At the end of the three-year compliance period, the remaining inventory and emission credit reserve are surrendered and removed from the balance sheet.

Property, Plant, and Equipment

Property, plant, and equipment is stated at original cost. The cost of repairs and maintenance is charged to expense and the cost of renewals and betterments that extend the useful life of property, plant, and equipment is capitalized. The capitalized cost of additions to property, plant, and equipment includes costs such as direct material, labor and benefits, and capitalized interest.

Depreciation is computed over the estimated useful life of the asset using the composite straight-line method. Depreciation studies are conducted periodically to update the composite rates. The average composite rates for both the years ended December 31, 2019 and 2018 was 2.8%. The average service life for both the years ended December 31, 2019 and 2018 was 36 years.

Capitalized Interest

In accordance with ASC 835, "Interest," the Company capitalized interest in the amount of $0.7 million and $0.9 million as of December 31, 2019 and 2018, respectively. The average capitalized interest rates for the years ended December 31, 2019 and 2018 were 2.01% and 1.45%, respectively.

Asset Retirement Obligations

Asset retirement obligations are recognized for legal obligations associated with the retirement of property, plant, and equipment. Asset retirement obligations are recorded at fair value in the period in which the obligation is incurred, if the fair value can be reasonably estimated. In the period in which new asset retirement obligations, or changes to the timing or amount of existing retirement obligations, are recorded, the associated asset retirement costs are capitalized as part of the carrying amount of the related long-lived asset. In each subsequent period, the asset retirement obligation is accreted to its present value.

The Company has various asset retirement obligations primarily associated with its electric generation activities. Generally, the Company's largest asset retirement obligations relate to: (i) cleaning and removal requirements associated with storage tanks containing waste oil and other waste contaminants; (ii) legal requirements to remove asbestos upon major renovation or demolition of structures and facilities; and (iii) waste water treatment pond removal.

The following table represents the changes in the Company's asset retirement obligations:

	December 31,	
	2019	2018
	(in thousands of dollars)	
Balance as of the beginning of the year	**$ 17,872**	$ 17,312
Accretion expense	**956**	886
Liabilities settled	**(1)**	(326)
Balance as of the end of the year	**$ 18,827**	$ 17,872

The Company had a current portion of asset retirement obligations of $0.9 million and $0.3 million included in Other Current Liabilities on the balance sheet as of December 31, 2019 and 2018, respectively.

Employee Benefits

The Company follows the accounting guidance for multi-employer accounting to record pension and postretirement benefits other than pension ("PBOP") expenses. The Company's pension and PBOP expenses represent direct charges and allocations from affiliated service companies, while the liability is recorded at the Parent. Contributions are also based on these pension and PBOP expenses.

Variable Interest Entities

A variable interest entity ("VIE") is an entity that does not have a sufficient equity investment at risk to permit it to finance its activities without additional subordinated financial support, or whose equity investors lack the obligation to absorb losses, the right to receive residual returns or the right to make decisions about the entity's activities. The primary beneficiary is the business enterprise that has the power to direct the activities of the VIE that most significantly impact the VIE's economic performance and either absorbs a significant amount of the VIE's losses or has the right to receive the benefits that could be significant to the VIE. The primary beneficiary holds a controlling financial interest in an entity and is required to consolidate the VIE.

We determine whether we are the primary beneficiary of a VIE by evaluating the purpose and design of the entity, the nature of the VIE's risks and the risks that we absorb, who has the power to direct the activities of the VIE that most significantly impact the economic performance of the VIE, and who has the obligation to absorb losses or receive benefits that could be significant to the VIE.

Through its wholly-owned subsidiary, National Grid Generation Ventures LLC ("Ventures"), the Company owned a 50% interest in each of four individual LLCs (Island Park Energy Center LLC, LI Solar Generation LLC, LI Energy Storage System LLC, and Clean Energy Generation LLC). Each of the four individual entities was a variable interest entity, however the Company was not the primary beneficiary as it did not have the power to direct the most significant activities of the entities. The Company accounted for its 50% ownership interest in the entities using the equity method of accounting for investments.

On November 30, 2019, the Company transferred its ownership interest in Ventures to NGNA through an equity distribution. See Note 3, "Equity Investments" for further information.

New and Recent Accounting Guidance

Accounting Guidance Recently Adopted

Leases

On January 1, 2019, the Company adopted Accounting Standards Update (ASU) No. 2016-02, "Leases (Topic 842)," including the amendments thereto. The standard ("Topic 842") supersedes the lease requirements within Topic 840, "Leases." The Company follows lessor accounting with regards to the A&R PSA and PPAs where the Company is the lessor. No material arrangements exist where by the Company qualify as the lessee, thus there was no balance sheet transition adjustment as of the date of adoption.

The new standard provides the Company with transition practical expedients including a package of three expedients that must be taken together and allows the Company to: not reassess whether existing contracts contain leases, carryforward the existing classification of any leases, and not reassess initial direct costs associated with existing leases. The Company has exercised its option to elect the package of practical expedients.

The new standard permits an entity to elect an optional transition practical expedient to not evaluate under Topic 842 land easements that exist or expire before the Company's adoption of Topic 842, that were not previously accounted for as leases under Topic 840. The Company has exercised its option to elect this expedient.

The new standard permits lessors, as an accounting policy election, to not evaluate whether certain sales taxes and other similar taxes are lessor costs or lessee costs. Instead, those lessors will account for those costs as if they are lessee costs. The Company has made this accounting policy election. In addition, the new standard also allows lessors to exclude certain costs from variable payments, and therefore revenue, for lessor costs paid by lessees directly to third parties. The Company has also made this accounting policy election.

The new standard also permits lessors, as an accounting policy election, to not separate lease and non-lease components if the non-lease components would otherwise be accounted for under FASB Topic 606 – Revenue from contracts with customers, the timing and pattern of both the lease and non-lease components is the same and the lease component would be accounted for as an operating lease under the new standard. The Company has not made this accounting policy election.

Accounting Guidance Not Yet Adopted

Goodwill and Other

In August 2018, the FASB issued ASU No. 2018-15 "Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40), Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract" to help entities evaluate the accounting for fees paid by a customer. The amendment will align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. For the Company, the requirements in this Update are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently assessing the application of the standard to determine if it will have a material impact on the presentation, results of operations, cash flows, and financial position of the Company.

Compensation

In August 2018, the FASB issued ASU No. 2018-14 "Compensation – Retirement Benefits – Defined Benefit Plans – General (Subtopic 715-20), Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans" which modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. For the Company, the requirements in this update are effective for financial statements ending after December 15, 2020. The Company is currently assessing the application of the standard to determine if it will have a material impact on its footnote disclosures.

Financial Instruments

In June 2016, the FASB issued ASU No. 2016-13 "Financial Instruments – Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments," requires a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. In May 2019, the FASB issued ASU 2019-05, "Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief", permitting entities to irrevocably elect fair value option for financial instruments that were previously recorded at amortized cost basis within the scope of Topic 326, with the exception of held-to-maturity debt securities. For the Company, the requirements in these updates, as amended by ASU 2019-10 "Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates," will be effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. The Company is currently assessing the application of the standard to determine if it will have a material impact on the presentation, results of operations, cash flows, and financial position of the Company.

3. EQUITY INVESTMENTS

The Company owned a 50% interest in each of Island Park Energy Center LLC, LI Solar Generation LLC, LI Energy Storage System LLC, and Clean Energy Generation LLC. The Company made contributions to these LLCs as needed to fund development activities and operations. Island Park Energy Center LLC was formed to develop, construct, own, and operate a proposed repowering of the E.F. Barrett steam and combustion turbine units, all located in Nassau County, New York. LI Solar Generation LLC was developing a 22.9 MW solar generation project in Calverton, NY based on a 2017 selection by LIPA for power contracts as part of a Request for Proposals ("RFP") process. Clean Energy Generation LLC was formed to jointly respond to RFPs in the State of New York related to generation, energy storage, and demand response resources with intent to develop, construct, own, and operate infrastructure assets if selected.

LI Energy Storage System LLC through its wholly-owned subsidiaries, East Hampton Storage Center LLC and Montauk Energy Storage Center LLC, were awarded contracts by LIPA as part of an RFP process. The award was for separate 5-megawatt hour ("MWh") and 40-MWh battery storage projects in East Hampton, NY and Montauk, NY. The entities owned and operated the facilities and provided energy and storage services to LIPA through an executed 20-year PPAs with LIPA. In 2019 the Company made $0.9 million capital contributions to LI Solar and in 2018 the Company made $11.1 million in capital contributions to East Hampton Storage Center and $9.5 million to Montauk Energy Storage Center. The East Hampton Storage Center commenced commercial operations on August 1, 2018. The Montauk Energy Storage Center commenced commercial operations on February 1, 2019.

The 50% equity interest in Island Park Energy Center LLC, LI Solar Generation LLC, LI Energy Storage System LLC, and Clean Energy Generation LLC were accounted for as equity investments as the Company did not have a controlling financial interest. Each of the LLCs described above were variable interest entities; however, the Company was not the primary beneficiary as it did not have the power to direct the most significant activities of the entities as under each LLC agreement, the Board of Managers was comprised of a number of representatives equal to two per Qualified Members (defined as Members with over a 25% interest): two representatives from Ventures and two representatives from NextEra, and there was no internal mechanism in place to resolve a board deadlock.

During 2019, NGNA commenced a restructuring plan to move certain of its nonregulated businesses, which were located throughout the organizational structure, underneath a single holding company. Subsequently, on November 30, 2019, the Company transferred its ownership interest in Ventures to NGNA through an equity distribution. As this was a transaction between entities under common control, the Company's interest in Ventures was transferred at net book value, or $27.0 million. There was no gain or loss as a result of this transfer.

Prior to December 1, 2019, the Company recognized equity earnings of $1.0 million within the statement of income for the year ended December 31, 2019 and $0.6 million for the year ended December 31, 2018. The Company had not issued any loans, commitments or guarantees any of the equity investment entities.

4. PROPERTY, PLANT, AND EQUIPMENT

The following table summarizes property, plant, and equipment at cost along with accumulated depreciation and amortization:

	December 31,	
	2019	2018
	(in thousands of dollars)	
Plant and machinery	**$ 1,710,816**	$ 1,682,457
Motor vehicles and equipment	**1,405**	1,448
Land and buildings	**361,227**	349,925
Assets in construction	**44,544**	40,092
Software and other intangibles	**8,364**	8,364
Total property, plant and equipment	**2,126,356**	2,082,286
Accumulated depreciation and amortization	**(1,457,969)**	(1,405,825)
Property, plant and equipment, net	**$ 668,387**	$ 676,461

5. FAIR VALUE MEASUREMENTS

The fair value of the Company's long-term debt is based on quoted market prices when available or estimated using quoted market prices for similar debt. The fair value of the Company's long-term debt is the same as its amortized cost on the consolidated balance sheets. See Note 7, "Capitalization" for additional information.

All other financial instruments in the accompanying consolidated balance sheets, such as accounts receivable, accounts payable, and the intercompany money pool, are stated at cost, which approximates fair value.

6. EMPLOYEE BENEFITS

The Company participates with certain other NGUSA subsidiaries in qualified and non-qualified non-contributory defined benefit plans (the "Pension plans") and PBOP plans (together with the Pension Plans (the "Plans")), covering substantially all employees.

The Pension plans provide union employees, as well as all non-union employees hired before January 1, 2011, with a retirement benefit. Supplemental non-qualified, non-contributory executive retirement programs provide additional defined pension benefits for certain executives.

The PBOP plans provide health care and life insurance coverage to eligible retired employees. Eligibility is based on age and length of service requirements, and, in most cases, retirees must contribute to the cost of their coverage.

Plan assets are maintained for all of NGUSA and its subsidiaries in commingled trusts. The Plans' costs are first directly charged to the Company based on the Company's employees that participate in the Plans. Costs associated with affiliated service companies' employees are then allocated as part of the labor burden for work performed on the Company's behalf. Pension and PBOP expenses are included within operations expenses in the accompanying statements of income.

The Company's A&R PSA with LIPA provides for the recovery of direct and allocated pension and PBOP costs through the capacity charge mechanism. These costs are presently recovered through the capacity charge mechanism during the subsequent contract year under the A&R PSA. These same costs are a direct input into funding considerations attributed to the Company in respect of the plans.

The KeySpan Retirement Income Plan, the KeySpan Benefit Plan for Retired (East) Union Employees, the KeySpan Life Insurance Plan for Retired (East) Management Employees, and the KeySpan Medical Plan for Retired (East) Management Employees are the primary Plans that provided pension and PBOP benefits in respect of the Company. Contributions in respect of the Company totaled $9.6 million and $5.4 million for the years ended December 31, 2019 and 2018, respectively.

All pension and PBOP costs associated with the Plan either directly charged or allocated from affiliated service companies are settled through the Company's Intercompany money pool (refer to the Intercompany Money Pool section of Note 12, "Related Party Transactions"). The amounts settled through the intercompany money pool are considered as the Company's contributions to the Plans.

The Company's gross pension and PBOP costs directly charged and allocated from affiliated service companies for the years ended December 31, 2019 and 2018 are as follows:

	Years Ended December 31,	
	2019	2018
	(in thousands of dollars)	
Pension	**$ 10,799**	$ 16,225
PBOP	**(1,986)**	(1,072)
	$ 8,813	$ 15,153

Gross pension and PBOP costs include $1.6 million and $2.3 million of capitalized costs for the years ended December 31, 2019 and 2018, respectively.

Defined Contribution Plan

NGUSA has a defined contribution pension plan that covers substantially all employees. For the years ended December 31, 2019 and 2018, the Company recognized an expense in the accompanying consolidated statements of income of $0.8 million in each year for matching contributions.

Other Benefits

As of December 31, 2019 and 2018, the Company had accrued workers compensation, auto, and general insurance claims which have been incurred but not yet reported ("IBNR") of $1.2 million and $1.3 million, respectively. IBNR reserves have been established for claims and/or events that have transpired but have not yet been reported to the Company for payment.

7. CAPITALIZATION

The aggregate maturities of long-term debt for the years subsequent to December 31, 2019 are as follows:

(in thousands of dollars)	
As of December 31,	
2020	$ 17,870
2021	17,870
2022	17,870
2023	17,870
2024	17,870
Thereafter	132,315
Total	$ 221,665

Debt Authorizations

Since January 12, 2015, the Company has had regulatory approval from the FERC to issue up to $250 million of short-term debt. The authorization, which was renewed with an effective date of January 11, 2019, is effective for a period of two years and expires on January 10, 2021. The Company had no short-term debt outstanding to third-parties as of December 31, 2019 or 2018.

State Authority Financing Bonds

As of December 31, 2019 and 2018, $41.1 million of 1999 Series A Pollution Control Revenue Bonds due October 1, 2028 were outstanding. The interest rate ranged from 0.85% to 3.33% for the year ended December 31, 2019 and from 0.80% to 3.72% for the year ended December 31, 2018.

The Company also had outstanding $24.9 million of variable rate 1997 Series A Electric Facilities Revenue Bonds due December 1, 2027 as of December 31, 2019 and 2018. The interest rate on these bonds is reset weekly and ranged from 1.13% to 2.28% during the year ended December 31, 2019 and 1.00% to 1.95% during the year ended December 31, 2018. These bonds are backed by a standby letter of credit and reimbursement agreement which includes a percent of indebtedness covenant that cannot exceed 70%. During the years ended December 31, 2019 and 2018, the Company was in compliance with this covenant.

Promissory Notes

On November 20, 2015, the Company entered into an intercompany loan with NGNA totaling $227 million, composed of a $165 million intercompany loan with an interest rate of 3.25% due to mature on April 30, 2028 and a $62 million intercompany loan with an interest rate of 3.13% due to mature on June 1, 2027. The intercompany loans have an annual sinking fund requirement totaling $17.9 million, which is included in current portion of long-term debt on the accompanying consolidated balance sheets as of December 31, 2019 and 2018, respectively.

Restrictions on Payment of Dividends

The Company is obligated to meet certain non-financial covenants pursuant to the participation agreement with the New York State Energy Research and Development Authority. During the years ended December 31, 2019 and 2018, the Company was in compliance with all such covenants.

Pursuant to FERC regulations, payment of dividends would not be permitted if, after giving effect to such payment of dividends, member's equity becomes less than 30% of total capitalization. As of December 31, 2019 and 2018, member's equity was 56.1% and 53.4% of total capitalization, respectively. Under these provisions, none of the Company's retained earnings as of December 31, 2019 or 2018 were restricted as to payment of dividends.

8. INCOME TAXES

Components of Income Tax Expense

	Years Ended December 31,	
	2019	2018
	(in thousands of dollars)	
Current tax expense (benefit):		
Federal	**$ 10,665**	$ 7,592
State	**3,526**	(8,708)
Total current tax expense (benefit)	**14,191**	(1,116)
Deferred tax expense:		
Federal	**315**	1,531
State	**641**	772
Total deferred tax expense	**956**	2,303
Total income tax expense	**$ 15,147**	$ 1,187

Statutory Rate Reconciliation

The Company's effective tax rate for the years ended December 31, 2019 and 2018 was 30.0% and 1.9%, respectively. The following table presents a reconciliation of income tax expense (benefit) at the federal statutory tax rate of 21% to the actual tax expense:

	Years Ended December 31,	
	2019	2018
	(in thousands of dollars)	
Computed tax	**$ 10,599**	$ 13,186
Change in computed taxes resulting from:		
State income tax, net of federal benefit	**3,292**	3,976
Audit and reserve settlements	**1,223**	(10,349)
Federal rate change	**-**	(5,309)
Other	**33**	(317)
Total changes	**4,548**	(11,999)
Total income tax expense	**$ 15,147**	$ 1,187

The Company is included in the NGNA and subsidiaries' consolidated federal income tax return and New York (NYS) unitary state income tax return. The Company has joint and several liability for any potential assessments against the consolidated group.

Deferred Tax Components

	December 31,	
	2019	2018
	(in thousands of dollars)	
Deferred tax assets:		
Reserves not currently deducted	**$ 2,536**	$ 2,536
Postretirement benefits and other employee benefits	**1,290**	1,218
Net operating losses	**1,452**	2,325
Other items	**3,680**	6,438
Total deferred tax assets	**8,958**	12,517
Deferred tax liabilities:		
Property related differences	**91,261**	93,359
Property taxes	**12,935**	12,740
Total deferred tax liabilities	**104,196**	106,099
Net deferred income tax liabilities	**$ 95,238**	$ 93,582

Net Operating Losses

The amounts and expiration dates of the Company's net operating losses carryforward as of December 31, 2019 are as follows:

	Carryforward Amount	Expiration Period
	(in thousands of dollars)	
Federal	**$ 16,105**	**2033-2036**
State	**32,843**	**2035**

As a result of the accounting for uncertain tax positions, the amount of deferred tax assets reflected in the financial statements is less than the amount of the tax effect of the federal and state operating losses carryforwards reflected on the income tax returns.

Federal and State Income Tax Audit Status

During the year ended December 31, 2019, the Company reached a settlement with the IRS for the tax years ended March 31, 2010, 2011 and 2012. The outcome of the settlement did not have a material impact to the Company’s results of operations, financial position, or cash flows.

During the year ended December 31, 2019, the IRS began its examination of the next audit cycle which includes the income tax returns for the years ended March 31, 2013 through March 31, 2015. The examination is expected to conclude in calendar year 2021 and result in a settlement agreement with the IRS. The Company does not anticipate the settlement to have a material impact on the Company's financial position. The income tax returns for the years ended March 31, 2016 through March 31, 2019 remain subject to examination by the IRS.

The Company was included in the Keyspan Corporation and subsidiaries (Keyspan) NYS combined corporate income tax returns for the periods ended December 31, 2003 through March 31, 2008. During the year ended December 31, 2018, Keyspan effectively settled the 2003 to 2009 NYS audit and, as a result, recognized a benefit of $10.3 million, net of federal benefit, through the release of tax reserves, and also derecognized interest expense of $18.5 million related to the NYS audit.

The State of New York concluded the audit for the years ended March 31, 2010 through March 31, 2015, which resulted in no material findings. The years ended March 31, 2016 through March 31, 2019 remain subject to examination by the State of New York.

The following table indicates the earliest tax year subject to examination for each major jurisdiction:

Jurisdiction	Tax Year
Federal	March 31, 2013
New York	March 31, 2016

Uncertain Tax Positions

The Company recognizes interest related to unrecognized tax benefits in other interest, including affiliate interest and related penalties, if applicable, in other income, net, in the accompanying consolidated statements of income. As of December 31, 2019 and 2018, the Company has accrued for interest related to unrecognized tax benefits of $0.8 million and $0.7 million, respectively. During the years ended December 31, 2019 and 2018, the Company recorded interest expense of $0.1 million and interest income of $18.2 million, respectively. No tax penalties were recognized during the years ended December 31, 2019 and 2018.

It is reasonably possible that other events will occur during the next twelve months that would cause the total amount of unrecognized tax benefits to increase or decrease. However, the Company does not believe any such increases or decreases would be material to its results of operations, financial position, or cash flows.

9. ENVIRONMENTAL MATTERS

Ordinary business operations subject the Company to various federal, state, and local laws, rules, and regulations dealing with the environment, including air, water, and hazardous waste. The Company's business operations are regulated by various federal, regional, state, and local authorities, including the EPA, the New York State Department of Environmental Conservation ("DEC"), the New York City Department of Environmental Protection, and the Nassau and Suffolk County Departments of Health.

Except as set forth below, no material proceedings relating to environmental matters have been commenced or, to the Company's knowledge, are contemplated by any federal, state, or local agency against the Company and the Company is not a defendant in any material litigation with respect to any matter relating to the protection of the environment. The Company believes that its operations are in substantial compliance with environmental laws and that requirements imposed by environmental laws are not likely to have a material adverse impact on the Company's financial position or results of operations.

Air

The Company's generating facilities are subject to increasingly stringent emissions limitations under current and anticipated future requirements of the EPA and the DEC. In addition to efforts to improve both ozone and particulate matter air quality, there has been an increased focus on greenhouse gas emissions in recent years. The Company's previous investments in low NO_x boiler combustion modifications, the use of natural gas firing systems at its steam electric generating stations, and the compliance flexibility available under cap and trade programs have enabled the Company to achieve its prior emission reductions in a cost-effective manner. These investments include the installation of enhanced NO_x controls and efficiency improvement projects at certain of the Company's Long Island based electric generating facilities. The total cost of these improvements was approximately $105.8 million, all of which have been placed in service as of the date of this report; a mechanism for recovery from LIPA of these investments has been established. The Company will continue to make investments for additional emissions reductions, as needed. The Company has developed a compliance strategy to address

anticipated future requirements and is closely monitoring the regulatory developments to identify any necessary changes to its compliance strategy. At this time, the Company is unable to predict what effect, if any, these future requirements will have on its consolidated financial position, results of operations, and cash flows.

Water

Additional capital expenditures associated with the renewal of the surface water discharge permits for the Company's steam electric power plants have been required by the DEC pursuant to Section 316 of the Clean Water Act to mitigate the plants' alleged cooling water system impacts to aquatic organisms. Final permits have been issued for Port Jefferson and Northport. Capital improvements have been completed at Port Jefferson and are in the design, procurement, and construction phase for Northport. The Company continues to engage in discussions with the DEC regarding the nature of capital upgrades or other mitigation measures necessary to reduce any impacts at E.F. Barrett. Total capital costs for these improvements at Northport and E.F. Barrett are estimated to be approximately $74.9 million as of December 31, 2019. Costs associated with these capital improvements are reimbursable from LIPA under the A&R PSA.

10. COMMITMENTS AND CONTINGENCIES

Capital Expenditure Commitments

The Company has various capital commitments related to the construction of property, plant, and equipment. The Company's commitments under these contracts for the years subsequent to December 31, 2019 are summarized in the table below:

Years Ended December 31,	Capital Expenditures
(in thousands of dollars)	
2020	2,343
Total	**$ 2,343**

There are no commitments past 2020.

Legal Matters

The Company is subject to various legal proceedings arising out of the ordinary course of its business. The Company does not consider any of such proceedings to be material, individually or in the aggregate, to its business or likely to result in a material adverse effect on its results of operations, financial position, or cash flows.

Amended and Restated Power Supply Agreement

Effective May 28, 2013 (and most recently amended on April 1, 2018), the Company provides services to LIPA under an A&R PSA. Under the A&R PSA, the Company has a return on equity of 9.75% and a capital structure of 50% debt and 50% equity. The Company's annual revenue requirement for the year ended December 31, 2019 was $458.6 million.

The A&R PSA has a term of fifteen years, provided LIPA has the option to terminate the agreement as early as April 2025 on two years advance notice. In addition, LIPA has options to ramp down blocks of capacity on two years advance notice for steam generating units and one year advance notice for other generating units covered by the A&R PSA. The earliest effective ramp down date for the Company's Northport steam generating units is May 2021; ramp downs for all other units could be effective at any time after consideration of the notice periods. Should any ramp downs be exercised, the Company is entitled to a ramp down payment plus operating and maintenance expenses for 18 months for steam generating units and 12 months for all other generating units. The ramp down payment is equivalent to the net book value of the generating unit, less a discount factor. This discount factor ranges from 50% of the unit's net book value if retired with an effective date in 2022 up

to 62.5% of the unit's net book value if retired with an effective date thereafter. LIPA provided advance notice for one non-steam generating unit ramp down in December 2019, with an effective date in December 2020. As this unit is fully depreciated, there is no significant financial impact from the ramp down provision included within the A&R PSA associated with this notice through the effective ramp down date.

The A&R PSA provides potential penalties to the Company if it does not maintain the output capability of the generating facilities, as measured by annual industry-standard tests of operating capability, plant availability, and efficiency. These penalties may total $4 million annually. Although the A&R PSA provides LIPA with all of the capacity from the generating facilities, LIPA has no obligation to purchase energy from the generating facilities and can purchase energy on a least-cost basis from all available sources consistent with existing transmission interconnection limitations of the transmission and distribution system. The Company must, therefore, operate its generating facilities in a manner such that the Company can remain competitive with other producers of energy. To date, the Company has dispatched to LIPA and LIPA has accepted the level of energy generated at the agreed to price per megawatt hour. Under the terms of the A&R PSA, LIPA is obligated to pay for capacity at rates that reflect recovery of an agreed level of the overall cost of maintaining and operating the generating facilities, including recovery of depreciation and return on its investment in plant. The capacity charge is approximately 95% of the annual revenue requirement and is adjusted each year using cost escalation and inflation factors applied to the prior year's capacity charge. A monthly variable maintenance charge is billed for each unit of energy actually acquired from the generating facilities. The billings to LIPA under the A&R PSA do not include a provision for fuel costs, as such fuel is owned by LIPA.

11. LEASES

Upon adoption of Topic 842, the Company continues to recognize operating revenue related to the A&R PSA and PPAs whereby LIPA agrees to purchase capacity, energy, and ancillary services from the Company and its subsidiaries. The agreements had been previously assessed by the Company and were determined to be leases under ASC 840, and classified as operating leases. Management elected the practical expedient whereby no reassessment is required for leases that have commenced prior to the adoption of the new lease standard. Refer to Note 2, "Summary of Significant Accounting Policies" for further discussion on the expedients taken as part of the transition.

The contracts have a range of expiration dates from 2025 through 2028. The payments associated with these contracts are variable in nature as they are tied to capacity charges and underlying expenses related to pension, 401K, emissions, operations and maintenance and other variable expenses of the Company. Capacity charges vary as these are reset annually and charged evenly for the 12-month period. The remaining expenses vary month to month with periodic true up billings. Variability of the remaining expenses is primarily due to the variable nature of maintenance, head count, value of carbon dioxide credits purchased, usage of contractors, long-term and short-term projects, and other factors.

The PSA provides LIPA with all the capacity from the generating facilities, LIPA has no obligation to purchase energy from the generating facilities and can purchase energy on a least-cost basis from all available sources consistent with existing transmission interconnection limitations of the transmission and distribution system. There are no significant assumptions taken in the accounting for these leases. Renewal options are available for LIPA. The revenues earned from the contracts amounted to $478.9 million for the year ended December 31, 2019 and comprise substantially all the revenue presented on the income statement.

12. RELATED PARTY TRANSACTIONS

Accounts Receivable from and Accounts Payable to Affiliates

NGUSA and its affiliates provide various services to the Company, including executive and administrative, customer services, financial (including accounting, auditing, risk management, tax, and treasury/finance), human resources, information technology, legal, and strategic planning, that are charged between the companies and charged to each company.

The Company records short-term receivables from, and payables to, certain of its affiliates in the ordinary course of business. The amounts receivable from, and payable to, its affiliates do not bear interest and are settled through the intercompany money pool. A summary of outstanding accounts receivable from affiliates and accounts payable to affiliates is as follows:

	Account Receivable from Affiliates		**Account Payable to Affiliates**	
	December 31,		**December 31,**	
	2019	2018	**2019**	2018
	(In thousands of dollars)			
NGUSA	**$ -**	$ 933	**$ 12,973**	$ 9,018
NGUSA Service Company	**1,816**	1,558	**6,888**	3,039
National Grid Engineering Services, LLC	**578**	1,140	**365**	2,120
National Grid Electric Services, LLC	**-**	-	**95**	329
Other Affiliates	**1**	1	**6**	1
Total	**$ 2,395**	$ 3,632	**$ 20,327**	$ 14,507

Intercompany Money Pool

The settlement of the Company's various transactions with NGUSA and certain affiliates generally occurs via the intercompany money pool in which it participates. The Company is a participant in the Regulated Money Pool and can both borrow and invest funds. Borrowings from the Regulated Money Pool bear interest in accordance with the terms of the Regulated Money Pool Agreement. As the Company fully participates in the Regulated Money Pool rather than settling intercompany charges with cash, all changes in the intercompany money pool balance are reflected as investing or financing activities in the accompanying consolidated statements of cash flows. For the purpose of presentation in the consolidated statements of cash flows, it is assumed all amounts settled through the intercompany money pool are constructive cash receipts and payments, and therefore are presented as such.

The Regulated Money Pool is funded by operating funds from participants. Collectively, NGUSA has the ability to borrow up to $3 billion from National Grid plc for working capital needs, including funding of the Regulated Money Pool, if necessary. The Company had short-term intercompany money pool investments of $73.9 million and $31.2 million as of December 31, 2019 and 2018, respectively. The average interest rates for the intercompany money pool were 2.54% and 2.22% for the years ended December 31, 2019 and 2018, respectively.

Service Company Charges

The affiliated service companies of NGUSA provide certain services to the Company at their cost. The service company costs are generally allocated to associated companies through a tiered approach. First and foremost, costs are directly charged to the benefited company whenever practicable. Secondly, in cases where direct charging cannot be readily determined, costs are allocated using cost/causation principles linked to the relationship of that type of service, such as number of employees, number of customers/meters, capital expenditures, value of property owned, and total transmission and distribution expenditures. Lastly, all other costs are allocated based on a general allocator determined using a 3-point formula based on net margin, net property, plant, and equipment, and operations and maintenance expense.

Charges from the service companies of NGUSA to the Company are mostly related to traditional administrative support functions, of which for the years ended December 31, 2019 and 2018 were $297.9 million and $291.1 million, respectively.