Annual Report 2008
The Narragansett Electric Company
A National Grid Company

nationalgrid

PRICEWATERHOUSECOOPERS

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Report of Independent Auditors

To the Stockholder and Board of Directors of
Narragansett Electric Company:

In our opinion, the accompanying balance sheets and the related statements of income, of comprehensive income, of retained earnings and of cash flows present fairly, in all material respects, the financial position of Narragansett Electric Company (the "Company") at March 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America and the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note E to the financial statements, the Company changed the manner in which it accounts for pension and postretirement benefit plans effective March 31, 2007 in accordance with Financial Accounting and Standards Board Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

PricewaterhouseCoopers LLP

June 27, 2008

The Narragansett Electric Company

Statements of Income

Year ended March 31 (In thousands)	2008	2007
Operating revenue:		
Electric	**$ 1,003,822**	$ 970,065
Gas	**463,392**	342,913
Total operating revenues	**1,467,214**	1,312,978
Operating expenses:		
Purchased electric energy:		
Non-affiliates	**607,756**	590,762
Contract termination charges from affiliate	**40,117**	50,052
Purchased gas	**312,214**	232,066
Other operations and maintenance	**290,623**	227,040
Depreciation and amortization	**64,364**	54,999
Taxes, other than income taxes	**84,084**	74,399
Income taxes	**12,519**	24,804
Total operating expenses	**1,411,677**	1,254,122
Operating income	**55,537**	58,856
Other income (expense):		
Other income (expense), net	**(409)**	1,968
Operating and other income	**55,128**	60,824
Interest:		
Interest on long-term debt	**6,825**	5,472
Other interest	**6,700**	4,533
Total interest	**13,525**	10,005
Net income	**$ 41,603**	$ 50,819

Statements of Comprehensive Income

Year ended March 31 (In thousands)	2008	2007
Net income	**$ 41,603**	$ 50,819
Other comprehensive income (loss), net of taxes:		
Unrealized gains (losses) on securities, net of taxes of $17 and ($75), respectively	**(32)**	140
Hedging activity	**14,256**	-
Change in additional minimum pension liability, net of taxes of $0 and ($275), respectively	-	510
Amortization of postretirement benefit costs, net of taxes of ($989) and $0	**1,836**	-
Reclassification adjustment for gain included in net income, net of taxes of ($114) and $46, respectively	**212**	(85)
Total other comprehensive income	**16,272**	565
Comprehensive income	**$ 57,875**	$ 51,384
Adjustment to initially apply SFAS No. 158	-	(80,163)
Change in accumulated other comprehensive income (loss)	**$ 16,272**	$ (79,598)

The Narragansett Electric Company

Statements of Retained Earnings

Year ended March 31 (In thousands)	**2008**	2007
Retained earnings at beginning of year	**$ 245,739**	$ 255,163
Net income	**41,603**	50,819
Dividends declared on cumulative preferred stock	**(198)**	(243)
Dividends declared on common stock	**-**	(60,000)
Retained earnings at end of year	**$ 287,144**	$ 245,739

The accompanying notes are an integral part of these financial statements

The Narragansett Electric Company

Balance Sheets

At March 31 (In thousands)	2008	2007
Assets		
Utility plant, at original cost	$ 1,928,277	$ 1,840,294
Less accumulated depreciation	(673,202)	(646,119)
Net utility plant	1,255,075	1,194,175
Goodwill	724,810	724,810
Other property and investments	7,336	7,334
Current assets:		
Cash and cash equivalents	8,641	29,778
Restricted cash	7,975	18,199
Accounts receivable, net (less reserves of $15,627 and $15,688, respectively, including $11,416 and $8,425 from affiliates, respectively)	333,660	268,177
Materials and supplies, at average cost		
Gas storage	18,205	14,322
Other	8,514	8,057
Prepaid and other current assets	25,152	5,018
Deferred federal income taxes	31,530	39,404
Total current assets	433,677	382,955
Regulatory assets	216,366	222,761
Prepaid pension	-	3,861
Deferred charges and other assets	5,188	6,021
Total assets	$ 2,642,452	$ 2,541,917
Capitalization and liabilities		
Capitalization:		
Common stock, par value $50 per share, authorized and outstanding 1,132,487 shares	$ 56,624	$ 56,624
Other paid-in capital	1,353,559	1,293,680
Retained earnings	287,144	245,739
Accumulated other comprehensive loss	(63,973)	(80,245)
Total common equity	1,633,354	1,515,798
Cumulative preferred stock, par value $50 per share, authorized and outstanding 49,089 and 106,146 shares, respectively	2,454	5,307
Long-term debt	58,277	64,898
Total capitalization	1,694,085	1,586,003
Current liabilities:		
Long-term debt due within one year	6,646	11,648
Short-term debt to affiliates	89,625	113,025
Accounts payable (including $9,568 and $22,322 to affiliates, respectively)	174,238	138,230
Accrued taxes	15,920	21,195
Accrued interest	2,296	1,979
Rate adjustment mechanisms	74,073	91,047
Accrued wages and benefits	8,265	8,410
Other accrued expenses	7,078	1,197
Customer deposits	7,163	6,372
Dividends payable	28	61
Total current liabilities	385,332	393,164
Deferred federal income taxes	103,946	94,956
Unamortized investment tax credits	3,380	3,984
Accrued pension and other post-retirement benefits	103,288	114,498
Regulatory liabilities	209,166	211,847
Other reserves and deferred credits	143,255	137,465
Total capitalization and liabilities	$ 2,642,452	$ 2,541,917

The accompanying notes are an integral part of these financial statements.

The Narragansett Electric Company

Statements of Cash Flows

Year ended March 31 (In thousands)	2008	2007
Operating activities:		
Net income	$ 41,603	$ 50,819
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	64,364	54,999
Deferred income taxes and investment tax credits, net	10,230	(17,247)
Allowance for funds used during construction	(296)	-
Changes in assets and liabilities:		
Accounts receivable, net and unbilled revenues	(38,417)	(37,995)
Materials and supplies	(4,340)	18,396
Prepaid and other current assets	(20,134)	5,468
Regulatory assets	6,395	14,514
Accounts payable	7,927	20,321
Other current liabilities	(15,405)	31,178
Accrued pension and other post-retirement benefits	(12,254)	(11,315)
Other reserves and deferred credits	(2,215)	10,175
Other, net	28,199	185
Net cash provided by operating activities	65,657	139,498
Investing activities:		
Plant expenditures, excluding allowance for funds used during construction	(119,444)	(76,835)
Acquisition of gas distribution assets	-	(493,125)
Proceeds received from sale of fixed assets	-	419
Change in restricted cash	10,224	(17,438)
Other investing activities	704	(550)
Net cash used in investing activities	(108,516)	(587,529)
Financing activities:		
Dividends paid on common stock	-	(60,000)
Capital contributed from parent	60,000	493,138
Dividends paid on preferred stock	(231)	(243)
Payment of long-term debt	(11,673)	(14,837)
Preferred stock – retirements	(2,974)	-
Changes in short-term debt	(23,400)	56,450
Net cash provided by financing activities	21,722	474,508
Net increase/(decrease) in cash and cash equivalents	(21,137)	26,477
Cash and cash equivalents at beginning of year	29,778	3,301
Cash and cash equivalents at end of year	$ 8,641	$ 29,778
Supplementary information:		
Interest paid; less amounts capitalized	$ 12,542	$ 7,934
Federal income taxes paid	$ 12,014	$ 36,550

The accompanying notes are an integral part of these financial statements

The Narragansett Electric Company

Notes to Financial Statements

Note A - Significant Accounting Policies

1. Nature of Operations:
The Narragansett Electric Company (the Company or Narragansett) is a wholly owned subsidiary of National Grid USA (NGUSA) operating in Rhode Island. The Company is affiliated with certain other US subsidiaries of National Grid USA including Niagara Mohawk Power Corporation, an upstate New York gas and electricity distribution provider. The Companies New England affiliates are as follows: New England Power Company, Massachusetts Electric Company, Nantucket Electric Company and Granite State Electric Company, New England Hydro-Transmission Electric Company, Inc., New England Hydro-Transmission Corporation, New England Hydro Finance Company, Inc. and National Grid USA Service Company (Service Company). Due to the recent acquisition discussed below, the Company is also affiliated with certain subsidiaries of KeySpan Corporation (KeySpan) including its service companies. The Company's primary business is the retail distribution of electricity and gas. Electric service is provided to approximately 485,000 customers and gas is distributed to approximately 250,000 customers in 38 cities and towns having a population of approximately 1,067,000 (2006 Population Estimate, US Census Bureau). The Company's service area, which includes urban, suburban, and rural areas, covers approximately 99 percent of Rhode Island. The properties of the Company include an integrated system of transmission and distribution lines, substations and gas distribution mains.

The Company's accounting policies conform to generally accepted accounting principles in the United States of America (GAAP), including the accounting principles for rate-regulated entities (see Note C), and are in accordance with the accounting requirements and ratemaking practices of the regulatory authorities.

2. System of Accounts:
The accounts of the Company are maintained in accordance with the Uniform System of Accounts prescribed by regulatory bodies having jurisdiction.

3. Use of Estimates:
The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

4. Revenue:
Revenues are based on billing rates authorized by the Rhode Island Public Utilities Commission (RIPUC). The Company follows the policy of accruing the estimated amount of base rate revenues for electricity and gas delivered but not yet billed (unbilled revenues), to match costs and revenues more closely. The unbilled revenues included in accounts receivable at March 31, 2008 and 2007 were approximately \$86,273,000 and \$72,465,000, respectively. During fiscal year 2008, the Company recorded revenues in an amount management believes to be recoverable pursuant to provisions of approved settlement agreements and state law. The Company normalizes the difference between revenue and expenses from energy conservation programs, standard offer/last resort service, transmission service, and the contract termination charge (CTC).

5. Allowance for Funds Used During Construction (AFUDC):
The Company capitalizes AFUDC as part of construction costs. AFUDC represents an allowance for the cost of funds used to finance construction. AFUDC is capitalized in "Utility plant" with offsetting cash credits to "Other interest" and non-cash credits to "Other income (expense), net." This method is in accordance with an established rate-making practice under which a utility is permitted to earn a return on, and the recovery of, prudently incurred capital costs through their ultimate inclusion in rate base and in the provision for depreciation. The composite AFUDC rates were 5.9 percent and 4.8 percent for the fiscal years ended March 31, 2008 and 2007, respectively.

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Notes to Financial Statements

6. Depreciation:
Depreciation is provided annually on a straight-line basis. The provision for depreciation, as a percentage of weighted average depreciable property, and the weighted average service life, in years, for the fiscal years ended March 31 are presented in the table below:

	2008		2007	
	Provision	**Service Life**	**Provision**	**Service Life**
Asset Category:				
Electric	3.3%	30	3.4%	30
Gas	3.8%	27	4.1%	24

7. Service Company Charges:
Affiliated service companies furnish services to the Company at the cost of such services since the merger with National Grid. These costs, including operating costs and capital expenditures, amounted to $92,156,000 and $72,551,000 for the fiscal years ended March 31, 2008 and 2007, respectively.

8. Cash and Cash Equivalents:
The Company classifies short-term investments with a maturity of 90 days or less at time of purchase as cash equivalents.

9. Restricted Cash:
In connection with the acquisition of the Rhode Island gas assets of New England Gas Company (NEG) from Southern Union Company (See Note B – "Acquisitions") and assumption of $77,000,000 of first mortgage bonds in August 2006, the Company has deposited approximately $17,000,000 with its first mortgage trustee to provide for the redemption of its own first mortgage bonds. The principal amount was $15,000,000 and the additional $2,000,000 would satisfy all interest and premium due on the bonds through maturity or first call date. During 2007, $10,000,000 of this principal amount was redeemed using the funds on deposit, leaving approximately $6,000,000 on deposit to satisfy the requirements of the remaining $5,000,000 principal amount. The Company will continue to comply with all requirements under the first mortgage indenture until all bonds have been redeemed or mature. Restricted Cash also consists of margin accounts for hedging activity associated with its hedge program for the purchase of natural gas.

10. Derivatives:
The Company accounts for derivative financial instruments under SFAS No. 133, "Accounting for Derivatives and Hedging Activities," and SFAS No. 149, "Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities," as amended (collectively "SFAS No. 133"). Under the provisions of SFAS No. 133, all derivatives except those qualifying for the normal purchase/normal sale exception are recognized on the balance sheet at their fair value. Fair value is determined using current quoted market prices. If a contract is designated as a cash flow hedge, the change in its market value is generally deferred as a component of other comprehensive income until the transaction it is hedging is completed. Conversely, the change in the market value of a derivative not designated as a cash flow hedge is deferred as a regulatory asset or liability as the Company has received approval from the PSC to establish a regulatory asset or liability for derivative instruments that did not qualify for hedge accounting and were the result of regulatory rulings. A cash flow hedge is a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability. To qualify as a cash flow hedge, the fair value changes in the derivative must be expected to offset 80 percent to 120 percent of the changes in fair value or cash flows of the hedged item. The Company will no longer apply cash flow hedge treatment for future transactions and will record the activity to a regulatory asset.

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Notes to Financial Statements

11. Utility Plant:
The cost of additions to utility plant and replacements of retirement units of property are capitalized. Costs include direct material, labor, overhead and AFUDC. Replacement of minor items of utility plant and the cost of current repairs and maintenance are charged to expense. Whenever utility plant is retired, its original cost, together with the cost of removal, less salvage, is charged to accumulated depreciation.

12. Goodwill:
In accordance with SFAS No. 142 "Goodwill and Other Intangible Assets," the Company reviews its goodwill annually for impairment and when events or circumstances indicate that the asset may be impaired. The Company utilized a discounted cash flow approach incorporating its most recent business plan forecasts in the performance of the annual goodwill impairment test. The result of the annual analysis determined that no adjustment to the goodwill carrying value was required. The Company recognized $235,058,000 of goodwill during the acquisition of the Rhode Island gas distribution assets of NEG (see Note B).

13. Federal Income Taxes:
Federal income taxes are recorded under the provisions of Financial Accounting Standards Board (FASB) SFAS No. 109 "Accounting for Income Taxes." 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 financial statement carrying amounts and the tax basis of existing assets and liabilities. Deferred investment tax credits are amortized over the useful life of the underlying property.

Effective on April 1, 2007, the Company implemented FASB Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109," which applies to all income tax positions reflected on the Company's balance sheets that have been included in previous tax returns or are expected to be included in future tax returns. FIN 48 addresses the methodology to be used prospectively in recognizing, measuring and classifying the amounts associated with tax positions that are deemed to be uncertain, including related interest and penalties. See Note F – Income Taxes for the impact of the adoption of FIN 48.

14. Comprehensive Income (Loss)
Comprehensive income/loss is the change in the equity of a company, not including those changes that result from shareholder transactions. While the primary component of comprehensive income (loss) is reported as net income or loss, the other components of comprehensive income (loss) relate to changes in SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Postretirement Plans," deferred gains and losses associated with hedging activity, and unrealized gains and losses associated with certain investments held as available for sale.

15. Reclassifications:
Certain amounts from prior years have been reclassified in the accompanying financial statements to conform to the current year presentation.

In the fiscal year 2007 financial statements, the adoption of SFAS No. 158 was presented as activity during the fiscal year and therefore was included in comprehensive income/(loss). However, it should have been reported as a direct reduction of accumulated other comprehensive income/(loss) in the changes in equity accounts disclosed as an adjustment in the reporting period and excluded from comprehensive income/(loss). The amount incorrectly recorded to comprehensive income/(loss) was $80,163,000. The March 31, 2007, accumulated other comprehensive income/(loss) balance reported in the fiscal year 2007 Annual Report was properly stated. See Note L – Accumulated Other Comprehensive Income/(Loss).

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Notes to Financial Statements

16. New Accounting Standards:
In July 2006, the FASB issued FIN 48. FIN 48 clarifies the accounting and reporting for uncertainties in income tax law. FIN 48 prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure for uncertain tax positions taken or expected to be taken in income tax returns. The cumulative effect of applying the provision of this interpretation is required to be reported separately as an adjustment to the opening balance of retained earnings in the year of adoption. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 on April 1, 2007. See Note F, "Income Taxes", for the impact of the adoption of the new standard on the Company's financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which provides enhanced guidance for using fair value measurements in financial reporting. While the standard does not expand the use of fair value in any new circumstance, it has applicability to several current accounting standards that require or permit entities to measure assets and liabilities at fair value. This standard defines fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. In February 2008, the FASB issued two staff positions which amend SFAS No. 157. FASB Staff Position (FSP) SFAS No. 157-1 excludes the application of SFAS No. 157 for the purposes of lease classification under SFAS No. 13 "Accounting for Leases." FSP SFAS No. 157-2 delays the adoption of SFAS No. 157 to fiscal years beginning after November 15, 2008, except for nonfinancial assets and nonfinancial liabilities recognized or disclosed at fair value on a recurring basis. The Company is currently evaluating the impact of this enhanced guidance and at this time cannot determine the full impact that the new standards may have on its financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of SFAS No. 115." This statement permits companies to choose to measure many financial assets and liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is evaluating the impact that the adoption of SFAS No. 159 will have on its financial statements.

In December 2007, FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of Accounting Research Bulletin No. 51, Consolidated Financial Statements." The objective of SFAS No. 160 is to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 shall be effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The adoption of SFAS No. 160 is not expected to have any impact on the Company's financial statements.

In December 2007, the FASB issued SFAS No. 141 (R), SFAS No. 141 (revised 2007), "Business Combinations," which replaces SFAS No. 141, "Business Combinations." SFAS No. 141 (R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling (minority) interests in an acquiree, and any goodwill acquired in a business combination or gain recognized from a bargain purchase. The impact to the Company of applying SFAS No. 141 (R) for periods subsequent to implementation will be dependent upon the nature of any transactions within the scope of SFAS No. 141 (R).

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities," which is an amendment of SFAS No. 133. SFAS No. 161 requires enhanced disclosures about an entity's derivative and hedging activities and thereby improves the transparency of financial reporting. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The adoption of SFAS No. 161 will not have an impact on the Company's financial statements.

Note B – Acquisitions

Following an extensive approval process, National Grid plc, the ultimate parent of the Company, completed the acquisition of KeySpan on August 24, 2007 for consideration of $7.5 billion together with the assumption of approximately $4.5 billion of debt.

The acquisition of KeySpan has significantly expanded National Grid plc's operations in the northeastern US as KeySpan was the fifth largest distributor of natural gas in the US and the largest in the northeast US, serving 2.6 million customers in New York, Massachusetts and New Hampshire. KeySpan also operated an electricity transmission and distribution network serving 1.1 million customers in New York under a long-term contract with the Long Island Power Authority.

On August 24, 2006, the Company acquired the Rhode Island gas distribution assets of NEG from Southern Union Company for approximately $570,000,000 which consists of $493,000,000 in cash and the assumption of $77,000,000 of debt. The Company received a contribution from it's parent company (NGUSA) in the amount of $493,000,000 to finance the acquisition. The amount of total consideration allocated to the regulated business was $570,000,000.

On the date of purchase, the Rhode Island gas business served approximately 245,000 customers through a distribution network of over 3,000 miles of mains. The network substantially overlaps the Company's existing electricity distribution service area in Rhode Island. The rates for the Rhode Island gas distribution business are set by the same state regulators that set the Company's electricity distribution rates in Rhode Island.

The acquisition was accounted for using the purchase method of accounting (SFAS No. 141 "Business Combinations"), with the purchase price paid by the Company allocated to the Company's net assets as of the acquisition date based on their fair values. The assets acquired and liabilities assumed have been recorded in the Company's balance sheet beginning August 24, 2006 at their fair values and the results of operations have been included in the Company's statement of operations since August 24, 2006. Therefore, balance sheet and statements of operations for the periods subsequent to the acquisition are not comparable to the same periods in prior years.

The following table summarizes the fair values of NEG's assets and liabilities assumed by The Narragansett Electric Company at the date of acquisition.

In thousands		At August 24, 2006
Net utility plant	$	357,667
Goodwill		235,058
Other property and investments		57
Cash and cash equivalents		16
Accounts receivable		71,875
Materials and supplies		36,099
Prepaid and other current assets		397
Regulatory assets		92,745
Deferred charges and other assets		423
Total assets acquired		794,337
Long-term debt		76,051
Long-term debt due in one year		544
Accounts payable		29,044
Other accrued expenses		39,438
Customer deposits		3,270
Accrued pension and other postretirement benefits		46,921
Other reserves and deferred credits		105,931
Total liabilities assumed		301,199
Net assets acquired	$	493,138

Note C – Rate and Regulatory

The Company's financial statements conform to GAAP, including the accounting principles for rate regulated entities with respect to its regulated operations. As electric utility rates have historically been based on a utility's costs, electric utilities are subject to certain accounting standards that are not generally applicable to other business enterprises. The Company applies the provisions of SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," which requires regulated entities, in appropriate circumstances, to establish regulatory assets or liabilities, and thereby defer the income statement impact of certain charges or revenues because they are expected to be collected or refunded through future customer billings. Rates for services rendered by the Company are subject to approval by RIPUC. The Company is earning a return on most of its regulatory assets under its rate agreement. If the Company could no longer apply SFAS No. 71, the resulting charge would be material to the Company's reported financial condition and results of operations.

Electric segment: In September 2004, the RIPUC approved a rate plan that reduced annual distribution rates effective November 1, 2004 by $10,200,000 and froze them at that level through 2009. From 2005 through 2009, the Company will keep 100 percent of its earnings up to an allowed return on equity of 10.5 percent, plus $4,650,000 (pre-tax), which represents its share of demonstrated savings under the rate plan. Earnings above that amount up to an 11.5 percent return on equity are to be shared equally between the Company and its customers, while earnings above an 11.5 percent return on equity will be allocated 75 percent to customers and 25 percent to the Company.

Gas segment: In May 2002, the RIPUC approved a settlement agreement between NEG and the Rhode Island Division of Public Utilities and Carriers (the Division). The settlement agreement resulted in a $3,900,000 decrease in base revenues for NEG, a unified rate structure ("One State, One Rate") and an integration /merger savings mechanism. The settlement agreement also allowed NEG to retain $2,000,000 of merger savings and to share incremental earnings with customers when the return on equity exceeds 11.25 percent. Included in the settlement agreement was a conversion to therm billing and the approval of a reconciling Distribution Adjustment Clause (DAC). The DAC allowed NEG to continue its low income assistance and weatherization programs and to recover environmental response cost over a ten year period, establishes a new weather normalization clause and allows for the sharing of non-firm margins (which is margin earned from interruptible customers with the ability to switch to alternative fuels). The weather normalization clause is designed to mitigate the impact of weather volatility on customer billings, which assists customers in paying bills and stabilizes the revenue stream. NEG defers the margin impact of weather that is greater than two percent colder-than-normal and will recover the margin impact of weather that is greater than two percent warmer-than-normal. The non-firm margin incentive mechanism allows NEG to retain 25 percent of all non-firm margins earned in excess of $1,600,000.

In August 2006, National Grid completed the acquisition of the Rhode Island gas assets of NEG. Pursuant to the Division order approving the acquisition, the Company and its parent agreed to honor the provisions of the former NEG Rate Settlement and committed to file a new rate plan with the RIPUC. On April 1, 2008 the Company submitted its new rate plan which included, among other things, a requested $20 million increase in distribution rates, including a return on equity of 11.50%, and proposals for revenue decoupling, an accelerated capital investment and recovery mechanism, low income distribution rates and sharing of merger related savings between customers and the Company. The submission also included an alternative three year rate plan which replaces the initial $20 million rate increase with annual increases of $13.8 million in each of the three years of the plan and includes other capital investment commitments by the Company. A decision on the April 1st submission is expected in the third quarter of calendar 2008.

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Notes to Financial Statements

The components of regulatory assets (liabilities), showing electric and gas separate and then combined, are as follows:

At March 31 (In thousands) - **ELECTRIC**	**2008**	2007
Regulatory assets included in accounts receivable:		
Rate adjustment mechanisms	**$ 32,695**	$ 1,970
Regulatory (liabilities) included in other accrued expenses:		
Rate adjustment mechanisms	**(52,204)**	(60,504)
Total net regulatory liabilities current	**(19,509)**	(58,534)
Regulatory assets:		
Unamortized losses on required debt	**7,564**	8,522
Regulatory tax asset	**12,375**	12,036
Environmental response fund	**84,802**	90,735
2003 VERO deferral	**14,439**	16,950
Other	**2,248**	2,479
Regulatory (liabilities):		
Revaluation - Pensions and PBOP	**(31,993)**	(34,036)
Environmental response costs	**(18,834)**	(20,488)
Deferred storm cost recoveries	**(19,369)**	(18,684)
Excess earnings	**-**	(4,235)
Cost of removal	**(42,778)**	(40,687)
Low income discount program	**(4,247)**	(5,052)
Other	**(1,851)**	(3,882)
Total net regulatory assets long term	**2,356**	3,658
Net regulatory liabilities	**$ (17,153)**	$ (54,876)

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Notes to Financial Statements

At March 31 (In thousands) - **GAS**	**2008**	2007
Regulatory assets included in accounts receivable:		
Rate adjustment mechanisms	**$ 1,033**	$ 1,964
Regulatory (liabilities) included in other accrued expenses:		
Rate adjustment mechanisms	**(21,869)**	(30,543)
Total net regulatory liabilities current	**(20,836)**	(28,579)
Regulatory assets:		
Regulatory tax asset	**24**	-
Environmental response fund	**34,115**	24,347
Post retirement benefits	**55,622**	61,478
Other	**5,177**	6,214
Regulatory (liabilities):		
Environmental response costs	**-**	(531)
Excess earnings	**(12)**	332
Cost of removal	**(86,398)**	(83,165)
Other	**(3,684)**	(1,419)
Total net regulatory assets long term	**4,844**	7,256
Net regulatory liabilities	**$ (15,992)**	$ (21,323)

The Narragansett Electric Company

Notes to Financial Statements

At March 31 (In thousands) - **COMBINED**	**2008**	2007
Regulatory assets included in accounts receivable:		
Rate adjustment mechanisms	**$ 33,728**	$ 3,934
Regulatory (liabilities) included in other accrued expenses:		
Rate adjustment mechanisms	**(74,073)**	(91,047)
Total net regulatory liabilities current	**(40,345)**	(87,113)
Regulatory assets:		
Unamortized losses on required debt	**7,564**	8,522
Regulatory tax asset	**12,399**	12,036
Environmental response fund	**118,917**	115,082
2003 VERO deferral	**14,439**	16,950
Post retirement benefits	**55,622**	61,478
Other	**7,425**	8,693
Regulatory (liabilities):		
Revaluation - Pensions and PBOP	**(31,993)**	(34,036)
Environmental response costs	**(18,834)**	(21,019)
Deferred Storm Costs	**(19,369)**	(18,684)
Excess earnings	**(12)**	(3,903)
Cost of removal	**(129,176)**	(123,852)
Low income discount program	**(4,247)**	(5,052)
Other	**(5,535)**	(5,301)
Total net regulatory assets long term	**7,200**	10,914
Net regulatory liabilities	**$ (33,145)**	$ (76,199)

Note D - Commitments and Contingencies

1. Plant Expenditures:
The Company's utility plant expenditures are estimated to be approximately $145,220,000 in fiscal year 2009. At March 31, 2008, substantial commitments had been made relative to future planned expenditures. Generally construction expenditures are consistent from year to year. However, the company has undertaken a Reliability Enhancement Program to improve performance and reliability. Capital expenditures are expected to increase as a result of the program.

2. Legal Matters:
The Company is in litigation with Constellation Energy Commodities Group in two cases. In the first case commenced on September 11, 2006 in the U.S. District Court for the District of Rhode Island, Constellation has alleged that certain power purchase agreements entitle it to additional compensation for capacity during calendar years 2006-2009, following the FERC-approved settlement in the forward capacity market. According to Constellation, the resolution of this claim "could adversely affect Constellation in amounts upwards of $150 million." In the second case commenced on April 14, 2008 in the U.S. District Court for the District of Massachusetts, Constellation has alleged that certain power purchase agreements entitle it to payments for a fuel adjustment factor during calendar years 2005-2009. The prospective portion of the fuel adjustment claim is subject to the effects of changing fuel prices. By Constellation's methodology for payment calculation, it is estimated that damages could exceed $200 million. The Company is exploring its options to resolve these matters. Regardless of the outcome, the Company is entitled to recover all purchased power costs from customers under current law and legal precedent, however any request to recover increased costs that may result from resolution of these matters would be subject to approval by the RIPUC.

3. Hazardous Waste:
The normal ongoing operations and historic activities of the Company are subject to various federal, state and local environmental laws and regulations. Like many other industrial companies, the Company's business uses or generates some hazardous and potentially hazardous wastes and by-products. Under federal and state Superfund laws, potential liability for the historic contamination of property may be imposed on responsible parties jointly and severally, without fault, even if the activities were lawful when they occurred.
The United States Environmental Protection Agency (EPA), the Massachusetts Department of Environmental Protection (DEP), and the Rhode Island Department of Environmental Management (DEM) have named the Company as a potentially responsible party for remediation of a number of sites at which hazardous waste is alleged to have been disposed. The Company's most significant liabilities relate to former manufactured gas plant (MGP) facilities formerly owned by the Blackstone Valley Gas and Electric Company and the Rhode Island assets of NEG. The Company is currently investigating and remediating, as necessary, the MGP sites and certain other properties under agreements with the EPA, DEM and DEP.

The RIPUC approved settlement agreements that provide for rate recovery of remediation costs of former MGP and other sites in Rhode Island. Under the agreement for the former Blackstone Valley Gas and Electric Company sites, qualified costs related to these sites are paid out of a special fund established on the Company's books. Rate-recoverable contributions of approximately $3,000,000 are added annually to the fund along with interest and any recoveries from insurance carriers and other third parties. Under the agreement for the former NEG sites, costs are amortized over a ten year period and subject to an annual cap linked to gas usage. The Company believes that obligations imposed on it because of the environmental laws will not have a material impact on its results of operations or financial condition.

Note E - Employee Benefits

Summary
The Company participates in a non-contributory defined benefit pension plan and PBOPs (the Plans) covering substantially all employees. The Plans cover the Company and certain other National Grid USA subsidiaries. The pension plan is a non-contributory, tax-qualified defined benefit plan which provides all employees with a minimum retirement benefit. Under the pension plan, a participant's retirement benefit is computed using formulas based on percentages of highest average compensation computed over five consecutive years. The compensation covered by the pension plan includes salary, bonus and incentive share awards. Non-union employees hired after July 15, 2002 participate under a non-contributory defined benefit cash balance design.

Supplemental nonqualified, non-contributory executive retirement programs provide additional defined pension benefits for certain executives.

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

Funding Policy

The Company's funding policy is to contribute amounts collected in rates to the pension plans until 100% to 110% of the PPA (Pension Protection Act of 2006) funding target is reached. In addition, the contribution for any one year will not be less than the minimum amount required under PPA. For PBOP plans, funding is made in accordance with the requirements of the various regulatory jurisdictions within which the Company operates.

Plan Assets

The target asset allocations for the Plans are:

	Pension		Non-Union-PBOP		Union-PBOP	
	2008	2007	**2008**	2007	**2008**	2007
U.S. equities	**37%**	37%	**35%**	35%	**53%**	53%
Global equities (including U.S.)	**5%**	5%	**-**	-	**-**	-
Global Tactical Asset Allocation	**13%**	13%	**-**	-	**-**	-
Non-U.S. equities	**10%**	10%	**15%**	15%	**27%**	27%
Fixed income	**31%**	31%	**50%**	50%	**20%**	20%
Private equity and other	**4%**	4%	**-**	-	**-**	-
	100%	100%	**100%**	100%	**100%**	100%

The percentage of the fair value of total plan assets at March 31 is:

	Pension		Non-Union-PBOP		Union-PBOP	
	2008	2007	**2008**	2007	**2008**	2007
U.S. equities	**35%**	38%	**33%**	37%	**50%**	53%
Global equities (including U.S.)	**5%**	6%	**-**	-	**-**	-
Global Tactical Asset Allocation	**14%**	12%	**-**	-	**-**	-
Non-U.S. equities	**10%**	11%	**15%**	15%	**29%**	28%
Fixed income	**32%**	30%	**52%**	48%	**21%**	19%
Private equity and other	**4%**	3%	**-**	-	**-**	-
	100%	100%	**100%**	100%	**100%**	100%

The Company manages the Plans' investments to minimize the long-term cost of operating the Plans, with a reasonable level of risk. Risk tolerance is determined as a result of a periodic asset/liability study which analyzes the Plans' liabilities and funded status and results in the determination of the allocation of assets across equity and fixed income. Equity investments are broadly diversified across U.S. and non-U.S. stocks, as well as across growth, value, and small and large capitalization stocks. Likewise, the fixed income portfolio is broadly diversified across the various fixed income market segments. Small investments are also held in private equity funds with the objective of enhancing long-term returns while improving portfolio diversification. Investment risk and return are reviewed by an investment committee on a quarterly basis.

The estimated rate of return for various passive asset classes is based both on analysis of historical rates of return and forward looking analysis of risk premiums and yields. Current market conditions, such as inflation and interest rates, are evaluated in connection with the setting of the long-term assumption. A small premium is added for active management and rebalancing of both equity and fixed income securities. The rates of return for each asset class are then weighted in accordance with the target asset allocation, and the resulting long-term return on asset rate is then applied to the market-related value of assets.

Assumptions Used for Benefits Accounting
The following weighted average assumptions were used to determine the benefit obligation and net periodic cost for the fiscal years ended March 31, 2008 and 2007.

	Pension Benefits			
	Benefit obligation		Net periodic benefit cost	
	2008	2007	**2008**	2007
Discount rate	**6.50%**	6.00%	**6.00%**	6.00%
Rate of compensation increase	**3.75%**	4.30%	**4.30%**	4.30%
Expected long-term rate of return	**8.00%**	8.00%	**8.00%**	8.00%
	PBOP			
	Benefit obligation		Net periodic benefit cost	
	2008	2007	**2008**	2007
Discount rate	**6.50%**	6.00%	**6.00%**	6.00%
Expected long-term rate of return *				
Union	**8.25%**	8.25%	**8.25%**	8.25%
Nonunion	**6.75%**	7.00%	**7.00%**	7.00%
Health care cost trend rate				
Initial rate – Pre 65	**9.00%**	9.50%	**9.50%**	10.00%
Initial rate – Post 65	**10.00%**	10.50%	**10.50%**	11.00%
Ultimate rate	**5.00%**	5.00%	**5.00%**	5.00%
Year ultimate rate is reached - Pre 65	**2014**	2012	**2012**	2011
Year ultimate rate is reached - Post 65	**2015**	2013	**2013**	2012

Contributions to the National Grid companies' pension and PBOP plans during fiscal year 2009 are expected to be $58,770,000 and $37,000,000, respectively. The Company participates in the plans with certain other National Grid USA subsidiaries. A portion of these contributions will be allocated to the Company.

Adoption of SFAS No. 158
The Company adopted SFAS No. 158 on March 31, 2007. This standard amends SFAS Nos. 87, 88, 106 and 132(R). SFAS No. 158 requires an employer with a defined benefit pension plan or other postretirement plan to recognize an asset or liability on its balance sheet for the over funded or under funded status of the plan as defined by SFAS No. 158. The pension asset or liability is the difference between the fair value of the pension plan's assets and the projected benefit obligation as of the year end. For PBOPs, the asset or liability is the difference between the fair value of the plan's assets and the accumulated postretirement benefit obligation as of year end. The offset of this asset or liability is a charge to AOCI or regulatory assets. The following table illustrates the effect on individual financial statement line items of applying SFAS No. 158 to the NGUSA companies' pension and PBOP plans in which the Company participates with certain other NGUSA subsidiaries.

(In thousands)	**Before application of SFAS No. 158**	**Adjustment**	**After application of SFAS No. 158**
Regulatory asset	$ 693	$ 61,672	$ 62,365
Deferred tax asset/(liability)	(59,745)	256,715	196,970
Current liability	-	(8,567)	(8,567)
Non-current prepaid/(accrued) liability	175,100	(696,304)	(521,204)
Accumulated other comprehensive income/(loss), net of tax	11,361	386,484	397,845
Accumulated other comprehensive income/(loss), pre tax	17,516	642,352	659,868

The Company recorded increases in it pension and PBOP liabilities of $67,431,000 and $63,716,000, respectively, with an offsetting charge to accumulated other comprehensive loss.

Pension Benefits:
The Company's net pension cost for the fiscal years ended March 31, 2008 and 2007 included the following components:

(In thousands)	**2008**	2007
Service cost	**$ 7,519**	$ 5,422
Interest cost	**21,723**	18,318
Expected return on plan assets	**(27,731)**	(22,903)
Amortization of prior service cost	**305**	287
Amortization of net loss	**3,893**	4,280
Net periodic benefit cost prior to special termination benefits (VERO)	**$ 5,709**	$ 5,404
Special termination benefits (VERO)*	**6,576**	-
Net periodic benefit cost	**$ 12,285**	$ 5,404

* Special termination benefits consist of costs related to Voluntary Early Retirement Offers.

The assets, benefit obligations and funded status of the pension plans cannot be presented separately for the Company as the Company participates in the plans with certain other NGUSA subsidiaries. The following table sets forth the total funded status at December 31 of the pension plans in which the Company participates:

(In thousands)	2008	2007
Change in benefit obligation:		
Benefit obligation at beginning of period	**$ (1,655,793)**	$ (1,407,105)
Service cost	**(29,677)**	(25,380)
Interest cost	**(96,555)**	(89,364)
Actuarial gain/(loss)	**87,470**	(65,207)
Benefits paid	**118,775**	97,169
Curtailments	**(659)**	-
Plan amendments	**(1,643)**	-
Special termination benefits (VERO)	**(27,920)**	-
Assumption of Rhode Island gas pension obligation*	**-**	(165,906)
Benefit obligation at end of period	**(1,606,002)**	(1,655,793)
Change in plan assets:		
Fair value of plan assets at beginning of period	**1,530,981**	1,244,035
Actual return on plan assets	**(12,931)**	139,218
Company contributions	**60,053**	91,294
Benefits paid	**(118,775)**	(97,169)
Assumption of Rhode Island gas pension assets*	**-**	153,603
Fair value of plan assets at end of period	**1,459,328**	1,530,981
Funded status at end of period	**(146,674)**	(124,812)

* On August 24, 2006, the Company, acquired the Rhode Island gas distribution assets of NEG from Southern Union Company. In connection with this acquisition, four small pension plans merged with the existing pension plan, resulting in an increase in the assets and benefit obligation of the plan in the amounts of $153,603,000 and $165,906,000, respectively.

The accumulated benefit obligation for all defined benefit pension plans in which the Company participates was $1,429,527,000 and $1,475,296,000 at March 31, 2008 and 2007, respectively.

Notes to Financial Statements

The following table details the amounts recognized in the Company's statements of financial position.

(In thousands)		**2008**		2007
Other accrued expenses – current	$	**(119)**	$	(119)
Prepaid pension / Accrued pension and other postretirement benefits		**(2,654)**		(2,371)
	$	**(2,773)**	$	(2,490)

(In thousands)		**2008**		2007
Net actuarial loss	$	**70,714**	$	65,478
Prior service cost		**2,208**		2,232
Amounts recognized in accumulated other comprehensive income/(loss)	$	**72,922**	$	67,710

The estimated net actuarial loss and prior service cost for the defined benefit pension plans that will be amortized from accumulated other comprehensive income/(loss) and regulatory assets into net periodic benefit cost during fiscal year 2009 are $17,146,000 and $1,613,000, respectively. The Company participates in the plans with certain other NGUSA subsidiaries. A portion of these costs will be recorded to expense with an offset to other comprehensive income/loss.

The following pension benefit payments, which reflect expected future services, as appropriate, are expected to be paid from the NGUSA companies' pension plans:

(In thousands)	**Pension Benefits**	
2009	$	108,770
2010	$	108,643
2011	$	99,561
2012	$	102,394
2013	$	103,152
2014-2018	$	513,199

Defined Contribution Plan
The Company has a defined contribution pension plan (employee savings fund plan) that covers substantially all employees. Employer matching contributions of approximately $2,694,000 and $1,883,000 were expensed for the fiscal years ended March 31, 2008 and 2007, respectively.

Notes to Financial Statements

Postretirement Benefits Other than Pension Benefits (PBOPs):
The Company's total net periodic benefit cost of PBOPs for the fiscal years ended March 31, 2008 and 2007 included the following components:

(In thousands)	**2008**	2007
Service cost	$ **2,657**	$ 2,090
Interest cost	**11,250**	10,283
Expected return on plan assets	**(7,578)**	(6,380)
Amortization of prior service cost	**(192)**	(194)
Amortization of net loss	**2,873**	3,228
Net periodic benefit cost prior to special termination benefits (VERO)	$ **9,010**	$ 9,027
Special termination benefits (VERO)*	**267**	-
Net periodic benefit cost	$ **9,277**	$ 9,027

* Special termination benefits consist of costs related to Voluntary Early Retirement Offers.

The following table sets forth the Company's portion of the funded status of the PBOP plans at March 31.

(In thousands)	**2008**	2007
Change in benefit obligation:		
Benefit obligation at beginning of period	$ **(207,030)**	$ (155,820)
Service cost	**(2,657)**	(2,090)
Interest cost	**(11,250)**	(10,283)
Actuarial gain/(loss)	**13,779**	(254)
Benefits paid	**12,111**	9,513
Acquisition of Rhode Island gas distribution obligation *	**-**	(47,640)
Plan amendments	**(31)**	-
Special termination benefits (VERO)	**(267)**	-
Medicare act subsidy	**(71)**	(456)
Benefit obligation at end of period	$ **(195,416)**	$ (207,030)
Change in plan assets:		
Fair value of plan assets at beginning of period	**94,023**	70,098
Actual return on plan assets	**(2,146)**	9,168
Company contributions	**14,362**	10,877
Acquisition of Rhode Island gas distribution assets *	**-**	13,021
Benefits paid	**(11,934)**	(9,141)
Fair value of plan assets at end of period	**94,305**	94,023
Funded status	$ **(101,111)**	$ (113,007)

* On August 24, 2006, The Narragansett Electric Company acquired the Rhode Island gas distribution assets of NEG from Southern Union Company. In connection with this acquisition, the Company's assets and benefit obligation of the PBOP plan increased by $13,021,000 and $47,640,000, respectively.

Amounts recognized in the Company's statements of financial position consist of:

(In thousands)	2008	2007
Accrued pension and other postretirement benefits	$ (101,111)	$ (113,007)
Accumulated other comprehensive loss	57,010	63,716

Amounts recognized in accumulated other comprehensive loss consist of:

(In thousands)	2008	2007
Net actuarial loss	$ 58,731	$ 65,660
Prior service cost	(1,721)	(1,944)
Net amount recognized	$ 57,010	$ 63,716

The estimated net actuarial loss and prior service cost for the PBOP plans that will be amortized from accumulated other comprehensive loss into net periodic benefit cost during the 2009 fiscal year are $2,555,000 and ($192,000), respectively.

As a result of the Medicare Act of 2003, the Company receives a federal subsidy for sponsoring a retiree healthcare plan that provides a benefit that is actuarially equivalent to Medicare Part D.

The following PBOP benefit payments and the U.S. Federal Government subsidies, which reflect future services, as appropriate, are expected to be:

(In thousands)	Payments	Subsidies
2009	$ 11,049	$ 765
2010	$ 11,532	$ 849
2011	$ 12,023	$ 922
2012	$ 12,420	$ 995
2013	$ 12,673	$ 1,052
2014-2018	$ 68,516	$ 6,146

The assumptions used in the health care cost trends have a significant effect on the amounts reported. A one percentage point change in the assumed rates would increase the accumulated postretirement benefit obligation (APBO) as of March 31, 2008 by $28,459,000 or decrease the APBO by $24,837,000, and increase or decrease the net PBOP cost for 2008 by $2,345,000 or $1,988,000, respectively.

Special Termination Benefits(Voluntary Early Retirement Offer)
In connection with the acquisition of KeySpan and in an effort to achieve necessary reductions through voluntary means, National Grid plc and KeySpan offered certain non-union employees voluntary early retirement offer (VERO) packages in June 2007. Of the 560 enrolled in the VERO, 36 were the Company's employees. Employees enrolled in the early retirement program will retire between October 1, 2007 and October 1, 2010. The Company's share of the cost of the VERO program is expected to be $10,239,000 which includes VERO costs allocated from affiliates. The Company recorded $3,400,000 of expense for the fiscal year 2008 for program participants who retired as of April 1, 2008. The remaining $6,839,000 will be recorded through October 1, 2010 as the program participants retire.

The Narragansett Electric Company

Notes to Financial Statements

Note F - Income Taxes

The Company and other related subsidiaries of National Grid USA participate with National Grid Holdings, Inc. (NGHI), a wholly owned subsidiary of National Grid plc, in filing consolidated United States federal income tax returns. The Company's tax provisions and tax accounts are calculated on a separate company basis. In accordance with the National Grid USA intercompany tax allocation agreement and the provisions of the support agreement, the increase or reduction in the consolidated current tax liability resulting from the inclusion of the Company in the consolidated federal income tax return is paid by or to the Company. The Company has joint and several liability for any potential assessments against the consolidated group.

Total income taxes in the statements of income are as follows:

Fiscal Year Ended March 31, (In thousands)	**2008**	2007
Income taxes charged to operations	**$ 12,519**	$ 24,804
Income taxes charged (credited) to "Other income"	**(225)**	428
Total income taxes	**$ 12,294**	$ 25,232

Total income taxes, as shown above, consist of the following components:

Fiscal Year Ended March 31, (In thousands)	**2008**	2007
Current income taxes	**$ 2,063**	$ 42,479
Deferred income taxes	**10,834**	(16,619)
Investment tax credits, net	**(603)**	(628)
Total income taxes	**$ 12,294**	$ 25,232

Investment tax credits have been deferred and are being amortized over the estimated lives of the property giving rise to the credits.

Fiscal Year Ended March 31, (In thousands)	**2008**	2007
Federal income taxes	**$ 12,250**	$ 25,232
State income taxes	**44**	-
Total income taxes	**$ 12,294**	$ 25,232

Consistent with rate-making policies of the RIPUC, the Company has adopted comprehensive interperiod tax allocation (normalization) for most temporary book/tax differences.

Total income taxes differ from the amounts computed by applying the federal statutory tax rates to income before taxes. The reasons for the differences are as follows:

Fiscal Year Ended March 31, (In thousands)	**2008**	2007
Computed tax at statutory rate	**$ 18,864**	$ 26,618
Increases/(reductions) in tax resulting from:		
Prior period true-ups	**(3,703)**	592
Medicare act	**(788)**	(556)
Amortization of investment tax credits	**(603)**	(629)
All other differences	**(1,476)**	(793)
Total income taxes	**$ 12,294**	$ 25,232

The Company recognizes deferred income taxes for temporary differences that are reported in different years for financial reporting and tax purposes using the liability method. Under the liability method, deferred tax liabilities or assets are computed using the tax rates that will be in effect when temporary differences reverse. Generally, for regulated companies, the change in tax rates may not be immediately recognized in operating results because of rate-making treatment and provisions in the Tax Reform Act of 1986.

The following table identifies the major components of total deferred income taxes:

At March 31, (In thousands)	2008	2007
Deferred tax asset:		
Plant related	$ 10,570	$ 9,421
Investment tax credits	899	1,110
All other	100,120	90,515
	111,589	101,046
Deferred tax liability:		
Plant related	(140,658)	(132,729)
All other	(43,347)	(23,869)
	(184,005)	(156,598)
Net deferred tax liability	$ (72,416)	$ (55,552)
Less current portion (net deferred tax asset)	31,530	39,404
Net deferred tax liability (non-current)	$ (103,946)	$ (94,956)

There were no valuation allowances for deferred tax assets deemed necessary at March 31, 2008 and 2007, respectively.

In July 2006, the FASB issued FIN 48 which prescribes guidance to address inconsistencies among entities with the measurement and recognition in accounting for income tax positions for financial statement purposes. Specifically, FIN 48 establishes criteria for the timing of the recognition of income tax benefits. FIN 48 requires the financial statement recognition of an income tax benefit when a company determines that it is more-likely-than-not that the tax position will be ultimately sustained.

The total amount of gross unrecognized tax benefits at March 31, 2007 was $0. Upon adoption of FIN 48 on April 1, 2007, the Company did not record any adjusting entries for unrecognized tax benefits. In addition, the Company has not accrued for interest. However, upon adoption of FIN 48 there was no material effect on our operations, financial position or cash flows.

Effective as of April 1, 2007, the Company recognizes interest accrued related to uncertain tax positions in interest income or interest expense and related penalties if applicable in operating expenses. In prior reporting periods, the Company recognized such accrued interest and penalties in income tax expense. No penalties were recognized during the twelve months ended March 31, 2008.

Federal income tax returns have been examined and all appeals and issues have been agreed upon by the Internal Revenue Service (IRS) and the NGHI consolidated filing group through March 31, 2002. The IRS has completed its audit for the NGHI consolidated filing group for the fiscal years ending March 31, 2003 and March 31, 2004. Certain adjustments proposed by the IRS are being appealed to the IRS Office of Appeals, but resolution is not expected within the next twelve months. The IRS is currently reviewing the March 31, 2005, 2006, 2007 tax returns of the NGHI consolidated filing group.

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Notes to Financial Statements

Note G - Short-Term Borrowings and Other Accrued Expenses

At March 31, 2008 and 2007, the Company had approximately $89,625,000 and $113,025,000, respectively, of short-term debt outstanding to affiliates. The Company has regulatory approval from the Federal Energy Regulatory Commission (FERC) to issue up to $145,000,000 of short-term debt. NGUSA and certain subsidiaries, including the Company, with regulatory approval, operate a money pool to more effectively utilize cash resources and to reduce outside short-term borrowings. Short-term borrowing needs are met first by available funds of the money pool participants. Borrowing companies pay interest at a rate designed to approximate the cost of outside short-term borrowings. Companies that invest in the pool share the interest earned on a basis proportionate to their average monthly investment in the money pool. Funds may be withdrawn from or repaid to the pool at any time without prior notice.

As of March 31, 2008, the Company had no lines of credit with banks.

Note H - Cumulative Preferred Stock

A summary of cumulative preferred stock at March 31, 2008 and 2007 is as follows (in thousands of dollars except for share data):

	Shares Outstanding		Amount		Dividends Declared		Call Price
	2008	2007	**2008**	2007	**2008**	2007	
$50 par value-							
4.50% Series	**49,089**	49,089	**$2,454**	$ 2,454	**$111**	$111	$55.000
4.64% Series	-	57,057	-	2,853	**87**	132	52.125 (a)
Total	**49,089**	106,146	**$ 2,454**	$ 5,307	**$ 198**	$ 243	

(a) – The stock was called on December 31, 2007 at a price of $52.125

There are no mandatory redemption provisions on the Company's cumulative preferred stock.

The Narragansett Electric Company

Notes to Financial Statements

Note I – Long-Term Debt

A summary of long-term debt is as follows:

At March 31 (In thousands)

Series	Rate %	Maturity	2008	2007
First Mortgage Bonds:				
U(93-3)	6.650	June 30, 2008	**$ 5,000**	$ 5,000
FMB Series M	10.250	July 31, 2008	**271**	544
FMB Series S	6.820	April 1, 2018	**14,464**	14,464
FMB Series N	9.630	May 30, 2020	**10,000**	10,000
FMB Series O	8.460	September 30, 2022	**12,500**	12,500
FMB Series P	8.090	September 30, 2022	**9,375**	10,000
FMB Series R	7.500	December 15, 2025	**13,500**	14,250
W(97-1)	7.390	September 30, 2027	**-**	3,000
W(97-2)	7.390	October 1, 2027	**-**	7,000
Unamortized discounts			**(187)**	(212)
Total long-term debt			**$ 64,923**	$ 76,546
Long-term debt due within one year			**6,646**	11,648
Total long-term debt, excluding current portion			**$ 58,277**	$ 64,898

Substantially all of the properties and franchises of the Company are subject to the lien of mortgage indentures under which the first mortgage bonds have been issued.

The aggregate maturities of long-term debt for the five years subsequent to March 31, 2008 and thereafter are, approximately:

(In thousands)

Fiscal Year	Amount
2009	$6,646
2010	1,375
2011	1,375
2012	1,375
2013	1,375
Thereafter	52,964
Total	$65,110

At March 31, 2008 and 2007, the Company's long-term debt had a carrying value of approximately $65,110,000 and $76,758,000 and had a fair value of approximately $78,458,000 and $90,925,000, respectively. The fair market value of the Company's long-term debt was estimated based on the quoted prices for similar issues or on the current rates offered to the Company for debt of the same remaining maturity.

In connection with the acquisition of the Rhode Island gas assets of Southern Union Gas and assumption of $77,000,000 of first mortgage bonds, the Company has deposited $17,000,000 with its first mortgage trustee to provide for the redemption of the Company's first mortgage bonds. The principal amount is $15,000,000 and the additional $2,000,000 would satisfy all interest and premium due on the bonds through maturity or first call date. This assumed debt may not exceed 60 percent of total capitalization of the Company or the rates on the debt will increase by 0.20 percent, and the debt may not exceed 70 percent of total capitalization or the bondholders may declare bonds due and payable. Narragansett will continue to comply with all requirements under the first mortgage indenture until all bonds have been redeemed or mature.

Note J - Restrictions on Retained Earnings Available for Dividends on Common Stock

As long as any preferred stock is outstanding, certain restrictions on payment of dividends on common stock would come into effect if the "junior stock equity" was, or by reason of payment of such dividends became, less than 25 percent of "Total capitalization." However, the junior stock equity at March 31, 2008 was 96 percent of total capitalization, and accordingly, none of the Company's retained earnings at March 31, 2008 were restricted as to dividends on common stock under the foregoing provisions.

Note K - Supplementary Income Statement Information

Advertising expenses, expenditures for research and development, and rents were not material and there were no royalties paid in the fiscal years ended March 31, 2008 or 2007. Taxes, other than income taxes, charged to operating expenses are set forth by class as follows:

Year ended March 31, (In thousands)	**2008**	2007
Municipal property taxes	**$ 28,060**	$ 23,461
Federal and state payroll and other taxes	**56,024**	50,938
Total taxes, other than income taxes	**$ 84,084**	$ 74,399

The Narragansett Electric Company

Notes to Financial Statements

Note L - Accumulated Other Comprehensive Income (Loss)

In thousands	Unrealized Gain (Loss) on Available-for-Sale Securities	Postretirement Benefit Liabilities	Cash Flow Hedging	Total Accumulated Other Comprehensive Income (Loss)
March 31, 2006 balance, net of tax	$ 349	$ (996)	$ -	$ (647)
Change in additional minimum pension liability	-	510	-	510
Adjustment to initially apply SFAS No. 158	-	(80,163)	-	(80,163)
Adjusted Balance - AOCI	349	(80,649)	-	(80,300)
Other comprehensive income/(loss):				
Unrealized gains on securities	140	-	-	140
Reclassification adjustment for gain included in net income	(85)	-	-	(85)
March 31, 2007 balance, net of tax	$ 404	$ (80,649)	$ -	$ (80,245)
Other comprehensive income/(loss):				
Unrealized gains on securities	(32)	-	-	(32)
Reclassification adjustment for gain included in net income	(71)	-	283	212
Hedging Activity	-	-	14,256	14,256
Amortization of postretirement costs	-	1,281	-	1,281
Tax on Medicare subsidy	-	555	-	555
March 31, 2008 balance, net of tax	$ 301	$ (78,813)	$ 14,539	$ (63,973)

Note M - Cost of Removal and Asset Retirement Obligation

SFAS No. 143, "Accounting for Asset Retirement Obligations" provides the accounting requirements for retirement obligations associated with tangible long-lived assets. The Company does not have any material asset retirement obligations arising from legal obligations as defined under SFAS No. 143. However, under the Company's current and prior rate plans, it has collected through rates an implied cost of removal for its plant assets. This cost of removal collected from customers differs from the SFAS No. 143 definition of an asset retirement obligation in that these collections are for costs to remove an asset when it is no longer deemed usable (i.e. broken or obsolete) and not necessarily from a legal obligation. These collections have been recorded to a regulatory liability account to reflect future use. The Company estimates it has collected over time approximately $129,176,000 and $123,852,000 for cost of removal through March 31, 2008 and 2007, respectively.

In March 2005 FIN 47, an interpretation of SFAS No. 143, which was adopted by the Company for the fiscal year ended March 31, 2006. FIN 47 clarifies that the term "conditional asset retirement obligation" used in SFAS No. 143 refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the Company. The Company continues to monitor such contingencies, which we do not believe would have a material impact on the Company's results of operations or its financial position for the periods ended March 31, 2008 and 2007.

The Narragansett Electric Company

Notes to Financial Statements

Note N – Derivatives and Hedging Activities

In the normal course of business, the Company is party to derivative financial instruments (derivatives) that are principally used to manage commodity prices associated with its natural gas operations. These financial exposures are monitored and managed as an integral part of the Company's overall Financial Risk Management Policy. At the core of the policy is a condition that the Company will engage in activities at risk only to the extent that those activities fall within commodities and financial markets to which it has a physical market exposure in terms and volumes consistent with its core business. The Company does not issue or intend to hold derivative instruments for speculative trading purposes. Derivatives are accounted for in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which requires derivatives to be reported at fair value as assets or liabilities on the balance sheet. The change in fair value of instruments that qualify for hedge accounting are deferred in AOCI and will be reclassified through purchased gas expense within the next twenty four months. The Company's rate agreements allow for the pass-through of the commodity costs of electricity and natural gas, including the costs of the gas hedging program.

The following table represents the open positions and the results on operations of these instruments for the fiscal years ended March 31, 2007 and 2008.

	Balances as of March 31, 2007				
Derivative Instrument	Asset	Regulatory Deferral	Accumulated OCI, net of tax	Accumulated Deferred Income Tax on OCI	Loss Reclass to Commodity Costs
Qualified for Hedge Accounting					
NYMEX futures - gas supply	-	-	-	-	-

	Balances as of March 31, 2008				
Derivative Instrument	Asset	Regulatory Deferral	Accumulated OCI, net of tax	Accumulated Deferred Income Tax on OCI	Loss Reclass to Commodity Costs
Qualified for Hedge Accounting					
NYMEX futures - gas supply	$ 21,190,470	-	$ 14,538,930	$ (7,828,000)	$ (435,535)