nationalgrid

# KeySpan Corporation and Subsidiaries

Consolidated Financial Statements

For the years ended March 31, 2015 and 2014

**KEYSPAN CORPORATION AND SUBSIDIARIES**

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## Independent Auditor's Report

To the Board of Directors of
KeySpan Corporation

We have audited the accompanying consolidated financial statements of KeySpan Corporation (the "Company"), which comprise the consolidated balance sheets as of March 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, cash flows, capitalization, and changes in shareholders' equity for the years then ended.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of the 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.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on the 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 financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider 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 KeySpan Corporation at March 31, 2015 and 2014, 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.

PricewaterhouseCoopers LLP

August 26, 2015

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**KEYSPAN CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF INCOME**
*(in millions of dollars)*

| | Years Ended March 31, | |
|---|---|---|
| | **2015** | 2014 |
| **Operating revenues:** | | |
| Gas distribution | **$ 4,200** | $ 4,275 |
| Electric services | **464** | 479 |
| Other | **29** | 24 |
| Total operating revenues | **4,693** | 4,778 |
| **Operating expenses:** | | |
| Purchased gas | **1,729** | 1,834 |
| Operations and maintenance | **1,468** | 1,512 |
| Depreciation and amortization | **371** | 345 |
| Other taxes | **599** | 587 |
| Total operating expenses | **4,167** | 4,278 |
| **Operating income** | **526** | 500 |
| **Other income and (deductions):** | | |
| Interest on long-term debt | **(177)** | (184) |
| Other interest, including affiliate interest | **(33)** | (31) |
| Income from equity investments | **41** | 35 |
| Other income, net | **28** | 65 |
| Total other deductions, net | **(141)** | (115) |
| **Income before income taxes** | **385** | 385 |
| **Income tax expense** | **152** | 154 |
| **Income from continuing operations** | **233** | 231 |
| Income from discontinued operations, net of taxes | **-** | 141 |
| **Net income** | **$ 233** | $ 372 |

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

**KEYSPAN CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
*(in millions of dollars)*

| | Years Ended March 31, | |
|---|---|---|
| | **2015** | 2014 |
| **Net income** | **$ 233** | $ 372 |
| **Other comprehensive income:** | | |
| Unrealized gains on securities | - | 1 |
| Change in pension and other postretirement obligations | - | 199 |
| Total other comprehensive income | - | 200 |
| **Comprehensive income** | **$ 233** | $ 572 |
| **Related tax expense:** | | |
| Unrealized gains on securities | **$ -** | $ (1) |
| Change in pension and other postretirement obligations | **-** | (135) |
| **Total tax expense** | **$ -** | $ (136) |

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

## KEYSPAN CORPORATION AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF CASH FLOWS
*(in millions of dollars)*

| | Years Ended March 31, | |
|---|---|---|
| | **2015** | 2014 |
| **Operating activities:** | | |
| Net income | **$ 233** | $ 372 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | **371** | 345 |
| Regulatory amortizations | **103** | 94 |
| Provision for deferred income taxes | **72** | 32 |
| Bad debt expense | **66** | 40 |
| Income from equity investments, net of dividends received | **(1)** | (10) |
| Allowance for equity funds used during construction | **-** | (3) |
| Net postretirement benefits expense | **264** | 197 |
| Net environmental remediation payments | **(61)** | (73) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable and other receivable, net, and unbilled revenues | **203** | (225) |
| Inventory | **(28)** | 59 |
| Regulatory assets and liabilities, net | **105** | (109) |
| Derivative contracts | **12** | 8 |
| Prepaid and accrued taxes | **(36)** | (84) |
| Accounts payable and other liabilities | **(75)** | 128 |
| Other, net | **21** | - |
| Net cash provided by operating activities | **1,249** | 771 |
| **Investing activities:** | | |
| Capital expenditures | **(982)** | (771) |
| Affiliated regulated money pool investing and receivables/payables, net | **(3)** | 173 |
| Affiliated unregulated money pool investing and receivables/payables, net | **(467)** | (16) |
| Advances to affiliate | **(72)** | 277 |
| Cost of removal | **(53)** | (69) |
| Insurance proceeds applied to capital expenditures | **2** | 17 |
| Other | **(12)** | (35) |
| Net cash used in investing activities | **(1,587)** | (424) |
| **Financing activities:** | | |
| Payments on long-term debt | **(2)** | (160) |
| Affiliated regulated money pool borrowing and receivables/payables, net | **(85)** | 508 |
| Affiliated unregulated money pool borrowing and receivables/payables, net | **28** | (754) |
| Parent loss tax allocation | **84** | 89 |
| Net cash provided by (used in) financing activities | **25** | (317) |
| Net (decrease) increase in cash and cash equivalents | **(313)** | 30 |
| Net cashflow from discontinued operations - operating | **112** | (372) |
| Net cashflow from discontinued operations - investing | **-** | 28 |
| Net cashflow from discontinued operations - financing | **31** | (88) |
| Cash and cash equivalents, beginning of year | **191** | 593 |
| Cash and cash equivalents, end of year | **$ 21** | $ 191 |
| **Supplemental disclosures:** | | |
| Interest paid | $ (190) | $ (219) |
| Income taxes paid | (28) | (73) |
| **Significant non-cash items:** | | |
| Capital-related accruals included in accounts payable | 105 | 70 |
| Long Island Power Authority settlement | - | 371 |

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

**KEYSPAN CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**
*(in millions of dollars)*

| | March 31, | |
|---|---|---|
| | **2015** | 2014 |
| **ASSETS** | | |
| **Current assets:** | | |
| Cash and cash equivalents | **$ 21** | $ 191 |
| Accounts receivable | **1,075** | 1,212 |
| Allowance for doubtful accounts | **(108)** | (85) |
| Other receivable | **-** | 58 |
| Accounts receivable from affiliates | **1,075** | 708 |
| Intercompany money pool | **1,612** | 1,442 |
| Advances to affiliate | **2,071** | 1,999 |
| Unbilled revenues | **278** | 329 |
| Inventory | **239** | 195 |
| Regulatory assets | **147** | 219 |
| Derivative contracts | **20** | 21 |
| Current portion of deferred income tax assets, net | **57** | 20 |
| Other | **120** | 136 |
| Current assets related to discontinued operations | **241** | 374 |
| Total current assets | **6,848** | 6,819 |
| **Equity investments** | **186** | 183 |
| **Property, plant and equipment, net** | **9,809** | 9,037 |
| **Other non-current assets:** | | |
| Regulatory assets | **2,168** | 2,065 |
| Goodwill | **3,766** | 3,766 |
| Derivative contracts | **22** | 18 |
| Loan to affiliate | **80** | 80 |
| Financial investments | **184** | 171 |
| Other | **78** | 91 |
| Other non-current assets related to discontinued operations | **-** | 29 |
| Total other non-current assets | **6,298** | 6,220 |
| **Total assets** | **$ 23,141** | $ 22,259 |

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

**KEYSPAN CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**
*(in millions of dollars)*

| | March 31, | |
|---|---|---|
| | **2015** | 2014 |
| **LIABILITIES AND CAPITALIZATION** | | |
| **Current liabilities:** | | |
| Accounts payable | **$ 464** | $ 488 |
| Accounts payable to affiliates | **147** | 157 |
| Current portion of long-term debt | **10** | 2 |
| Taxes accrued | **59** | 12 |
| Interest accrued | **61** | 64 |
| Regulatory liabilities | **306** | 225 |
| Intercompany money pool | **2,441** | 2,421 |
| Derivative contracts | **35** | 25 |
| Other | **138** | 162 |
| Current liabilities related to discontinued operations | **670** | 689 |
| Total current liabilities | **4,331** | 4,245 |
| **Other non-current liabilities:** | | |
| Regulatory liabilities | **1,337** | 1,271 |
| Asset retirement obligations | **63** | 67 |
| Deferred income tax liabilities, net | **1,918** | 1,881 |
| Postretirement benefits | **1,985** | 1,617 |
| Environmental remediation costs | **673** | 676 |
| Derivative contracts | **10** | 5 |
| Other | **281** | 258 |
| Total other non-current liabilities | **6,267** | 5,775 |
| **Commitments and contingencies (Note 13)** | | |
| **Capitalization:** | | |
| Shareholders' equity | **9,250** | 8,933 |
| Long-term debt | **3,293** | 3,306 |
| **Total capitalization** | **12,543** | 12,239 |
| **Total liabilities and capitalization** | **$ 23,141** | $ 22,259 |

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

**KEYSPAN CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CAPITALIZATION**
*(in millions of dollars)*

| | | | March 31, | |
|---|---|---|---|---|
| | | | **2015** | 2014 |
| **Total shareholders' equity** | | | **$ 9,250** | $ 8,933 |
| **Long-term debt:** | Interest Rate | Maturity Date | | |
| Medium and long-term notes | 3.30% - 9.75% | October 2015 - March 2042 | **2,388** | 2,390 |
| Gas facilities revenue bonds | Variable | December 2020 - July 2026 | **230** | 230 |
| Gas facilities revenue bonds | 4.70% - 6.95% | April 2020 - July 2026 | **411** | 411 |
| Total | | | **641** | 641 |
| Industrial development bonds | 5.25% | June 2027 | **128** | 128 |
| First mortgage bonds | 6.90% - 8.80% | July 2022 - April 2028 | **75** | 75 |
| State Authority financing notes | Variable | December 2027 - October 2028 | **66** | 66 |
| Unamortized debt premium | | | **5** | 8 |
| Total debt | | | **3,303** | 3,308 |
| Current portion of long-term debt | | | **(10)** | (2) |
| Long-term debt | | | **3,293** | 3,306 |
| **Total capitalization** | | | **$ 12,543** | $ 12,239 |

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

**KEYSPAN CORPORATION AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**
*(in millions of dollars)*

| | | Accumulated Other Comprehensive Income (Loss) | | | | |
|---|---|---|---|---|---|---|
| | Additional Paid-in Capital | Unrealized Gain on Available-For-Sale Securities | Pension and Other Postretirement Benefits | Total Accumulated Other Comprehensive Income (Loss) | Retained Earnings | Total |
| **Balance as of March 31, 2013** | $ 7,211 | $ 32 | $ (592) | $ (560) | $ 1,621 | $ 8,272 |
| Net income | - | - | | - | 372 | 372 |
| Other comprehensive income: | | | | | | |
| Unrealized gains on securities, net of $1 tax expense | - | 1 | - | 1 | - | 1 |
| Change in pension and other postretirement obligations, net of $135 tax expense | - | - | 199 | 199 | - | 199 |
| Total comprehensive income | | | | | | 572 |
| Parent loss tax allocation | 89 | - | - | - | - | 89 |
| **Balance as of March 31, 2014** | 7,300 | 33 | (393) | (360) | 1,993 | 8,933 |
| Net income | - | - | | - | 233 | 233 |
| Parent loss tax allocation | 84 | - | - | - | - | 84 |
| **Balance as of March 31, 2015** | **$ 7,384** | **$ 33** | **$ (393)** | **$ (360)** | **$ 2,226** | **$ 9,250** |

The Company had 100 shares of common stock authorized, issued and outstanding, with a par value of $0.10 per share and 2 shares of cumulative preferred stock authorized, issued and outstanding, with a par value of $1 per share at March 31, 2015 and 2014.

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

## KEYSPAN CORPORATION AND SUBSIDIARIES
## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

KeySpan Corporation ("KeySpan" or "the Company") is a public utility holding company operating in New York City, Long Island, and Massachusetts. KeySpan is a wholly-owned subsidiary of National Grid USA ("NGUSA"), 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.

KeySpan has two major lines of business, "Gas Distribution" and "Electric Services," and operates various energy services and investment companies.

*Gas Distribution*

The Company's Gas Distribution business consists of four gas distribution subsidiaries. The Brooklyn Union Gas Company ("Brooklyn Union") provides gas distribution services to customers in the New York City boroughs of Brooklyn, Queens, and Staten Island. KeySpan Gas East Corporation ("KeySpan Gas East") provides gas distribution services to customers in the Long Island Counties of Nassau and Suffolk, and the Rockaway Peninsula of Queens County, New York. Boston Gas Company ("Boston Gas") and Colonial Gas Company ("Colonial Gas"), provide gas distribution services to customers in Massachusetts.

*Electric Services*

The Company's Electric Services business consists of certain subsidiaries which have provided operational and energy management services and continue to supply capacity to and produce energy for the use of customers of the Long Island Power Authority ("LIPA"), on Long Island, New York. The services provided to LIPA were, or continue to be, provided through the following contractual arrangements. The Power Supply Agreement ("PSA"), which was amended and restated for a maximum term of 15 years in October 2012, provides LIPA with electric generating capacity, energy conversion and ancillary services from the Company's Long Island generating units. The Energy Management Agreement ("EMA"), which expired on May 28, 2013, provided management of all aspects of fuel supply for the Company's Long Island generating facilities. The Management Service Agreement ("MSA"), which expired on December 31, 2013, provided operation, maintenance and construction services, and significant administrative services relating to the Long Island electric transmission and distribution system. The results of the MSA are reflected as discontinued operations in the accompanying consolidated financial statements for the years ended March 31, 2015 and 2014.

*Other Services*

The Company's Energy Services business includes companies that provide energy-related services to customers located primarily within the northeastern United States. These services comprise the operation, maintenance, and design of energy systems for commercial and industrial customers.

The Company's Energy Investments business consists of gas production and development investments such as natural gas pipelines, as well as certain other domestic energy-related investments. Through the Company's wholly-owned subsidiary, National Grid LNG, it owns a 600,000 barrel liquefied natural gas ("LNG") storage and receiving facility in Providence, Rhode Island.

The Company's consolidated financial statements also include a 26.25% interest in Millennium Pipeline Company LLC ("Millennium") and a 20.4% interest in Iroquois Gas Transmission System, which are accounted for under the equity method of accounting.

On August 14, 2015, the Company entered into an agreement to exchange its 20.4% interest in Iroquois Gas Transmission System to Dominion Midstream Partners, LP ("DM") in exchange for approximately 6.8 million common units (representing approximately a 15% interest) in DM. DM owns, operates, develops and acquires natural gas import, storage, regasification, transportation and related assets, including a preferred equity interest in the Cove Point LNG facility in Lusby, Maryland and ownership of Carolina Gas Transmission ("CGT") in Cayce, South Carolina. Cove Point provides LNG import, storage and transportation services to the Mid-Atlantic marketplace and CGT is an interstate natural gas transportation company delivering natural gas to wholesale and direct industrial customers throughout South Carolina. This exchange transaction is expected to close by September 30, 2015.

Through its indirect wholly-owned subsidiary, National Grid Generation Ventures LLC, the Company owns a 50% interest in Island Park Energy Center LLC, formed to construct, install, hold, own, protect, finance, manage, operate and maintain projects consisting of the repowering of the E.F. Barrett Steam Unit and Barrett CT Units all located in Nassau County, New York.

Additionally, National Grid Generation Ventures LLC owns a 50% interest in three LLCs (LI Solar Generation LLC, LI Energy Storage System LLC, and LI Peaker Generation LLC). These LLCs were formed to jointly respond to LIPA's Request for Proposals ("RFP's") for Generation, Energy Storage and Demand Response Resources, and to jointly develop, construct, install, hold, own, protect, finance, manage, operate and maintain the respective RFP projects (none were awarded) or future proposals for similar projects.

Grid NY LLC, a direct wholly-owned subsidiary of Keyspan Corporation, was formed pursuant to the articles of organization filed on October 10, 2014 to own a 28.261% equity interest in New York Transco LLC ("NY Transco LLC"), a New York limited liability company, which was formed pursuant to the articles of organization filed on November 14, 2014 for the purpose of planning, construction, owning, operating, maintaining and expanding transmission facilities in the state of New York.

The Company uses the equity method of accounting for its investments in affiliates when it has the ability to exercise significant influence over the operating and financial policies, but does not control the affiliates. The Company's share of the earnings or losses of such affiliates is included as income from equity investments in the accompanying consolidated statements of income.

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"), including the accounting principles for rate-regulated entities as applicable. The consolidated financial statements reflect the ratemaking practices of the applicable regulatory authorities.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Non-controlling interests of majority-owned subsidiaries are calculated based upon the respective non-controlling interest ownership percentages. All intercompany transactions have been eliminated in consolidation.

Under its holding company structure, the Company has no independent operations or source of income of its own and conducts all of its operations through its subsidiaries. As a result, the Company depends on the earnings and cash flow of, and dividends or distributions from, its subsidiaries to provide the funds necessary to meet its debt and contractual obligations. Furthermore, a substantial portion of the Company's consolidated assets, earnings and cash flow is derived from the operations of its regulated utility subsidiaries, whose legal authority to pay dividends or make other distributions to the Company is subject to regulation by state regulatory authorities.

The Company has evaluated subsequent events and transactions through August 26, 2015, 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 March 31, 2015.

## 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.

### Regulatory Accounting

The New York Public Service Commission ("NYPSC") and the Massachusetts Department of Public Utilities ("DPU") regulate the rates the Company's regulated subsidiaries charge their customers in the applicable states. In these cases, the subsidiaries defer costs (as regulatory assets) or recognize obligations (as regulatory liabilities) if it is probable that such amounts will be recovered from, or refunded to, customers through future rates. Regulatory assets and liabilities are amortized to the consolidated statements of income consistent with the treatment of the related costs in the ratemaking process. Iroquois' transmission assets are regulated by the Federal Energy Regulatory Commission ("FERC") and its rates are filed with the FERC.

### Revenue Recognition

Gas *Distribution*

Revenues are recognized for gas distribution services provided on a monthly billing cycle basis. The Company's gas regulated subsidiaries records unbilled revenues for the estimated amount of services rendered from the time meters were last read to the end of the accounting period.

With respect to base distribution rates, the state regulators have approved revenue decoupling mechanisms ("RDM"), which require the Company's gas regulated subsidiaries to adjust their base rates periodically to reflect the over or under recovery of targeted base distribution revenues.

The Company's gas regulated subsidiaries' tariff includes a cost of gas adjustment factor which requires a periodic reconciliation of recoverable gas costs, revenues, and other operating expenses. Any difference is deferred pending recovery from, or refund to, customers.

*Electric Services*

Electric revenues are recognized for sales of capacity and energy to LIPA under terms of the PSA, with rates approved by the FERC. Please see Note 13, "Commitments and Contingencies" for additional information on the 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 Revenues*

Revenues earned for service and maintenance contracts associated with commercial energy systems are recognized as earned or over the life of the service contract, as appropriate.

### Other Taxes

The Company's subsidiaries collect taxes and fees from customers such as sales taxes, other taxes, surcharges, and fees that are levied by state or local governments on the sale or distribution of gas. The Company accounts for taxes that are imposed on customers (such as sales taxes) on a net basis (excluded from revenues), while taxes imposed on the Company, such as excise taxes, are recognized on a gross basis. Excise taxes collected and paid for the years ended March 31, 2015 and 2014 were $60.5 million and $58.3 million, respectively.

The state of New York imposes on corporations a franchise tax that is computed as the higher of a tax based on income or a tax based on capital. To the extent the Company's New York state tax based on capital is in excess of the state tax based on income, the Company reports such excess in other taxes and taxes accrued in the accompanying consolidated financial statements.

**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 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 company determines its current and deferred taxes based on the separate return method. The Company settles its current tax liability or benefit each year with NGNA pursuant to a tax sharing arrangement between NGNA and its subsidiaries. Tax benefits attributable to the tax attributes of other group companies and allocated by NGNA are treated as capital contributions.

**Cash and Cash Equivalents**

Cash equivalents consist of short-term, highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at cost which approximates fair value.

**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 based on a variety of factors including, for each type of receivable, applying an estimated reserve percentage to each aging category, taking into account historical collection and write-off experience and management's assessment of collectability from individual customers as appropriate. 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 accounts are disconnected and/or terminated and the balances are deemed to be uncollectible.

**Inventory**

Inventory is comprised of materials and supplies, emission credits, and gas in storage. Materials and supplies are stated at the lower of weighted average cost or market and are expensed or capitalized as used. The Company's policy is to write-off obsolete inventory; there were no material write-offs of obsolete inventory for the years ended March 31, 2015 or 2014. Emission credits are comprised of sulfur dioxide, nitrogen oxide ("NOx"), and carbon dioxide credits. Emission credits are held primarily for consumption or may be sold to third-party purchasers.

Gas in storage is stated at weighted average cost and the related cost is recognized when delivered to customers. Existing rate orders allow the Company to pass directly through to customers the cost of gas purchased, along with any applicable authorized delivery surcharge adjustments. Gas costs passed through to customers are subject to regulatory approvals and are reported periodically to the applicable state regulators.

The Company had materials and supplies of $71 million, emission credits of $44 million and $28 million, and gas in storage of $124 million and $96 million, at March 31, 2015 and 2014, respectively.

**Derivative Contracts**

All of the Company's derivative financial instruments are held by its regulated subsidiaries. The Company uses derivative contracts to manage commodity price risk. All derivative contracts are recorded in the accompanying consolidated balance sheets at their fair value. All commodity costs, including the impact of derivative contracts, are passed on to customers through the Company's gas cost adjustment mechanisms. Therefore, gains or losses on the settlement of these contracts are initially deferred and then refunded to, or collected from, customers consistent with regulatory requirements.

The Company's accounting policy is to not offset fair value amounts recognized for derivative contracts and related cash collateral receivable or payable with the same counterparty under a master netting agreement, and to record and present the fair value of the derivative contract on a gross basis, with related cash collateral recorded within restricted cash and special deposits in the accompanying consolidated balance sheets. There was no related cash collateral as of March 31, 2015 or 2014.

**Fair Value Measurements**

The Company measures derivatives and available-for-sale securities at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following is the fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities that a company has the ability to access as of the reporting date;
- Level 2: inputs other than quoted prices included within Level 1 that are directly observable for the asset or liability or indirectly observable through corroboration with observable market data; and
- Level 3: unobservable inputs, such as internally-developed forward curves and pricing models for the asset or liability due to little or no market activity for the asset or liability with low correlation to observable market inputs.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The Company uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs.

**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 an allowance for funds used during construction ("AFUDC") for the regulated subsidiaries and capitalized interest for non-regulated projects.

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 and are approved by the state authorities. The average composite rates and average service lives for the years ended March 31, 2015 and 2014 are as follows:

| | Electric | | Gas | |
|---|---|---|---|---|
| | Years Ended March 31, | | Years Ended March 31, | |
| | **2015** | 2014 | **2015** | 2014 |
| Composite rates | **3.4%** | 3.3% | **3.0%** | 3.0% |
| Average service lives | **39 years** | 39 years | **45 years** | 45 years |

Depreciation expense, for regulated subsidiaries, includes a component for estimated future cost of removal, which is recovered through rates charged to customers. Any difference in cumulative costs recovered and costs incurred is recognized as a regulatory liability. When property, plant and equipment is retired, the original cost, less salvage, is charged to accumulated depreciation, and the related cost of removal is removed from the associated regulatory liability. The Company had cumulative costs recovered in excess of costs incurred of $869 million and $817 million at March 31, 2015 and 2014, respectively.

*Allowance for Funds Used During Construction*

In accordance with applicable accounting guidance, the regulated subsidiaries record AFUDC, which represents the debt and equity costs of financing the construction of new property, plant and equipment. AFUDC equity is reported in the consolidated statements of income as non-cash income in other income, net, and AFUDC debt is reported as a non-cash offset to other interest, including affiliate interest. After construction is completed, the Company is permitted to recover these costs through their inclusion in rate base and corresponding depreciation expense. The Company recorded AFUDC related to equity of zero and $3 million and AFUDC related to debt of $0.3 and $2.4 million for the years ended March 31, 2015 and 2014. The average AFUDC rates for the years ended March 31, 2015 and 2014 were zero and 2.3%, respectively.

**Goodwill**

The Company tests goodwill for impairment annually on January 1, and when events occur or circumstances change that would more likely than not reduce the fair value of each of the Company's respective reporting units below its carrying amount. Goodwill is tested for impairment using a two-step approach. The first step compares the estimated fair value of each reporting unit with its carrying value, including goodwill. If the estimated fair value exceeds the carrying value, then goodwill is considered not impaired. If the carrying value exceeds the estimated fair value, then a second step is performed to determine the implied fair value of goodwill. If the carrying value of goodwill exceeds its implied fair value, then an impairment charge equal to the difference is recorded.

The fair value of each reporting unit was calculated in the annual goodwill impairment test for the year ended March 31, 2015 utilizing both income and market approaches.

- To estimate fair value utilizing the income approach, the Company used a discounted cash flow methodology incorporating its most recent business plan forecasts together with a projected terminal year calculation. Key assumptions used in the income approach were: (a) expected cash flows for the period from April 1, 2015 to March 31, 2020; (b) a discount rate of 5.2%, which was based on the Company's best estimate of its after-tax weighted-average cost of capital; and (c) a terminal growth rate of 2.25%, based on the Company's expected long-term average growth rate in line with estimated long-term U.S. economic inflation.

- To estimate fair value utilizing the market approach, the Company followed a market comparable methodology. Specifically, the Company applied a valuation multiple of earnings before interest, taxes, depreciation and amortization ("EBITDA"), derived from data of publicly-traded benchmark companies, to business operating data.

Benchmark companies were selected based on comparability of the underlying business and economics. Key assumptions used in the market approach included the selection of appropriate benchmark companies and the selection of an EBITDA multiple of 11, which the Company believes is appropriate based on comparison of its business with the benchmark companies.

The Company determined the fair value of the business using 50% weighting for each valuation methodology, as it believes that each methodology provides equally valuable information. Based on the resulting fair value from the annual analyses, the Company determined that no adjustment of the goodwill carrying value was required at March 31, 2015 or 2014.

Prior to 2015, the Company utilized an annual impairment assessment date of January 31. Management has determined that the use of January 1 as its annual impairment assessment date is preferable to January 31 because it facilitates a more timely evaluation in advance of the Company's fiscal year end of March 31. The movement of the date has not resulted in a substantive change in the timing of recording any potential impairment.

**Available-For-Sale Securities**

The Company holds available-for-sale securities that include equities, municipal bonds and corporate bonds. These investments are recorded at fair value and are included in other non-current assets in the accompanying consolidated balance sheets. Changes in the fair value of these assets are recorded within other comprehensive income.

**Asset Retirement Obligations**

Asset retirement obligations are recognized for legal obligations associated with the retirement of property, plant and equipment, primarily associated with the Company's gas distribution and electric generation facilities. 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 a legal obligation to dismantle the Glenwood and Far Rockaway facilities and remediate the associated sites. These facilities were shut down and decommissioning began in July 2012; demolition and remediation activities at Glenwood were completed in July 2015 and will be completed at Far Rockaway in August 2015.

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

| | Years Ended March 31, | |
|---|---|---|
| | **2015** | 2014 |
| | *(in millions of dollars)* | |
| Balance as of the beginning of the year | **$ 67** | $ 88 |
| Accretion expense | **4** | 4 |
| Liabilities settled | **(11)** | (25) |
| Revaluations to present values of estimated cash flows | **3** | - |
| Balance as of the end of the year | **$ 63** | $ 67 |

At March 31, 2015, the Company carried out a revaluation study that resulted in a net upward revaluation in estimated cost related to the asset retirement obligations. These increases were due to changes in remediation cost and enhanced asset replacement programs.

Accretion expense for the Company's regulated subsidiaries is deferred as part of the Company's asset retirement obligation regulatory asset as management believes it is probable that such amounts will be collected in future rates.

**Employee Benefits**

The Company has defined benefit pension and postretirement benefit other than pension ("PBOP") plans for its employees. The Company recognizes all pension and PBOP plans' funded status in the accompanying consolidated balance sheets as a net liability or asset with an offsetting adjustment to accumulated other comprehensive income ("AOCI") in shareholders' equity. In the case of regulated entities, the cost of providing these plans is recovered through rates; therefore, the net funded status is offset by a regulatory asset or liability. The Company measures and records its pension and PBOP funded status at the year-end date. Pension and PBOP plan assets are measured at fair value, using the year-end market value of those assets.

**Supplemental Executive Retirement Plans**

The Company has corporate assets included in financial investments in the accompanying consolidated balance sheets representing funds designated for Supplemental Executive Retirement Plans. These funds are invested in corporate owned life insurance policies and available-for-sale securities primarily consisting of equity investments and investments in municipal and corporate bonds. The corporate owned life insurance investments are measured at cash surrender value with increases and decreases in the value of these assets recorded in the accompanying consolidated statements of income.

**New and Recent Accounting Guidance**

**Accounting Guidance Adopted in Fiscal Year 2015**

*Reclassifications From Accumulated Other Comprehensive Income*

In February 2013, the FASB issued ASU 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income," to improve the reporting of reclassifications out of AOCI. The amendments require an entity to provide information either on the face of the consolidated financial statements or in a single footnote on significant amounts reclassified out of AOCI and the related income statement line items to the extent an amount is reclassified in its entirety to net income. For significant items not reclassified to net income in their entirety, an entity is required to cross-reference to other disclosures that provide additional information. For non-public entities, the amendments are effective prospectively for reporting periods beginning after December 15, 2013. Early adoption is permitted. The Company adopted this guidance effective April 1, 2014 with no impact on its financial position, results of operations or cash flows.

**Accounting Guidance Not Yet Adopted**

*Presentation of Financial Statements - Going Concern, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*

In August 2014, the FASB issued amendments on reporting about an entity's ability to continue as a going concern in ASU No. 2014-15, "Presentation of Financial Statements – Going Concern (Subtopic 205 - 40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern." The amendments provide guidance about management's responsibility to evaluate whether there is substantial doubt surrounding an entity's ability to continue as a going concern. If management concludes that substantial doubt exists, the amendments also require additional disclosures relating to management's evaluation and conclusion. The amendments are effective for the annual reporting period ending after December 15, 2016 and interim periods thereafter. The application of this guidance is not expected to have a material impact on the Company's financial position, results of operations and cash flows.

*Revenue Recognition*

In May 2014, the FASB and the International Accounting Standards Board jointly issued a new revenue recognition standard ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." The objective of the new guidance is to provide a single comprehensive revenue recognition model for all contracts with customers to improve comparability. The standard

contains principles that an entity will apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services in an amount that reflects the consideration the entity expects to receive. The new guidance must be adopted using either a full retrospective approach or a modified retrospective approach. For non-public entities, the new guidance is effective for periods beginning after December 15, 2018, with early adoption permitted for periods beginning after December 15, 2017. The Company is currently evaluating the impact of the new guidance on its financial position, results of operations and cash flows.

**Financial Statement Revision**

During 2015, management determined that certain accounting transactions were not properly recorded in the Company's previously issued consolidated financial statements. The Company corrected the accounting by revising the prior period consolidated financial statements, the key impacts of which are described below. The Company concluded that the revisions were not material to any prior periods.

- During its review of the Company's accounting for its RDM, management determined it had incorrectly applied its methodology related to the unbilled component of revenue. A cumulative adjustment of $14.6 million (net of income taxes) was recorded in the consolidated financial statements for the year ended March 31, 2014, of which $21.1 million was recorded as a decrease to opening retained earnings (as of March 31, 2013) and $6.5 million was recorded as an increase to net income within operating revenues for the year ended March 31, 2014.

- During 2015, management determined it had not recognized a regulatory liability in relation to Brooklyn Union's Net Utility Plant Tracker. A cumulative adjustment of $9.4 million (net of income taxes) was recorded in the consolidated financial statements for the year ended March 31, 2014, of which $1.3 million was recorded as a decrease to opening retained earnings (as of March 31, 2013) and $8.1 million was recorded as a decrease to net income within operating revenues for the year ended March 31, 2014.

- During 2015, management determined it had not recognized a regulatory liability for carrying charges related to under-funded pension and PBOP balances for Brooklyn Union and KeySpan Gas East ("The New York Gas Companies"). A cumulative adjustment of $6.6 million (net of income taxes) was recorded in the consolidated financial statements for the year ended March 31, 2014, of which $4.1 million was recorded as a decrease to opening retained earnings (as of March 31, 2013) and $2.5 million was recorded as a decrease to net income within other interest, including affiliate interest for the year ended March 31, 2014.

- During management's review of National Grid Generation's ("Genco") billings to LIPA, management determined there were certain accounting errors related to the timing of recognition of rate resets and true-ups, in accordance with the terms of the PSA. A cumulative adjustment of $6.4 million (net of income taxes) was recorded in the consolidated financial statements for the year ended March 31, 2014, of which $0.3 million was recorded as an increase to opening retained earnings (as of March 31, 2013) and $6.7 million was recorded as a decrease to net income within operating revenues for the year ended March 31, 2014.

- During 2015, management determined it had not adjusted the value of a liability associated with a historical lease agreement of the Company, prior to the Company's acquisition by NGUSA. A cumulative adjustment of $5.3 million (net of income taxes) was recorded as a decrease to opening retained earnings as of March 31, 2013.

In addition, the Company has corrected various account balances in continuing and discontinued operations that were improperly recorded. A cumulative adjustment of $9.7 million (net of income taxes) was recorded in the consolidated financial statements for the year ended March 31, 2014, of which $9.5 million was recorded as a decrease to opening retained earnings (as of March 31, 2013) and $0.2 million was recorded as a decrease to net income for the year ended March 31, 2014.

The following tables shows the amounts previously reported as revised:

| | As Previously Reported | | Adjustments | | As Revised | |
|---|---|---|---|---|---|---|
| | | | *(in millions of dollars)* | | | |
| **Consolidated Statement of Income** | **March 2014** | | | | **March 2014** | |
| Operating revenues | $ | 4,795 | $ | (17) | $ | 4,778 |
| Operating income | | 512 | | (12) | | 500 |
| Total other deductions, net | | (110) | | (5) | | (115) |
| Income before income taxes | | 402 | | (17) | | 385 |
| Income tax expense | | 158 | | (4) | | 154 |
| Net income from discontinued operations, net of taxes | | 139 | | 2 | | 141 |
| Net income | | 383 | | (11) | | 372 |
| | | | | | | |
| **Consolidated Statement of Cash Flows** | **March 2014** | | | | **March 2014** | |
| Net cash provided by operating activities | $ | 765 | $ | 6 | $ | 771 |
| Net cash used in investing activities | | (421) | | (3) | | (424) |
| Net cash provided by financing activities | | (314) | | (3) | | (317) |

| | As Previously Reported[1] | | Adjustments | | As Revised | |
|---|---|---|---|---|---|---|
| | | | *(in millions of dollars)* | | | |
| **Consolidated Balance Sheet** | **March 2014** | | | | **March 2014** | |
| Total current assets | $ | 6,822 | $ | (3) | $ | 6,819 |
| Property, plant and equipment, net | | 9,046 | | (9) | | 9,037 |
| Total other non-current assets | | 6,391 | | 12 | | 6,403 |
| Total current liabilities | | 4,209 | | 36 | | 4,245 |
| Total other non-current liabilities | | 5,759 | | 16 | | 5,775 |
| | | | | | | |
| Retained Earnings | | | | | | |
| March 31, 2014 | | 2,045 | | (52) | | 1,993 |
| March 31, 2013 | | 1,662 | | (41) | | 1,621 |
| | | | | | | |
| Shareholders' Equity | | | | | | |
| March 31, 2014 | | 8,985 | | (52) | | 8,933 |
| March 31, 2013 | | 8,313 | | (41) | | 8,272 |

(1) During 2015, the Company changed its accounting policy for classification of regulatory accounts. The change in policy resulted in reclassification of balances reported at March 31, 2014.

## 3. REGULATORY ASSETS AND LIABILITIES

The Company records regulatory assets and liabilities that result from the ratemaking process. The following table presents the regulatory assets and regulatory liabilities recorded in the accompanying consolidated balance sheets.

| | March 31, | |
|---|---|---|
| | **2015** | 2014 |
| | *(in millions of dollars)* | |
| **Regulatory assets** | | |
| Current: | | |
| Derivative contracts | **$ 25** | $ 10 |
| Gas costs adjustment | **112** | 199 |
| Other | **10** | 10 |
| Total | **147** | 219 |
| Non-current: | | |
| Asset retirement obligation | **23** | 42 |
| Capital tracker | **10** | 16 |
| Environmental response costs | **1,067** | 1,067 |
| Postretirement benefits | **618** | 518 |
| Property taxes | **62** | 54 |
| Rate mitigation | **37** | 36 |
| Recovery of acquisition premium | **200** | 208 |
| Temperature control and interruptible sharing | **82** | 44 |
| Other | **69** | 80 |
| Total | **2,168** | 2,065 |
| **Regulatory liabilities** | | |
| Current: | | |
| Derivative contracts | **22** | 19 |
| Energy efficiency | **48** | 43 |
| Gas costs adjustment | **69** | 48 |
| Profit sharing | **46** | 38 |
| Revenue decoupling mechanism | **87** | 65 |
| Temporary state assessment | **18** | - |
| Other | **16** | 12 |
| Total | **306** | 225 |
| Non-current: | | |
| Capital tracker | **28** | 37 |
| Carrying charges | **84** | 70 |
| Cost of removal | **869** | 817 |
| Delivery rate adjustment | **128** | 128 |
| Excess earnings | **95** | 95 |
| Temporary state assessment | **-** | 51 |
| Other | **133** | 73 |
| Total | **1,337** | 1,271 |
| Net regulatory assets | **$ 672** | $ 788 |

**Asset retirement obligation:** Represents accretion expense deferred as part of the Company's asset retirement obligation and is recovered through rates as part of depreciation expense.

**Capital tracker:** The Company's regulated subsidiaries have capital tracker mechanisms that reconcile their capital expenditures to the amounts permitted in rates.

**Cost of removal:** Represents cumulative amounts collected, but not yet spent, to dispose of property, plant and equipment. This liability is discharged as removal costs are incurred.

**Delivery rate adjustment:** The NYPSC authorized a combined annual surcharge for recovery of regulatory assets ("Delivery Rate Surcharge") of $15 million in January 2008 and 2009, respectively, for the New York Gas Companies. The annual surcharge increased incrementally by $5 million for the first five years of the Brooklyn Union's rate plan and increased by $10 million in rate year 2010 through 2012 of KeySpan Gas East's rate plan, aggregating to a total of $175 million over the term of the rate agreement. In its order issued and effective November 28, 2012, the NYPSC authorized a Site Investigation and Remediation ("SIR") Surcharge in the amount of $65 million which superseded the Delivery Rate Surcharge effective January 1, 2013. These SIR recoveries will be used to amortize existing SIR deferral balances. On June 5, 2015, Brooklyn Union submitted a petition to the NYPSC to increase its existing SIR Surcharge by $37.5 million annually, effective September 1, 2015 (or sooner) and remaining in effect until new base rates are set. The proposed increase in the SIR Surcharge will allow Brooklyn Union to recover some of its environmental response costs and minimize future bill impacts for customers.

**Derivative contracts:** The Company's gas regulated subsidiaries evaluate open derivative contracts for regulatory deferral by determining if they are probable of recovery from, or refund to, customers through future rates. Derivative contracts that qualify for regulatory deferral are recorded at fair value, with changes in fair value recorded as regulatory assets or regulatory liabilities in the period in which the change occurs.

**Energy efficiency**: Represents the difference between revenue billed to customers through the Company's gas regulated subsidiaries energy efficiency charge and the costs of its energy efficiency programs as approved by the state authorities.

**Environmental response costs:** Represents deferred costs associated with the estimated costs to investigate and perform certain remediation activities at former manufactured gas plant ("MGP") sites and related facilities. The Company believes future costs, beyond the expiration of current rate plans, will continue to be recovered through rates.

**Excess earnings:** At the end of each rate year (calendar year), the New York Gas Companies are required to provide the NYPSC with a computation of its return on common equity capital ("ROE"). During the primary term of the rate plan (2008-2012), if the ROE in the applicable rate year exceeds 10.5%, the New York Gas Companies were required to defer a portion of the revenue equivalent associated with any over earnings for the benefit of customers. Beginning January 1, 2013, Brooklyn Union's threshold for earnings sharing has been reduced from 10.5% to 9.4% and the sharing mechanism is calculated based upon a cumulative average ROE over rate years 2013 and 2014 with 80% of any excess earnings applied as a credit against the SIR deferral balance.

**Gas costs adjustment**: The Company's gas regulated subsidiaries are subject to rate adjustment mechanisms for commodity costs, whereby an asset or liability is recognized resulting from differences between actual revenues and the underlying cost being recovered or differences between actual revenues and targeted amounts, as approved by state regulators. These amounts will be refunded to, or recovered from, customers over the next year.

**Postretirement benefits:** Primarily represents the excess costs of the Company's pension and PBOP plans over amounts received in rates that are deferred to a regulatory asset to be recovered in future periods, and the non-cash accrual of net actuarial gains and losses. Also included within this amount are certain pension deferral amounts from prior to the acquisition of KeySpan by NGUSA, which are being recovered in rates over a ten year period ending August 2017.

**Profit sharing:** Represents a portion of deferred margins from off-system sale transactions. Under current rate orders, Boston Gas and Colonial Gas (the "Massachusetts Gas Companies") are required to return 90% of margins earned from such optimization transactions to firm customers. The amounts deferred in the accompanying balance sheet will be refunded to customers over the next year.

**Property taxes**: Represents 90% of actual property and special franchise tax expenses above or below the rate allowance for future collection from, or payment to, the New York Gas Companies' customers.

**Rate mitigation:** The existing rate agreements provide for the establishment of a regulatory liability to be amortized through revenues for the deferral of amortization adjustments.

**Recovery of acquisition premium:** Represents the unrecovered amount (plus related taxes) by which the purchase price paid exceeded the net book value of Colonial Gas' assets in the 1998 acquisition of Colonial Gas by Eastern Enterprises, Inc. In exchange for certain rate concessions and the achievement of certain merger savings targets, the DPU has allowed Colonial Gas to recover the acquisition premium through rates for the next 25 years (through August 2039).

**Revenue decoupling mechanism**: As approved by the NYPSC, the RDM applies only to the New York Gas Companies' firm residential heating sales and transportation customers. The RDM allows for annual adjustment to the New York Gas Companies' delivery rates as a result of the reconciliation between allowed revenue per customer and actual revenue per customer. For the Massachusetts Gas Companies, the DPU approved a RDM which allows for seasonal (peak/off peak) adjustments to the Massachusetts Gas Companies' delivery rates as a result of the reconciliation between allowed revenue per customer and actual revenue per customer. Any difference between the allowed revenue per customer and the actual revenue per customer is recorded as a regulatory asset or regulatory liability.

**Temperature control and interruptible ("TC/IT") sharing:** Under the existing rate agreement, the revenue requirement reflects certain levels of imputed TC/IT margins. Differences between the actual margins and imputed margins are shared 90% by ratepayers and 10% by shareholders. This regulatory asset represents the ratepayer share of the differences.

**Temporary state assessment:** In June 2009, the NYPSC authorized utilities, including the New York Gas Companies, to recover the costs required for payment of the Temporary State Energy & Utility Service Conservation Assessment ("Temporary State Assessment"), including carrying charges. The Temporary State Assessment is subject to reconciliation over a five year period beginning July 1, 2009. On June 18, 2014, the NYPSC issued an order authorizing certain utilities, including the New York Gas Companies, to recover the Temporary State Assessment subject to reconciliation, including carrying charges, from July 1, 2014 through June 30, 2017. As of March 31, 2015, the New York Gas Companies over-collected on these costs. The New York Gas Companies are required to net any deferred over-collected amounts against the amount to be collected during fiscal years 2014 and 2015 as well as the first payment relating to fiscal years 2015 and 2016.

The Company records carrying charges on all regulatory balances (with the exception of derivative contracts, cost of removal, environmental response costs, and regulatory deferred tax balances), for which cash expenditures have been made and are subject to recovery, or for which cash has been collected and is subject to refund. Carrying charges are not recorded on items for which expenditures have not yet been made.

## 4. RATE MATTERS

### The New York Gas Companies

*General Rate Case*

KeySpan Gas East has been subject to a rate plan with a primary term of five years (2008-2012), which remains in effect until modified by the NYPSC. Under this rate plan, base delivery rates include an allowed ROE of 9.8% with a 45% equity ratio in the capital structure.

On June 13, 2013, the NYPSC approved a rate plan extension covering Brooklyn Union's 2013 and 2014 rate years. Brooklyn Union's revenue requirements for both years have been modified as follows: (i) there is no change in base delivery rates, other than those previously approved by the NYPSC in the rate plan extension, (ii) the allowed ROE decreased from 9.8% to 9.4%, and (iii) the common equity ratio in the capital structure increased from 45% to 48%.

*Capital Investment*

On June 13, 2014, KeySpan Gas East filed a petition with the NYPSC to implement a three year capital investment program that would allow KeySpan Gas East to invest more than $700 million in gas infrastructure projects designed to enhance the safety and reliability of its gas systems and promote gas growth, while maintaining base delivery rates.

On December 15, 2014, KeySpan Gas East received an order which authorizes it to replace leak prone pipe up to its forecasted budget of $211.7 million for calendars years 2015 and 2016. KeySpan Gas East is allowed to establish a 21-month surcharge mechanism beginning April 2, 2015 through December 31, 2016, which will be capped at $10 million and $13.4 million, respectively, to address KeySpan Gas East's capital needs for replacement of leak prone pipe, while minimizing future customer bill impacts. KeySpan Gas East was authorized to spend up to its forecasted budget of $202.7 million for calendar years 2015 and 2016 for its Neighborhood Expansion and other related programs. KeySpan Gas East is directed to establish a new deferral mechanism that allows it to defer the pre-tax revenue requirements associated with its capital spending program up to a maximum capital expenditure of $202.7 million made in calendar years 2015 and 2016. KeySpan Gas East's existing city/state deferral mechanism was eliminated as of January 1, 2015 and the non-growth deferral mechanism is continued. The order also included additional obligations and filing requirements.

*Management Audit*

In February 2011, the NYPSC selected Overland Consulting Inc., ("Overland") to perform a management audit of NGUSA's affiliate cost allocations, policies and procedures. The New York Gas Companies disputed certain of Overland's final audit conclusions and the NYPSC ordered that further proceedings be conducted to address what, if any, ratemaking adjustments were necessary. On September 5, 2014, the NYPSC approved a settlement that resolves all outstanding issues relating to the audit and establishes a $24.7 million regulatory liability

*Gas Management Audit*

In February 2013, the NYPSC initiated a comprehensive management and operational audit of NGUSA's New York gas businesses, including the New York Gas Companies, pursuant to the Public Service Law requirement that major electric and gas utilities undergo an audit every five years. The audit commenced in August 2013 and the NYPSC issued an audit findings report in October 2014. The audit findings found that the New York Gas Companies operations performed well in providing reliable gas service, and strength in operations, network planning, project management, work management, load forecasting, supply procurement and customer systems support. Also included were 31 recommendations for improvement, including: reconstituting the boards of directors of NGUSA and the gas companies in New York to include more objective oversight; establishing stronger reporting authority between the New York jurisdictional president and operational organizations; preparing a true strategic plan for NGUSA's New York operations to serve as a road map for investments, programs and operations to build upon the state energy plan and energy initiatives; developing a five-year, integrated, system-wide plan that includes all gas reliability work, mandated replacements, growth projects and system planning work, enhancing internal service level agreements to promote accountability for performance and costs; and undertaking a full accounting of all costs associated with NGUSA's SAP enterprise wide system. In November 2014, NGUSA's New York gas businesses filed audit implementation plans addressing each of the audit recommendations. On May 14, 2015, the NYPSC issued an order accepting without modifications the joint implementation plans and directing NGUSA's New York gas businesses to execute the plans.

*Operations Audit*

In August 2013, the NYPSC initiated an operational audit to review the accuracy of the customer service, electric reliability, and gas safety data reported by the investor owned utilities operating in New York, including the New York Gas Companies. On December 19, 2013, the NYPSC selected Overland to conduct the audit, which commenced in February 2014. At the time of the issuance of these consolidated financial statements, the Company has not received the final audit findings and cannot predict the outcome of this audit.

*Operations Staffing Audit*

In January 2014, the NYPSC initiated an operational audit to review internal staffing levels and use of contractors for the core utility functions of the investor owned utilities operating in New York, including the New York Gas Companies. On June 26, 2014, the NYPSC selected The Liberty Consulting Group to conduct the audit. At the time of the issuance of these consolidated financial statements, the Company cannot predict the outcome of this operational audit.

*Capital Reconciliation Mechanism Petition*

In June 2015, Brooklyn Union submitted a petition to the NYPSC requesting a modification to the Capital Expenditures and Net Utility Plant and Depreciation Expense Reconciliation Mechanism ("Capital Reconciliation Mechanism") in its current rate plan. The Capital Reconciliation Mechanism is a downward only net utility plant reconciliation mechanism that permits a cumulative, two-year reconciliation for the two years ended December 31, 2014 and annual reconciliations thereafter. While Brooklyn Union implemented and largely completed its capital program for 2013 and 2014, its ability to launch certain programs was hampered by Superstorm Sandy and its aftermath. The impact of these delays and other related issues was a deferred liability, which was offset against the regulatory asset recorded in relation to the primary term of the rate plan. The requested modification to the Capital Reconciliation Mechanism would provide for an additional two year reconciliation period (calendar years 2015 and 2016) to complete more capital projects and facilitate Brooklyn Union's plan to invest in its distribution system infrastructure. If approved, the extension would be effective September 1, 2015.

**The Massachusetts Gas Companies**

*General Rate Case*

In November 2010, the DPU issued an order in the Massachusetts Gas Companies' 2010 rate case approving a revenue increase of $58 million based upon a 9.75% ROE and a 50% equity ratio. The Massachusetts Gas Companies filed two motions in response. These motions resulted in a final revenue increase of $65.3 million reflected in rates effective February 1, 2013.

*DPU Audit Settlement Agreement*

Associated with its general rate case, the DPU opened an investigation to address the allocation and assignment of costs to the Massachusetts Gas Companies by the NGUSA service companies. Subsequently, the Massachusetts Gas Companies filed a Settlement Agreement on May 19, 2014, which was approved by the DPU on July 25, 2014. As a result of the approval of the Settlement, the Company will implement reporting and review practices similar to those in place for its New York affiliates, and NGUSA contributed $1 million to the Massachusetts Association for Community Action that will be used for the benefit of the Company's gas customers and the customers of its Massachusetts electric distribution affiliates who are eligible for fuel assistance.

*Postretirement Benefit Other than Pension Carrying Charges*

On June 1, 2011, in conjunction with the DPU's annual investigation of Boston Gas' calendar year 2009 pension and PBOP rate reconciliation mechanism, the Massachusetts Attorney General argued that Boston Gas be obligated to provide carrying charges to the benefit of customers on its PBOP liability balances related to its 2003 to 2006 rate reconciliation filings. In August 2010, the DPU ordered Boston Gas to provide carrying charges on its PBOP liability balances on its 2007 and 2008 rate reconciliation filings, but the order was silent about providing carrying charges prior to those years. On August 29, 2014, the DPU ordered Boston Gas to provide carrying charges on its 2003 to 2006 PBOP liability balances in its next annual pension and PBOP reconciliation filing. On September 15, 2014, the 2014-2015 Pension Adjustment Factor filing was finalized and Boston Gas recorded an $8.3 million reduction to the regulatory asset in the accompanying consolidated financial statements.

*Gas System Enhancement Plan*

On April 30, 2015, the DPU approved the Massachusetts Gas Companies' first Gas System Enhancement Plan for calendar year 2015 and the associated factors ("GSEAFs"). The approved GSEAFs are designed to provide concurrent recovery of the revenue requirement associated with the Massachusetts Gas Companies' capital costs for the replacement of eligible leak prone pipe and ancillary equipment pursuant to the 2014 Gas Leaks Act passed in Massachusetts. This new program will replace the currently effective Targeted Infrastructure Replacement Program. The approved GSEAFs are designed to recover from all firm sales and transportation customers a surcharge of approximately $9.7 million.

## 5. PROPERTY, PLANT AND EQUIPMENT

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

| | March 31, | |
|---|---|---|
| | **2015** | 2014 |
| | *(in millions of dollars)* | |
| Plant and machinery | **$ 9,541** | $ 8,649 |
| Land and buildings | **737** | 718 |
| Assets in construction | **461** | 446 |
| Software and other intangibles | **284** | 155 |
| Total property, plant and equipment | **11,023** | 9,968 |
| Accumulated depreciation and amortization | **(1,214)** | (931) |
| Property, plant and equipment, net | **$ 9,809** | $ 9,037 |

## 6. DERIVATIVE CONTRACTS

The Company's subsidiaries utilize derivative contracts, such as gas swap contracts, gas option contracts, and gas purchase contracts, to manage commodity price risk associated with its natural gas purchases. The Company's risk management strategy is to reduce fluctuations in firm gas sales prices to its customers.

The Company's financial exposures are monitored and managed as an integral part of the Company's overall financial risk management policy. The Company engages in risk management activities, only in commodities and financial markets where it has an exposure, and only in terms and volumes consistent with its core business.

**Volumes**

Volumes of outstanding commodity derivative contracts measured in dekatherms ("dths") are as follows:

| | March 31, | |
|---|---|---|
| | **2015** | 2014 |
| | *(in thousands)* | |
| Gas swap contracts | **45,784** | 36,202 |
| Gas option contracts | **2,920** | 16,540 |
| Gas purchase contracts | **48,380** | 68,271 |
| Total | **97,084** | 121,013 |

## Amounts Recognized in the Accompanying Consolidated Balance Sheets

| | Asset Derivatives | | | | Liability Derivatives | | | |
|---|---|---|---|---|---|---|---|---|
| | March 31, | | | | March 31, | | | |
| | **2015** | | 2014 | | **2015** | | 2014 | |
| | *(in millions of dollars)* | | | | *(in millions of dollars)* | | | |
| Current assets: | | | | Current liabilities: | | | | |
| Rate recoverable contracts: | | | | Rate recoverable contracts: | | | | |
| Gas swap contracts | **$** | **2** | $ 8 | Gas swap contracts | **$** | **25** | $ 4 | |
| Gas option contracts | | **-** | 2 | Gas option contracts | | **-** | - | |
| Gas purchase contracts | | **18** | 11 | Gas purchase contracts | | **10** | 21 | |
| | | **20** | 21 | | | **35** | 25 | |
| Other non-current assets: | | | | Other non-current liabilities: | | | | |
| Rate recoverable contracts: | | | | Rate recoverable contracts: | | | | |
| Gas swap contracts | | **-** | - | Gas swap contracts | | **2** | - | |
| Gas purchase contracts | | **22** | 18 | Gas purchase contracts | | **8** | 5 | |
| | | **22** | 18 | | | **10** | 5 | |
| Total | **$** | **42** | $ 39 | Total | **$** | **45** | $ 30 | |

The changes in fair value of the Company's rate recoverable contracts are offset by changes in regulatory assets and liabilities. As a result, the changes in fair value of those contracts had no impact in the accompanying consolidated statements of income. The Company had no derivative contracts not subject to rate recovery as of March 31, 2015 and 2014.

## Credit and Collateral

The Company is exposed to credit risk related to transactions entered into for commodity price risk management. Credit risk represents the risk of loss due to counterparty non-performance. Credit risk is managed by assessing each counterparty's credit profile and negotiating appropriate levels of collateral and credit support.

The credit policy for commodity transactions is managed and monitored by NGUSA's Executive Energy Risk Management Committee ("EERC"), which is responsible for approving risk management policies and objectives for risk assessment, control and valuation, and the monitoring and reporting of risk exposures. NGUSA's Energy Procurement Risk Management Committee ("EPRMC") is responsible for approving transaction strategies, annual supply plans, and counterparty credit approval, as well as all valuation and control procedures. The EERC is chaired by the Global Tax and Treasury Director and reports to the Finance Committee. The EPRMC is chaired by the Vice President of U.S. Treasury and reports to the EERC.

The EPRMC monitors counterparty credit exposure and appropriate measures are taken to bring such exposures below the limits, including, without limitation, netting agreements, and limitations on the type and tenor of trades. The Company enters into enabling agreements that allow for payment netting with its counterparties, which reduce its exposure to counterparty risk by providing for the offset of amounts payable to the counterparty against amounts receivable from the counterparty. In instances where a counterparty's credit quality has declined, or credit exposure exceeds certain levels, the Company may limit its credit exposure by restricting new transactions with the counterparty, requiring additional collateral or credit support, and negotiating the early termination of certain agreements. Similarly, the Company may be required to post collateral to its counterparties.

The Company's credit exposure for all derivative contracts, applicable payables and receivables, and instruments that are subject to master netting agreements, was a liability of $9.5 million and an asset of $9.2 million as of March 31, 2015 and 2014, respectively.

The aggregate fair value of the Company's derivative contracts with credit-risk-related contingent features that are in a liability position at March 31, 2015 and 2014 was $27 million and $6.7 million, respectively. The Company had no collateral posted for these instruments at March 31, 2015 or 2014. If the Company's credit rating were to be downgraded by one or two levels, it would not be required to post any additional collateral. If the Company's credit rating were to be downgraded by three levels, it would be required to post $27.8 million and $7.6 million additional collateral to its counterparties at March 31, 2015 and 2014, respectively.

**Offsetting Information for Derivatives Subject to Master Netting Arrangements**

**March 31, 2015**
**Gross Amounts Not Offset in the Consolidated Balance Sheets**
*(in millions of dollars)*

| ASSETS: | Gross amounts of recognized assets | Gross amounts offset in the Consolidated Balance Sheets | Net amounts of assets presented in the Consolidated Balance Sheets | Financial instruments | Cash collateral received | Net amount |
|---|---|---|---|---|---|---|
| | *A* | *B* | *C=A+B* | *Da* | *Db* | *E=C-D* |
| **Derivative contracts** | | | | | | |
| Gas swap contracts | $ 2 | $ - | $ 2 | $ - | $ - | $ 2 |
| Gas purchase contracts | 40 | - | 40 | - | - | 40 |
| Total | $ 42 | $ - | $ 42 | $ - | $ - | $ 42 |

| LIABILITIES: | Gross amounts of recognized liabilities | Gross amounts offset in the Consolidated Balance Sheets | Net amounts of liabilities presented in the Consolidated Balance Sheets | Financial instruments | Cash collateral paid | Net amount |
|---|---|---|---|---|---|---|
| | *A* | *B* | *C=A+B* | *Da* | *Db* | *E=C-D* |
| **Derivative contracts** | | | | | | |
| Gas swap contracts | $ 27 | $ - | $ 27 | $ - | $ - | $ 27 |
| Gas purchase contracts | 18 | - | 18 | - | - | 18 |
| Total | $ 45 | $ - | $ 45 | $ - | $ - | $ 45 |

**March 31, 2014**

**Gross Amounts Not Offset in the Consolidated Balance Sheets**

*(in millions of dollars)*

| ASSETS: | Gross amounts of recognized assets<br>*A* | Gross amounts offset in the Consolidated Balance Sheets<br>*B* | Net amounts of assets presented in the Consolidated Balance Sheets<br>*C=A+B* | Financial instruments<br>*Da* | Cash collateral received<br>*Db* | Net amount<br>*E=C-D* |
|---|---|---|---|---|---|---|
| **Derivative contracts** | | | | | | |
| Gas swap contracts | $ 8 | $ - | $ 8 | $ - | $ - | $ 8 |
| Gas option contracts | 2 | - | 2 | - | - | 2 |
| Gas purchase contracts | 29 | - | 29 | - | - | 29 |
| Total | $ 39 | $ - | $ 39 | $ - | $ - | $ 39 |

| LIABILITIES: | Gross amounts of recognized liabilities<br>*A* | Gross amounts offset in the Consolidated Balance Sheets<br>*B* | Net amounts of liabilities presented in the Consolidated Balance Sheets<br>*C=A+B* | Financial instruments<br>*Da* | Cash collateral paid<br>*Db* | Net amount<br>*E=C-D* |
|---|---|---|---|---|---|---|
| **Derivative contracts** | | | | | | |
| Gas swap contracts | $ 4 | $ - | $ 4 | $ - | $ - | $ 4 |
| Gas purchase contracts | 26 | - | 26 | - | - | 26 |
| Total | $ 30 | $ - | $ 30 | $ - | $ - | $ 30 |

## 7. FAIR VALUE MEASUREMENTS

The following tables present assets and liabilities measured and recorded at fair value in the accompanying consolidated balance sheets on a recurring basis and their level within the fair value hierarchy as of March 31, 2015 and 2014:

| | **March 31, 2015** | | | |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Total** |
| | *(in millions of dollars)* | | | |
| **Assets:** | | | | |
| Derivative contracts | | | | |
| Gas swap contracts | $ - | $ 2 | $ - | $ 2 |
| Gas purchase contracts | - | - | 40 | 40 |
| Available-for-sale securities | 8 | 4 | - | 12 |
| Total | 8 | 6 | 40 | 54 |
| **Liabilities:** | | | | |
| Derivative contracts | | | | |
| Gas swap contracts | - | 27 | - | 27 |
| Gas purchase contracts | - | - | 18 | 18 |
| Total | - | 27 | 18 | 45 |
| **Net assets (liabilities)** | $ 8 | $ (21) | $ 22 | $ 9 |

| | March 31, 2014 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | *(in millions of dollars)* | | | |
| **Assets:** | | | | |
| Derivative contracts | | | | |
| Gas swap contracts | $ - | $ 8 | $ - | $ 8 |
| Gas option contracts | - | - | 2 | 2 |
| Gas purchase contracts | - | 1 | 28 | 29 |
| Available-for-sale securities | 7 | 5 | - | 12 |
| Total | 7 | 14 | 30 | 51 |
| **Liabilities:** | | | | |
| Derivative contracts | | | | |
| Gas swap contracts | - | 4 | - | 4 |
| Gas purchase contracts | - | - | 26 | 26 |
| Total | - | 4 | 26 | 30 |
| **Net assets** | $ 7 | $ 10 | $ 4 | $ 21 |

**Derivative Contracts**: The Company's Level 2 fair value derivative contracts primarily consist of over-the-counter ("OTC") gas swap contracts with pricing inputs obtained from the New York Mercantile Exchange and the Intercontinental Exchange ("ICE"), except in cases where the ICE publishes seasonal averages or where there were no transactions within the last seven days. The Company may utilize discounting based on quoted interest rate curves, including consideration of non-performance risk, and may include a liquidity reserve calculated based on bid/ask spread for the Company's Level 2 derivative contracts. Substantially all of these price curves are observable in the marketplace throughout at least 95% of the remaining contractual quantity, or they could be constructed from market observable curves with correlation coefficients of 95% or higher.

The Company's Level 3 fair value derivative contracts primarily consist of OTC gas option contracts and gas purchase contracts, which are valued based on internally-developed models. Industry-standard valuation techniques, such as the Black-Scholes pricing model, Monte Carlo simulation, and Financial Engineering Associates libraries are used for valuing such instruments. A derivative is designated Level 3 when it is valued based on a forward curve that is internally developed, extrapolated or derived from market observable curves with correlation coefficients less than 95%, where optionality is present, or if non-economic assumptions are made. The internally developed forward curves have a high level of correlation with Platts Mark-to-Market curves and are reviewed by the middle office. The Company considers non-performance risk and liquidity risk in the valuation of derivative contracts categorized in Level 2 and Level 3.

**Available-for-Sale Securities:** Available-for-sale securities are included in other non-current assets in the accompanying consolidated balance sheets and primarily include equity and debt investments based on quoted market prices (Level 1) and municipal and corporate bonds based on quoted prices of similar traded assets in open markets (Level 2).

**Changes in Level 3 Derivative Contracts**

| | Years Ended March 31, | |
|---|---|---|
| | **2015** | 2014 |
| | *(in millions of dollars)* | |
| Balance as of the beginning of the year | **$ 4** | $ 11 |
| Total gains or losses included in regulatory assets and liabilities | **(5)** | (7) |
| Settlements | **23** | - |
| Balance as of the end of the year | **$ 22** | $ 4 |

A transfer into Level 3 represents existing assets or liabilities that were previously categorized at a higher level for which the inputs became unobservable during the year. A transfer out of Level 3 represents assets and liabilities that were previously classified as Level 3 for which the inputs became observable based on the criteria discussed previously for classification in Level 2. These transfers, which are recognized at the end of each period, result from changes in the observability of forward curves from the beginning to the end of each reporting period. There were no transfers between Level 1 and Level 2, and no transfers into or out of Level 3, during the years ended March 31, 2015 or 2014.

**Quantitative Information About Level 3 Fair Value Measurements**

The following tables provide information about the Company's Level 3 valuations:

| Commodity | Level 3 Position | Fair Value as of March 31, 2015 | | | Valuation Technique(s) | Significant Unobservable Input | Range |
|---|---|---|---|---|---|---|---|
| | | Assets | (Liabilities) | Total | | | |
| | | *(in millions of dollars)* | | | | | |
| Gas | Purchase contracts | $ 35 | $ (18) | $ 17 | Discounted Cash Flow | Forward Curve | $0.96-$11.47/dth |
| Gas | Cross commodity contracts | 5 | - | 5 | Discounted Cash Flow | Forward Curve | $17.47-$378.51/dth |
| | **Total** | $ 40 | $ (18) | $ 22 | | | |

| Commodity | Level 3 Position | Fair Value as of March 31, 2014 | | | Valuation Technique(s) | Significant Unobservable Input | Range |
|---|---|---|---|---|---|---|---|
| | | Assets | (Liabilities) | Total | | | |
| | | *(in millions of dollars)* | | | | | |
| Gas | Purchase contracts | $ 25 | $ (12) | $ 13 | Discounted Cash Flow | Forward Curve | $2.43-$17.31/dth |
| Gas | Cross commodity contracts | 3 | - | 3 | Discounted Cash Flow | Forward Curve | $43.19-$98.98/dth |
| Gas | Purchase contracts | - | (14) | (14) | Discounted Cash Flow | LNG Forward Curve | $6.62-$11.01/dth |
| Gas | Option contracts | 2 | - | 2 | Discounted Cash Flow | Implied Volatility | 29%-31% |
| | **Total** | $ 30 | $ (26) | $ 4 | | | |

The significant unobservable inputs listed above would have a direct impact on the fair values of the Level 3 instruments if they were adjusted. The significant unobservable inputs used in the fair value measurement of the Company's gas purchase and gas option derivatives are forward commodity prices, forward gas curve and implied volatility. A relative change in commodity price at various locations underlying the open positions can result in significantly different fair value estimates.

**Other Fair Value Measurements**

The Company's consolidated balance sheets reflect long-term debt at amortized cost. The fair value of the Company's long-term debt was based on quoted market prices when available, or estimated using quoted market prices for similar debt. The fair value of this debt at March 31, 2015 and 2014 was $4 billion and $3.7 billion, respectively.

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.

## 8. EMPLOYEE BENEFITS

The Company sponsors several pension and PBOP Plans. In general, the Company calculates benefits under these plans based on age, years of service and pay using March 31 as a measurement date. In addition, NGUSA also sponsors defined contribution plans for eligible employees.

*Pension Plans*

The Pension Plans are comprised of both qualified and non-qualified plans. The qualified pension plans provide substantially all union employees, as well as all non-union employees hired before January 1, 2011, with a retirement benefit. The qualified pension plans are a cash balance pension plan design in which pay-based credits are applied based on service time and interest credits are applied at rates set forth in the plan. For non-union employees, effective January 1, 2011, pay-based credits are based on a combination of service time and age. The non-qualified pension plans provide additional defined pension benefits to certain eligible executives. The Company funds the qualified plans by contributing at least the minimum amount required under Internal Revenue Service ("IRS") regulations. The Company expects to contribute $166.8 million to the qualified pension plan during the year ending March 31, 2016.

*PBOP Plans*

The Company's 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. The Company funds these plans based on the requirements of the various regulatory jurisdictions in which it operates. The Company expects to contribute $66.4 million to the PBOP Plans during the year ending March 31, 2016.

*Defined Contribution Plans*

NGUSA offers two defined contribution plans to eligible union and management employees. These plans are defined contribution plans subject to the Employee Retirement Income Security Act, which requires disclosure of financial and other information concerning plans to beneficiaries and minimum standards for pension plans. In the plans, eligible employees contribute to their own participant account. In addition, employees may receive certain employer contributions, including matching contributions and a 15% discount on the purchase of National Grid plc common stock. Employer matching contributions of approximately $4.3 million were expensed in each of the years ended March 31, 2015 and 2014.

**Components of Net Periodic Benefit Costs**

| | Pension Plans | | PBOP Plans | |
|---|---|---|---|---|
| | Years Ended March 31, | | Years Ended March 31, | |
| | **2015** | 2014 | **2015** | 2014 |
| | (in millions of dollars) | | | |
| Service cost | **$ 55** | $ 68 | **$ 24** | $ 35 |
| Interest cost | **195** | 188 | **79** | 89 |
| Expected return on plan assets | **(241)** | (227) | **(62)** | (56) |
| Amortization of prior service cost (credit), net | **3** | 2 | **(5)** | (2) |
| Amortization of net actuarial loss | **123** | 117 | **22** | 43 |
| Settlements/curtailments | **-** | 1 | **-** | - |
| Total cost | **$ 135** | $ 149 | **$ 58** | $ 109 |

All of the Company's regulated subsidiaries have regulatory recovery of these costs and therefore have recorded related regulatory assets (liabilities) in the accompanying consolidated balance sheets. The Company records amounts for its

unregulated subsidiaries within operations and maintenance expense in the accompanying consolidated statements of income.

**Amounts Recognized in AOCI and Regulatory Assets**

| | Pension Plans | | PBOP Plans | |
|---|---|---|---|---|
| | Years Ended March 31, | | Years Ended March 31, | |
| | **2015** | 2014 | **2015** | 2014 |
| | *(in millions of dollars)* | | | |
| Net actuarial loss (gain) | **$ 422** | $ (41) | **$ 97** | $ (330) |
| Prior service cost (credit) | **2** | - | **-** | (31) |
| Amortization of net actuarial (gain) loss | **(123)** | (117) | **(22)** | 98 |
| Amortization of prior service (cost) credit, net | **(3)** | (3) | **5** | 1 |
| Total | **$ 298** | $ (161) | **$ 80** | $ (262) |
| Included in regulatory assets | **$ 101** | $ (48) | **$ 33** | $ (41) |
| Included in AOCI | **197** | (113) | **47** | (221) |
| Total | **$ 298** | $ (161) | **$ 80** | $ (262) |

The Company's gas distribution subsidiaries have regulatory recovery of these obligations and therefore amounts are included in regulatory assets in the accompanying consolidated balance sheets. Costs of non-regulated subsidiaries are recorded as part of AOCI in the accompanying consolidated balance sheets.

**Amounts Recognized in AOCI and Regulatory Assets – not yet recognized as components of net actuarial loss**

| | Pension Plans | | PBOP Plans | |
|---|---|---|---|---|
| | Years Ended March 31, | | Years Ended March 31, | |
| | **2015** | 2014 | **2015** | 2014 |
| | *(in millions of dollars)* | | | |
| Net actuarial loss | **$ 1,035** | $ 736 | **$ 323** | $ 248 |
| Prior service cost (credit) | **20** | 21 | **(24)** | (29) |
| Total | **$ 1,055** | $ 757 | **$ 299** | $ 219 |
| Included in regulatory assets | **$ 375** | $ 274 | **$ 126** | $ 93 |
| Included in AOCI | **680** | 483 | **173** | 126 |
| Total | **$ 1,055** | $ 757 | **$ 299** | $ 219 |

The amount of expected net actuarial loss and prior service credit to be amortized from regulatory assets and AOCI during the year ended March 31, 2016 for the Pension Plans and PBOP Plans is $206 million and $2 million, respectively.

### Reconciliation of Funded Status to Amount Recognized

| | Pension Plans | | PBOP Plans | |
|---|---|---|---|---|
| | Years Ended March 31, | | Years Ended March 31, | |
| | **2015** | 2014 | **2015** | 2014 |
| | *(in millions of dollars)* | | | |
| **Change in benefit obligation:** | | | | |
| Benefit obligation as of the beginning of the year | **$ (4,173)** | $ (4,079) | **$ (1,793)** | $ (2,062) |
| Service cost | **(55)** | (68) | **(24)** | (35) |
| Interest cost on projected benefit obligation | **(195)** | (188) | **(80)** | (89) |
| Plan amendments | **-** | - | **-** | 31 |
| Net actuarial loss | **(518)** | (60) | **(76)** | (9) |
| Benefits paid | **220** | 195 | **79** | 78 |
| Settlements/curtailments | **-** | 27 | **-** | 304 |
| Other | **(2)** | - | **(12)** | (11) |
| Benefit obligation as of the end of the year | **(4,723)** | (4,173) | **(1,906)** | (1,793) |
| **Change in plan assets:** | | | | |
| Fair value of plan assets as of the beginning of the year | **3,469** | 3,186 | **876** | 722 |
| Actual return on plan assets | **337** | 302 | **42** | 92 |
| Company contributions | **132** | 176 | **81** | 140 |
| Benefits paid | **(220)** | (195) | **(79)** | (78) |
| Fair value of plan assets as of the end of the year | **3,718** | 3,469 | **920** | 876 |
| **Funded status** | **$ (1,005)** | $ (704) | **$ (986)** | $ (917) |

The benefit obligation shown above is the projected benefit obligation ("PBO") for the Pension Plans and the accumulated benefit obligation ("ABO") for the PBOP Plans. The Company is required to reflect the funded status of its Pension Plans above in terms of the PBO, which is higher than the ABO, because the PBO includes the impact of expected future compensation increases on the pension obligation. The aggregate ABO balances for the Pension Plans were $4.6 billion and $4 billion as of March 31, 2015 and 2014, respectively.

### Amounts Recognized in the Accompanying Consolidated Balance Sheets

| | Pension Plans | | PBOP Plans | |
|---|---|---|---|---|
| | March 31, | | March 31, | |
| | **2015** | 2014 | **2015** | 2014 |
| | *(in millions of dollars)* | | | |
| Non-current assets | **$ -** | $ - | **$ 10** | $ 15 |
| Current liabilities | **(13)** | (12) | **(3)** | (7) |
| Non-current liabilities | **(992)** | (692) | **(993)** | (925) |
| Total | **$ (1,005)** | $ (704) | **$ (986)** | $ (917) |

**Expected Benefit Payments**

Based on current assumptions, the Company expects to make the following benefit payments subsequent to March 31, 2015:

| *(in millions of dollars)*<br>Years Ending March 31, | Pension Benefits | PBOP Benefits |
|---|---|---|
| 2016 | $ 223 | $ 74 |
| 2017 | 230 | 76 |
| 2018 | 238 | 79 |
| 2019 | 244 | 82 |
| 2020 | 250 | 84 |
| Thereafter | 1,364 | 461 |
| Total | $ 2,549 | $ 856 |

**Assumptions Used for Employee Benefits Accounting**

| | **Pension Plans** | | **PBOP Plans** | |
|---|---|---|---|---|
| | **Years Ended March 31,** | | **Years Ended March 31,** | |
| | **2015** | 2014 | **2015** | 2014 |
| **Benefit Obligations:** | | | | |
| Discount rate | **4.10%** | 4.80% | **4.10%** | 4.80% |
| Rate of compensation increase | **3.50%** | 3.50% | **3.50%** | 3.50% |
| Expected return on plan assets | **6.25%** | 7.00% | **6.25%-6.75%** | 7.00%-7.25% |
| **Net Periodic Benefit Costs:** | | | | |
| Discount rate | **4.80%** | 4.70% | **4.80%** | 4.70% |
| Rate of compensation increase | **3.50%** | 3.50% | **3.50%** | 3.50% |
| Expected return on plan assets | **7.00%** | 7.25% | **7.00% - 7.25%** | 7.25% |

The Company selects its discount rate assumption based upon rates of return on highly rated corporate bond yields in the marketplace as of each measurement date. Specifically, the Company uses the Hewitt AA Above Median Curve along with the expected future cash flows from the Company retirement plans to determine the weighted average discount rate assumption.

Mortality assumptions are used to estimate life expectancies of plan participants and the expected period over which they will receive pension benefits. The mortality assumption is composed of a base table that represents the current expectation of life expectancy of the population and an improvement scale that anticipates future improvements in life expectancy. In October 2014, the Society of Actuaries ("SOA") issued updated mortality tables (RP-2014) and a mortality improvement scale (MP-2014), which reflect longer life expectancies than previously projected.

The Company's pension and PBOP obligations as of March 31, 2015 reflect a change in the underlying mortality assumption consistent with the SOA study. These changes resulted in an increase in the projected benefit obligation of $169.9 million as of March 31, 2015.

The expected 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 assumptions. A small premium is added for active management of both equity and fixed income securities. The rates of return for each asset class are then weighted in accordance with the actual asset allocation, resulting in a long-term return on asset rate for each plan.

**Assumed Health Cost Trend Rate**

| | March 31, | |
|---|---|---|
| | **2015** | 2014 |
| Health care cost trend rate assumed for next year | | |
| Pre 65 | **8.00%** | 8.00% |
| Post 65 | **6.50%** | 7.00% |
| Prescription | **6.50%** | 7.00% |
| Rate to which the cost trend is assumed to decline (ultimate) | **5.00%** | 5.00% |
| Year that rate reaches ultimate trend | | |
| Pre 65 | **2022** | 2022 |
| Post 65 | **2022** | 2021 |
| Prescription | **2022** | 2021 |

**Sensitivity to Changes in Assumed Health Care Cost Trend Rates**

| *(in millions of dollars)* | **March 31, 2015** |
|---|---|
| 1% point increase | |
| Total of service cost plus interest cost | $ 19 |
| Postretirement benefit obligation | 285 |
| 1% point decrease | |
| Total of service cost plus interest cost | (14) |
| Postretirement benefit obligation | (226) |

**Plan Assets**

NGUSA manages the benefit plan 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 securities. 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 market segments. Small investments are also approved for private equity, real estate, and infrastructure with the objective of enhancing long-term returns while improving portfolio diversification. For the PBOP Plans, since the earnings on a portion of the assets are taxable, those investments are managed to maximize after tax returns consistent with the broad asset class parameters established by the asset allocation study. Investment risk and return are reviewed by NGUSA's investment committee on a quarterly basis.

The target asset allocations for the benefit plans as of March 31, 2015 and 2014 are as follows:

| | Pension Plans | | PBOP Plans | |
|---|---|---|---|---|
| | March 31, | | March 31, | |
| | **2015** | 2014 | **2015** | 2014 |
| U.S. equities | **20%** | 20% | **40%** | 40% |
| Global equities (including U.S.) | **7%** | 7% | **6%** | 6% |
| Global tactical asset allocation | **10%** | 10% | **9%** | 9% |
| Non-U.S. equities | **10%** | 10% | **21%** | 21% |
| Fixed income | **40%** | 40% | **24%** | 24% |
| Private equity | **5%** | 5% | **-** | - |
| Real estate | **5%** | 5% | **-** | - |
| Infrastructure | **3%** | 3% | **-** | - |
| | **100%** | 100% | **100%** | 100% |

**Fair Value Measurements**

The following tables provide the fair value measurements amounts for the pension and PBOP assets.

| | March 31, 2015 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | *(in millions of dollars)* | | | |
| **Pension Assets:** | | | | |
| Cash and cash equivalents | $ 11 | $ 63 | $ - | $ 74 |
| Accounts receivable | 94 | - | - | 94 |
| Accounts payable | (99) | - | - | (99) |
| Equity | 503 | 986 | 132 | 1,621 |
| Global tactical asset allocation | - | - | 165 | 165 |
| Fixed income securities | - | 1,414 | 58 | 1,472 |
| Preferred securities | 1 | 10 | - | 11 |
| Futures contracts | - | 3 | - | 3 |
| Private equity | - | - | 198 | 198 |
| Real estate | - | 77 | 102 | 179 |
| Total | $ 510 | $ 2,553 | $ 655 | $ 3,718 |
| **PBOP Assets:** | | | | |
| Cash and cash equivalents | $ 7 | $ 10 | $ - | $ 17 |
| Accounts receivable | 1 | - | - | 1 |
| Equity | 119 | 381 | 40 | 540 |
| Global tactical asset allocation | 23 | - | 46 | 69 |
| Fixed income securities | 2 | 284 | - | 286 |
| Private equity | - | - | 7 | 7 |
| Total | $ 152 | $ 675 | $ 93 | $ 920 |

| | March 31, 2014 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | | (in millions of dollars) | | |
| **Pension Assets:** | | | | |
| Cash and cash equivalents | $ 1 | $ 64 | $ - | $ 65 |
| Accounts receivable | 71 | - | - | 71 |
| Accounts payable | (60) | - | - | (60) |
| Equity | 485 | 915 | 130 | 1,530 |
| Global tactical asset allocation | - | 126 | 25 | 151 |
| Fixed income securities | - | 1,356 | 4 | 1,360 |
| Futures contracts | 2 | - | - | 2 |
| Private equity | - | - | 197 | 197 |
| Real estate | - | - | 153 | 153 |
| Total | $ 499 | $ 2,461 | $ 509 | $ 3,469 |
| **PBOP Assets:** | | | | |
| Cash and cash equivalents | $ 8 | $ 16 | $ - | $ 24 |
| Accounts receivable | 1 | - | - | 1 |
| Equity | 118 | 365 | 25 | 508 |
| Global tactical asset allocation | 25 | 35 | 8 | 68 |
| Fixed income securities | 2 | 265 | - | 267 |
| Private equity | - | - | 8 | 8 |
| Total | $ 154 | $ 681 | $ 41 | $ 876 |

The methods used to fair value pension and PBOP assets are described below:

**Cash and Cash Equivalents**: Cash and cash equivalents that can be priced daily are classified as Level 1. Active reserve funds, reserve deposits, commercial paper, repurchase agreements, and commingled cash equivalents are classified as Level 2. Such instruments are generally valued using a curve methodology that includes observable inputs such as money market rates for specific instruments, programs, currencies and maturity points obtained from a variety of market makers, reflective of current trading levels. The methodologies consider an instrument's days to final maturity to generate a yield based on the relevant curve for the instrument.

**Accounts Receivable and Accounts Payable:** Accounts receivable and accounts payable are classified in the same category as the investments to which they relate. Such amounts are short-term and settle within a few days of the measurement date.

**Equity and Preferred Securities:** Common stocks, preferred stocks, and real estate investment trusts are valued using the official close of the primary market on which the individual securities are traded. Equity securities are primarily comprised of securities issued by public companies in domestic and foreign markets plus investments in commingled funds, which are valued on a daily basis. The Company can exchange shares of the publicly traded securities and the fair values are primarily sourced from the closing prices on stock exchanges where there is active trading, in which case they are classified as Level 1 investments. If there is less active trading, then the publicly traded securities would typically be priced using observable data, such as bid and ask prices, and these measurements are classified as Level 2 investments. Investments that are not publicly traded and valued using unobservable inputs are classified as Level 3 investments. Commingled funds with publicly quoted prices and active trading are classified as Level 1 investments. For investments in commingled funds that are not publicly traded and have ongoing subscription and redemption activity, the fair value of the investment is the net asset value ("NAV") per fund share, derived from the underlying securities' quoted prices in active markets, and they are classified as Level 2 investments. Investments in commingled funds with redemption restrictions and that use NAV are classified as Level 3 investments.

**Global Tactical Asset Allocation:** Assets held in global tactical asset allocation funds are managed by investment managers who use both top-down and bottom-up valuation methodologies to value asset classes, countries, industrial sectors, and individual securities in order to allocate and invest assets opportunistically. If the inputs used to measure a financial instrument fall within different levels of the fair value hierarchy within the commingled fund, the categorization is based on the lowest level input that is significant to the measurement of that financial instrument. The assets invested through commingled funds are classified as Level 2. Those which are open ended mutual funds with observable pricing are classified as Level 1. However, the underlying Level 3 assets that makeup these funds are classified in the same category as the investments to which they relate.

**Fixed Income Securities:** Fixed income securities (which include corporate debt securities, municipal fixed income securities, U.S. Government and Government agency securities including government mortgage backed securities, index linked government bonds, and state and local bonds) convertible securities, and investments in securities lending collateral (which include repurchase agreements, asset backed securities, floating rate notes and time deposits) are valued with an institutional bid valuation. A bid valuation is an estimated price at which a dealer would pay for a security (typically in an institutional round lot). Oftentimes, these evaluations are based on proprietary models which pricing vendors establish for these purposes. In some cases there may be manual sources when primary vendors do not supply prices. Fixed income investments are primarily comprised of fixed income securities and fixed income commingled funds. The prices for direct investments in fixed income securities are generated on a daily basis. Prices generated from less active trading with wider bid ask prices are classified as Level 2 investments. If prices are based on uncorroborated and unobservable inputs, then the investments are classified as Level 3 investments. Commingled funds with publicly quoted prices and active trading are classified as Level 1 investments. For commingled funds that are not publicly traded and have ongoing subscription and redemption activity, the fair value of the investment is the NAV per fund share, derived from the underlying securities' quoted prices in active markets, and are classified as Level 2 investments. Investments in commingled funds with redemption restrictions and that use NAV are classified as Level 3.

**Private Equity and Real Estate:** Commingled equity funds, commingled special equity funds, limited partnerships, real estate, venture capital and other investments are valued using evaluations (NAV per fund share), based on proprietary models, or based on the NAV. Investments in private equity and real estate funds are primarily invested in privately held real estate investment properties, trusts, and partnerships as well as equity and debt issued by public or private companies. The Company's interest in the fund or partnership is estimated based on the NAV. The Company's interest in these funds cannot be readily redeemed due to the inherent lack of liquidity and the primarily long-term nature of the underlying assets. Distribution is made through the liquidation of the underlying assets. The Company views these investments as part of a long-term investment strategy. These investments are valued by each investment manager based on the underlying assets. The funds utilize valuation techniques consistent with the market, income, and cost approaches to measure the fair value of certain real estate investments. The majority of the underlying assets are valued using significant unobservable inputs and often require significant management judgment or estimation based on the best available information. Market data includes observations of the trading multiples of public companies considered comparable to the private companies being valued. As a result, the Company classifies these investments as Level 3.

While management believes its valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of Level 3 financial instruments could result in a different fair value measurement at the reporting date.

**Changes in Level 3 Plan Investments**

| | Pension Plans | | PBOP Plans | |
|---|---|---|---|---|
| | Years Ended March 31, | | Years Ended March 31, | |
| | **2015** | 2014 | **2015** | 2014 |
| | *(in millions of dollars)* | | | |
| Balance as of the beginning of the year | **$ 509** | $ 366 | **$ 41** | $ 31 |
| Transfers out of Level 3 | **(344)** | - | **(16)** | (41) |
| Transfers into Level 3 | **319** | 104 | **33** | 39 |
| Actual gain or loss on plan assets: | | | | |
| Realized gain | **40** | 14 | **4** | 2 |
| Unrealized gain | **41** | 29 | **6** | - |
| Purchases | **187** | 51 | **44** | 28 |
| Sales | **(97)** | (55) | **(19)** | (18) |
| Balance as of the end of the year | **$ 655** | $ 509 | **$ 93** | $ 41 |

**Other Benefits**

At March 31, 2015 and 2014, the Company had accrued workers compensation, auto, and general insurance claims which have been incurred but not yet reported of $49.8 million and $51.7 million, respectively.

**9. ACCUMULATED OTHER COMPREHENSIVE INCOME**

The following table represents the changes in the Company's AOCI for the year ended March 31, 2015:

| | Unrealized Gain on Available-For-Sale Securities | Pension and other Postretirement Benefits | Total |
|---|---|---|---|
| Balance as of the beginning of the year | $ 33 | $ (393) | $ (360) |
| Other comprehensive income before reclassifications: | | | |
| Unrecognized net acturial loss (net of $14 tax benefit) | - | (21) | (21) |
| Amounts reclassified from other comprehensive income: | | | |
| Amortization of net actuarial loss (net of $14 tax expense) | - | 21 | 21 |
| **Net current period other comprehensive income** | - | - | - |
| Balance as of the end of the year | $ 33 | $ (393) | $ (360) |

**10. CAPITALIZATION**

*Debt Authorizations*

The Company's electric generation subsidiary, Genco, had regulatory approval from the FERC to issue up to $250 million of short-term debt, which expired on November 30, 2013. Genco's subsequent request for short-term borrowing authority was approved and became effective January 12, 2015 for a period of two years.

Effective April 25, 2014, Genco entered into an Equity Contribution Agreement ("ECA") with NGUSA, which provided Genco with the ability to call upon NGUSA for contributions to Genco's capital, in an aggregate amount equal to the short-term borrowing limit until such time as regulatory approval for short-term borrowing is regained. Genco did not make use of this

ECA. Since Genco has regained its short-term borrowing authority, as of January 12, 2015, the ECA is no longer in effect. Genco had no short-term debt outstanding to third-parties as of March 31, 2015 or 2014.

*Gas Facilities Revenue Bonds*

Brooklyn Union has outstanding tax-exempt Gas Facilities Revenue Bonds ("GFRB") issued through the New York State Energy Research and Development Authority ("NYSERDA"). At March 31, 2015 and 2014, $641 million of GFRB were outstanding; $230 million of which are variable-rate, auction rate bonds. The interest rate on the various variable rate series due starting December 1, 2020 through July 1, 2026 is reset weekly and ranged from 0.07% to 0.44% during the year ended March 31, 2015 and 0.07% to 0.51% during the year ended March 31, 2014. The GFRB are currently in auction rate mode and are backed by bond insurance. These bonds cannot be put back to Brooklyn Union and, in the case of a failed auction, the resulting interest rate on the bonds would revert to the maximum rate which depends on the current appropriate, short-term benchmark rates and the senior unsecured rating of the Brooklyn Union's bonds. The effect of the failed auctions on interest expense was not material for the years ended March 31, 2015 or 2014.

*Promissory Notes to LIPA*

The Company had previously issued $155 million of promissory notes to LIPA to support certain debt obligations assumed by LIPA. Following the expiration of the MSA on December 31, 2013, the debt was fully extinguished (refer to Note 15, "Discontinued Operations").

*First Mortgage Bonds*

The assets of Colonial Gas are subject to liens and other charges and are provided as collateral over borrowings of $75 million, of non-callable First Mortgage Bonds ("FMB"). These FMB indentures include, among other provisions, limitations on the issuance of long-term debt. Interest rates range from 6.9% to 8.8% and maturity dates range from July 2022 to April 2028.

*Industrial Development Revenue Bonds*

At March 31, 2015 and 2014, Genco had outstanding $128 million of 5.25% tax-exempt bonds due June 1, 2027. Of this amount, $53 million was issued through the Nassau County Industrial Development Authority for the construction of the Glenwood electric-generation peaking plant and the balance of $75 million was issued by the Suffolk County Industrial Development Authority for the Port Jefferson electric-generation peaking plant. The Company has fully and unconditionally guaranteed the payment obligations with regard to these tax-exempt bonds.

*State Authority Financing Notes*

Genco can issue tax-exempt bonds through the NYSERDA. At March 31, 2015 and 2014, $41 million of 1999 Series A Pollution Control Revenue Bonds due October 1, 2028 were outstanding. The interest rates are reset weekly and ranged from 0.10% to 1.44% for the year ended March 31, 2015 and 0.15% to 1.35% for the year ended March 31, 2014.

Genco also has outstanding $25 million variable rate 1997 Series A Electric Facilities Revenue Bonds due December 1, 2027. The interest rate on these bonds is reset weekly and ranged from 0.13% to 0.28% during the year ended March 31, 2015 and from 0.04% to 0.25% for the year ended March 31, 2014.

*Preferred Stock*

In connection with the acquisition of KeySpan by NGUSA, the New York Gas Companies became subject to a requirement to issue a class of preferred stock (the "Golden Shares"), subordinate to any existing preferred stock. The holder of the Golden Shares would have voting rights that limit the Company's right to commence any voluntary bankruptcy, liquidation, receivership or similar proceeding without the consent of the holder of the Golden Shares. The NYPSC subsequently authorized the issuance of the Golden Shares to a trustee, GSS Holdings, Inc. ("GSS"), who will hold the Golden Shares

subject to a Services and Indemnity Agreement requiring GSS to vote the Golden Shares in the best interests of New York State. On July 8, 2011, the Company issued a total of 2 Golden Shares pertaining to the New York Gas Companies, each with a par value of $1.

*Debt Maturities*

The aggregate maturities of long-term debt for the years subsequent to March 31, 2015 are as follows:

| *(in millions of dollars)* | |
|---|---|
| Years Ending March 31, | |
| 2016 | $ 10 |
| 2017 | 510 |
| 2018 | 8 |
| 2019 | 20 |
| 2020 | 7 |
| Thereafter | 2,743 |
| Total | $ 3,298 |

The Company is obligated to meet certain financial and non-financial covenants. The Company's subsidiaries also have restrictions on the payment of dividends which relate to their debt to equity ratios. During the years ended March 31, 2015 and 2014, the Company was in compliance with all such covenants and restrictions.

## 11. INCOME TAXES

### Components of Income Tax Expense

| | Years Ended March 31, | |
|---|---|---|
| | **2015** | 2014 |
| | *(in millions of dollars)* | |
| Current tax expense: | | |
| Federal | **$ 58** | $ 89 |
| State | **22** | 33 |
| Total current tax expense | **80** | 122 |
| Deferred tax expense: | | |
| Federal | **61** | 24 |
| State | **12** | 9 |
| Total deferred tax expense | **73** | 33 |
| Amortized investment tax credits [1] | **(1)** | (1) |
| Total deferred tax expense | **72** | 32 |
| Total income tax expense | **$ 152** | $ 154 |

[1] Investment tax credits ("ITC") are being deferred and amortized over the depreciable life of the property giving rise to the credits.

**Statutory Rate Reconciliation**

The Company's effective tax rates for the years ended March 31, 2015 and 2014 are 39.1% and 39.6%, respectively. The following table presents a reconciliation of income tax expense at the federal statutory tax rate of 35% to the actual tax expense:

| | Years Ended March 31, | |
|---|---|---|
| | **2015** | 2014 |
| | *(in millions of dollars)* | |
| Computed tax | **$ 136** | $ 136 |
| Change in computed taxes resulting from: | | |
| State income tax, net of federal benefit | **22** | 25 |
| Change in cash surrender value | **(4)** | (9) |
| Other items, net | **(2)** | 2 |
| Total | **16** | 18 |
| Federal and state income taxes | **$ 152** | $ 154 |

The Company is included in the NGNA and subsidiaries consolidated federal income tax return. The Company has joint and several liability for any potential assessments against the consolidated group. The Company also files unitary, combined and separate state income tax returns.

In September 2013, the U.S. Department of the Treasury issued final tangible property regulations which provide guidance for the application of IRC §162(a) and IRC §263(a) to amounts paid to acquire, produce, or improve tangible property. In August 2014, the U.S. Department of the Treasury also finalized the depreciable property disposition regulations. Both sets of regulations become effective for tax years beginning on or after January 1, 2014, which, for the Company, is the fiscal year ended March 31, 2015. The Company intends to adopt these regulations with its fiscal year 2015 federal tax return and has estimated a favorable §481(a) adjustment of $19 million related to dispositions of depreciable property and an unfavorable 481(a) adjustment of $2 million related to repairs deduction following casualty loss.

On July 24, 2013, the Massachusetts legislature enacted into law transportation finance legislation which included significant tax changes affecting the classification of utility corporations. For tax years beginning on or after January 1, 2014, Massachusetts utility corporations will be taxed in the same manner as general business corporations. The state income tax rate increased from 6.5% to 8%. Also, any unitary net operating loss generated post-2013 and allocated to the utilities will be allowed as a carryforward tax attribute. As of March 31, 2014, all Massachusetts state deferred tax balances at the regulated utilities were remeasured to the 8% rate, resulting in an increase in deferred tax liabilities by $17.4 million with an offset to the regulatory deferred tax asset.

On March 31, 2014, New York's legislature enacted as part of the 2014-15 budget package legislation which included significant tax changes. For tax years beginning on or after January 1, 2016, the New York corporate franchise rate is reduced from 7.1% to 6.5%. Additionally, for tax years beginning on or after January 1, 2015, New York State will generally require combined reporting if the taxpayer is engaged in a unitary business and a 50% common ownership test is met. As of March 31, 2014, the Company remeasured its New York State deferred tax assets and liabilities based upon the enacted law that will apply when the corresponding state temporary differences are expected to be realized or settled. Specifically to reflect the decrease in tax rate, the Company decreased its New York State deferred tax liability by $11.1 million with an offset of $14 million to regulatory liability and $2.9 million to income tax expense. During the year ended March 31, 2015, the Company updated the impact of the tax rate change and adjusted its New York State deferred tax liability by $2.2 million with an offset of $1 million to regulatory liabilities and $1.2 million to income tax benefit.

**Deferred Tax Components**

| | March 31, | |
|---|---|---|
| | **2015** | 2014 |
| | *(in millions of dollars)* | |
| **Deferred tax assets:** | | |
| Environmental remediation costs | **$ 317** | $ 293 |
| Future federal benefit on state taxes | **105** | 104 |
| Net operating losses | **335** | 141 |
| Postretirement benefits and other employee benefits | **499** | 603 |
| Regulatory liabilities - other | **226** | 242 |
| Other items | **135** | 81 |
| Total deferred tax assets [1] | **1,617** | 1,464 |
| | | |
| **Deferred tax liabilities:** | | |
| Property related differences | **2,366** | 2,136 |
| Regulatory assets - environmental response costs | **484** | 462 |
| Regulatory assets - postretirement benefits | **198** | 262 |
| Other items | **427** | 461 |
| Total deferred tax liabilities | **3,475** | 3,321 |
| | | |
| Net deferred income tax liabilities | **1,858** | 1,857 |
| Deferred investment tax credits | **3** | 4 |
| Net deferred income tax liabilities and investment tax credits | **1,861** | 1,861 |
| Current portion of deferred income tax assets, net | **(57)** | (20) |
| **Deferred income tax liabilities, net** | **$ 1,918** | $ 1,881 |

[1] There were no valuation allowances for deferred tax assets at March 31, 2015 or 2014.

The following table presents the amounts and expiration dates of net operating losses as of March 31, 2015:

| Expiration of net operating losses: | Federal | State of New York | City of New York |
|---|---|---|---|
| | | *(in millions of dollars)* | |
| 3/31/2029 | $ 108 | $ - | $ - |
| 3/31/2030 | 41 | - | - |
| 3/31/2032 | 59 | - | - |
| 3/31/2033 | 352 | - | - |
| 3/31/2034 | 188 | - | - |
| 3/31/2035 | 255 | 1,019 | 255 |

**Unrecognized Tax Benefits**

As of March 31, 2015 and 2014, the Company’s unrecognized tax benefits totaled $287 million and $281 million, respectively, of which $49 million in each of the years would affect the effective tax rate, if recognized. The unrecognized tax benefits are included in other non-current liabilities in the accompanying consolidated balance sheets.

The following table presents changes to the Company's unrecognized tax benefits:

| | Years Ended March 31, | |
|---|---|---|
| | **2015** | 2014 |
| | *(in millions of dollars)* | |
| Balance as of the beginning of the year | **$ 281** | $ 435 |
| Gross increases - tax positions in prior periods | **4** | 40 |
| Gross decreases - tax positions in prior periods | **(29)** | (79) |
| Gross increases - current period tax positions | **31** | 45 |
| Settlements with tax authorities | **-** | (160) |
| Balance as of the end of the year | **$ 287** | $ 281 |

As of March 31, 2015 and 2014, the Company has accrued for interest related to unrecognized tax benefits of $28 million and $40 million, respectively. During the years ended March 31, 2015 and 2014, the Company recorded interest expense of $5 million and $15 million, respectively. The Company recognizes interest related to unrecognized tax benefits in other interest, including affiliate interest, if applicable, in other income, net, in the accompanying consolidated statements of income. No tax penalties were recognized during the years ended March 31, 2015 or 2014.

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.

During the year ended March 31, 2014, the IRS concluded its examination of the NGNA consolidated filing group's corporate income tax returns, which includes corporate income tax returns of KeySpan Corporation and subsidiaries for the short period ended August 24, 2007, and of NGNA and subsidiaries for the periods ended March 31, 2008 and 2009. These examinations were completed on March 27, 2014 and March 31, 2014, respectively, with an agreement on the majority of income tax issues for the years referenced above, as well as an acknowledgment that certain discrete items remain disputed. NGNA is in the process of appealing these disputed issues with the IRS Office of Appeals. The Company does not anticipate a change in its unrecognized tax positions in the next twelve months as a result of the appeals. However, pursuant to the Company's tax sharing agreement, the audit or appeals may result in a change to allocated tax. The tax returns for the years ended March 31, 2010 through March 31, 2015 remain subject to examination by the IRS.

The Company is a member of the NGUSA Service Company Massachusetts unitary group since the fiscal year ended March 31, 2010. The tax returns for the fiscal years ended March 31, 2010 through March 31, 2015 remain subject to examination by the State of Massachusetts.

The state of New York is in the process of examining the Company's New York State income tax returns for KeySpan Gas East for the period January 1, 2003 through March 31, 2008, and for Brooklyn Union for the period January 1, 2007 through March 31, 2008. The tax returns for the years ended March 31, 2009 through March 31, 2015 remain subject to examination by the state of New York.

New York State and New York City are in the process of an examining the returns of KeySpan Corporation and subsidiaries for the period January 1, 2003 through March 31, 2008 and January 1, 2003 through December 31, 2005, respectively.

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

| Jurisdiction | Tax Year |
|---|---|
| Federal | August 24, 2007 * |
| Massachusetts | March 31, 2010 |
| New York | December 31, 2003 |
| New York City | December 31, 2003 |

*The KeySpan consolidated filing group for the tax year ended August 24, 2007 and the NGNA consolidated filing group for the fiscal years ended March 31, 2008 and 2009, are in the process of appealing certain disputed issues with the IRS Office of Appeals.

## 12. ENVIRONMENTAL MATTERS

The normal ongoing operations and historic activities of the Company are subject to various federal, state and local environmental laws and regulations. Under federal and state Superfund laws, potential liability for the historic contamination of property may be imposed on responsible parties jointly and severally, without regard to fault, even if the activities were lawful when they occurred.

### Air

Genco's generating facilities are subject to increasingly stringent emissions limitations under current and anticipated future requirements of the United States Environmental Protection Agency and the New York State Department of Environmental Conservation ("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. Genco's previous investments in low NOx 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 Genco to achieve its prior emission reductions in a cost-effective manner. Recently completed investments include the installation of enhanced NOx controls and efficiency improvement projects at certain of Genco's Long Island based electric generating facilities. The total cost of these improvements was approximately $103 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. Genco 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, Genco 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 Genco's power plants will likely be required by the DEC at each of the Long Island power plants pursuant to Section 316 of the Clean Water Act to mitigate the plants' alleged cooling water system impacts to aquatic organisms. Genco is currently engaged in discussions with the DEC and environmental groups regarding the nature of capital upgrades or other mitigation measures necessary to reduce any impacts. Although these discussions have been productive and have led to mutually agreeable final permits at some of the plants, it is possible that the determination of required capital improvements and the issuance of final renewal permits for the remaining plants could involve adjudicatory hearings among Genco, the agency, and the environmental groups. Capital costs for expected mitigation requirements at the plants had been estimated at approximately $76 million and do not anticipate a need for cooling towers at any of the plants. Depending on the outcome of the adjudicatory process, which could extend beyond the next fiscal year, ultimate costs could be substantially higher. Costs associated with any finally ordered capital improvements would be reimbursable from LIPA under the PSA.

### Land, Manufactured Gas Plants and Related Facilities

Within the Company's service areas, the Company has identified numerous MGP sites and related facilities, which were owned or operated by the Company or its predecessors. These former sites, some of which are no longer owned by the Company, have been identified to the NYPSC and the DEC for inclusion on appropriate site inventories. Administrative

Consent Orders or Voluntary Cleanup Agreements have been executed with the DEC to address the investigation and remediation activities associated with certain sites. The Company is also aware of numerous former MGP sites and related facilities within the existing or former service territories of the Company in the Commonwealth of Massachusetts.

Expenditures incurred for the years ended March 31, 2015 and 2014 were $61 million and $72 million, respectively.

Upon acquisition by NGUSA, the Company recognized its environmental liabilities at fair value. The fair values included discounting of the reserve, which is being accreted over the period for which remediation is expected to occur. Following the acquisition, these environmental liabilities are recognized in accordance with the current accounting guidance for environmental obligations.

The Company estimated the remaining costs of environmental remediation activities were $650 million and $654 million at March 31, 2015 and 2014, respectively. The Company's environmental obligation is discounted at a rate of 6.5%; the undiscounted amount of environmental liabilities at March 31, 2015 and 2014 was $801 million and $799 million, respectively. These costs are expected to be incurred over approximately 56 years, and the discounted amounts have been recorded as reserves in the accompanying consolidated balance sheets. However, remediation costs for each site may be materially higher than estimated, depending on changing technologies and regulatory standards, selected end use for each site, and actual environmental conditions encountered. The Company has recovered amounts from certain insurers, and, where appropriate, the Company may seek recovery from other insurers and from other potentially responsible parties, but it is uncertain whether, and to what extent, such efforts will be successful.

Through various rate orders issued by the NYPSC and DPU, the majority of costs related to MGP environmental cleanup activities are recovered in rates charged to gas distribution customers. Accordingly, the Company has reflected a regulatory asset of $1.1 billion on the consolidated balance sheets at March 31, 2015 and 2014.

**Non-Utility Sites**

The Company is aware of numerous non-utility sites for which it may have, or share, environmental remediation or ongoing maintenance responsibility. Expenditures incurred were approximately zero and $1 million for the years ended March 31, 2015 and 2014, respectively. The Company presently estimates the remaining cost of the environmental cleanup activities for these non-utility sites will be approximately $23 million and $22 million, which has been accrued at March 31, 2015 and 2014, respectively. The Company's environmental obligation is net of a discount rate of 6.5%, and the undiscounted amount totaled $29 million and $27 million in liabilities as of March 31, 2015 and 2014, respectively. The Company believes this to be a reasonable estimate of probable costs for known sites; however, remediation costs for each site may be materially higher than noted, depending upon changing technologies and regulatory standards, selected end use for each site, and actual environmental conditions encountered.

The Company believes that in the aggregate, the accrued liability for all of the sites and related facilities identified above are reasonable estimates of the probable cost for the investigation and remediation of these sites and facilities. As circumstances warrant, the Company periodically re-evaluates the accrued liabilities associated with MGP sites and related facilities. The Company may be required to investigate and, if necessary, remediate each site previously noted, or other currently unknown former sites and related facility sites, the cost of which is not presently determinable.

The Company believes that its ongoing operations, and its approach to addressing conditions at historic sites, are in substantial compliance with all applicable environmental laws, and that the obligations imposed on it because of the environmental laws will not have a material impact on its results of operations or financial position since, as noted above, environmental expenditures incurred by the Company are generally recoverable from customers.

## 13. COMMITMENTS AND CONTINGENCIES

### Operating Lease Obligations

The Company has various operating leases for buildings, office equipment, vehicles and power operating equipment utilized by both the Company and its affiliates. Additionally, a portion of the Company's affiliates' lease expense is allocated to the Company according to usage. Total rental expense for operating leases included in operations and maintenance expense in the accompanying consolidated statements of income was $64.4 million and $84.9 million for the years ended March 31, 2015 and 2014, respectively.

The future minimum lease payments for the years subsequent to March 31, 2015 are as follows:

| *(in millions of dollars)* Years Ending March 31, | | |
|---|---|---|
| 2016 | $ | 71 |
| 2017 | | 71 |
| 2018 | | 72 |
| 2019 | | 58 |
| 2020 | | 31 |
| Thereafter | | 158 |
| Total | $ | 461 |

### Purchase Commitments

The Company and its subsidiaries have entered into various contracts for gas delivery, storage and supply services. Certain of these contracts require payment of annual demand charges. The Company's gas distribution subsidiaries are liable for these payments regardless of the level of services required from third-parties. Such charges are currently recovered from customers as gas costs. In addition, the Company has various capital commitments related to the construction of property, plant and equipment.

The Company's commitments under these long-term contracts for the years subsequent to March 31, 2015 are summarized in the table below:

| *(in millions of dollars)* Years Ending March 31, | | Gas Purchases | | Capital Expenditures |
|---|---|---|---|---|
| 2016 | $ | 649 | $ | 104 |
| 2017 | | 580 | | 55 |
| 2018 | | 484 | | 61 |
| 2019 | | 353 | | 45 |
| 2020 | | 275 | | 30 |
| Thereafter | | 1,306 | | - |
| Total | $ | 3,647 | $ | 295 |

**Financial Guarantees**

The Company has issued financial guarantees in the normal course of business, on behalf of its subsidiaries, to various third-party creditors. At March 31, 2015, the following amounts would have to be paid by the Company in the event of non-payment by the primary obligor at the time payment is due:

| Guarantees for Subsidiaries: | | Amount of Exposure | Expiration Dates |
|---|---|---|---|
| | | *(in millions of dollars)* | |
| Industrial Development Revenue Bonds | (i) | $ 128 | June 2027 |
| Surety Bonds | (ii) | 80 | Revolving |
| Commodity Guarantees and Other | (iii) | 33 | November 2027 - June 2032 |
| Letters of Credit | (iv) | 77 | July 2015 - December 2015 |
| NY Transco Parent Guaranty | (v) | 842 | None |
| | | $ 1,160 | |

The following is a description of the Company's outstanding subsidiary guarantees:

(i) The Company has fully and unconditionally guaranteed the payment obligations of its subsidiaries with regard to $128 million of Industrial Development Revenue Bonds issued through the Nassau County and Suffolk County Industrial Development Authorities for the construction of two electric-generation peaking plants on Long Island, New York. The face value of these notes is included in long-term debt in the accompanying consolidated balance sheets.

(ii) The Company has agreed to indemnify the issuers of various surety bonds associated with various construction requirements or projects of its subsidiaries. In the event that the Company or its subsidiaries fail to perform their obligations under contracts, the injured party may demand that the surety make payments or provide services under the bond. The Company would then be obligated to reimburse the surety for any expenses or cash outlays it incurs.

(iii) The Company has guaranteed commodity-related payments for certain subsidiaries. These guarantees are provided to third-parties to facilitate physical and financial transactions involved in the purchase and transportation of natural gas, oil and other petroleum products for gas and electric production and marketing activities. The guarantees cover actual purchases by these subsidiaries that are still outstanding as of March 31, 2015.

(iv) The Company has arranged for stand-by letters of credit to be issued to third-parties that have extended credit to certain subsidiaries. Certain vendors require the posting of letters of credit to guarantee subsidiary performance under the Company's contracts and to ensure payment to the Company's subsidiary subcontractors and vendors under those contracts. Certain of the Company's vendors also require letters of credit to ensure reimbursement for amounts they are disbursing on behalf of the Company's subsidiaries, such as to beneficiaries under the Company's self-funded insurance programs. Such letters of credit are generally issued by a bank or similar financial institution. The letters of credit commit the issuer to pay specified amounts to the holder of the letter of credit if the holder demonstrates that the Company has failed to perform specified actions. If this were to occur, the Company would be required to reimburse the issuer of the letter of credit.

(v) The Company has entered into a Parent Guaranty (the "Guaranty") dated November 14, 2014 for the benefit of NY Transco LLC, which Guaranty irrevocably and unconditionally guarantees all of Grid NY LLC's payment obligations under the New York Transco Limited Liability Company Agreement ("NY Transco LLC Agreement") dated November 14, 2014 entered into by and among Consolidated Edison Transmission, LLC, Grid NY LLC, Iberdrola USA Networks, NY Transco, LLC and Central Hudson Electric Transmission LLC. Grid NY LLC's payment obligations relate to, but are

not limited to, funding project development of the initial projects, obtaining initial regulatory approvals and making capital contributions as set forth in the LLC Agreement.

As of the date of this report, the Company has not had a claim made against it for any of the above guarantees and has no reason to believe that the Company's subsidiaries or former subsidiaries will default on their current obligations. However, the Company cannot predict when, or if, any defaults may take place or the impact any such defaults may have on its consolidated results of operations, financial position, or cash flows.

**Legal Matters**

The Company is subject to various legal proceedings, primarily injury claims, 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.

**Electric Services and LIPA Agreements**

Effective May 28, 2013, Genco provides services to LIPA under an amended and restated PSA. Under the PSA, Genco has a revenue requirement of $418.6 million, a ROE of 9.75% and a capital structure of 50% debt and 50% equity. The 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. Genco accounts for the PSA as an operating lease.

The PSA provides potential penalties to Genco 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 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. Genco must, therefore, operate its generating facilities in a manner such that the Company can remain competitive with other producers of energy. To date, Genco 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 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. A monthly variable maintenance charge is billed for each unit of energy actually acquired from the generating facilities. The billings to LIPA under the PSA do not include a provision for fuel costs, as such fuel is owned by LIPA.

In June 2011, LIPA and Genco executed an amendment to the then-current PSA pursuant to which the parties agreed that LIPA would reduce purchases of capacity from specified generating facilities, specifically the Glenwood and Far Rockaway, New York steam facilities. The Company has retired these generating facilities and removed them from the PSA and is in the process of dismantling these facilities. As part of this amendment, Genco paid an Economic Equivalent Payment ("EEP") of $18 million which represented the economic benefit to LIPA which would have been realized under the original agreement. Half of the EEP was paid on July 3, 2012, with the remaining balance on May 28, 2013. The EEP was accrued on a straight-line basis over the 24-month term, from June 2011 through May 2013, as a reduction in operating revenues.

Pursuant to the EMA, the Company procured and managed fuel supplies for LIPA to fuel the Company's Long Island based generating facilities. In exchange for these services, the Company earned an annual fee of $750,000. The EMA expired on May 28, 2013. LIPA did not renew the EMA contract with the Company.

**SuperStorm Sandy**

In October 2012, SuperStorm Sandy hit the northeastern U.S. affecting energy supply to customers in the Company's service territory. Total costs associated with gas customer service restoration from this storm (including capital expenditures) through March 31, 2014 were approximately $204.1 million for the New York Gas Companies.

The Company had recorded an “other receivable” in the accompanying consolidated balance sheets in the amount of $58 million as of March 31, 2014, relating to claims filed against its property damage insurance policy, net of insurance deductibles, allowances, and advance payments received. In December 2014, NGUSA reached a final settlement with its insurers of which the Company’s allocated portion was $154.2 million (inclusive of advance payments of $83.4 million), and received final payment for the remaining amounts due. This resulted in the Company recognizing a gain of $11.1 million for the year ended March 31, 2015, recorded as a reduction to operations and maintenance expense in the accompanying consolidated statements of income.

## 14. RELATED PARTY TRANSACTIONS

### Accounts Receivable from and Accounts Payable to Affiliates

The Company engages in various transactions with NGUSA and its subsidiaries. Certain activities and costs, primarily executive and administrative and some human resources, legal, and strategic planning are shared between the Company and NGUSA. At March 31, 2015 and 2014, the Company had net receivable balances from NGUSA subsidiaries of $928 million and $551 million, respectively.

### Advances to Affiliate

In January 2008, the Company and NGUSA entered into an agreement whereby either party can borrow up to $2.5 billion from time to time for working capital needs. These advances do not bear interest. At March 31, 2015 and 2014, the Company had outstanding advances to affiliate of $2.1 billion and $2 billion, respectively.

### Intercompany Money Pool

The settlement of the Company’s various transactions with NGUSA and certain affiliates generally occurs via the Regulated and Unregulated Money Pools. The Company, as a participant in both Money Pools, can both borrow and invest funds. Borrowings from the Regulated and Unregulated Money Pools bear interest in accordance with the terms of the applicable money pool agreement. All changes in the intercompany money pool balances and accounts receivable from affiliates and accounts payable to affiliates balances are reflected as investing or financing activities in the accompanying consolidated statements of cash flows. In addition, for the purpose of presentation in the consolidated statement of cash flows, it is assumed all amounts settled through intercompany money pool are constructive receipts and payments, and therefore are presented as such.

The Regulated and Unregulated Money Pools are funded by operating funds from participants in the applicable pool. Collectively, the Company and NGUSA have the ability to borrow up to $3 billion from National Grid plc for working capital needs including funding of the Money Pools, if necessary.

The following table provides information about the Company's Regulated and Unregulated Money Pools:

| | March 31 | |
|---|---|---|
| | **2015** | 2014 |
| | *(in millions of dollars)* | |
| **Assets:** | | |
| Regulated Money Pool | **$ 174** | $ 194 |
| Unregulated Money Pool | **1,438** | 1,248 |
| Total | **$ 1,612** | $ 1,442 |
| **Liabilities:** | | |
| Regulated Money Pool | **$ 1,179** | $ 1,011 |
| Unregulated Money Pool | **1,262** | 1,410 |
| Total | **$ 2,441** | $ 2,421 |

**Capitalization of Affiliates**

In October 2012, the Company and NGUSA's service company entered into an agreement whereby the Company transferred to NGUSA's service company $313 million of debt as part of the merger of two service companies that the Company previously owned. In addition, the Company advanced $82 million in cash to NGUSA's service company. The Company has accounted for this transaction as a capitalization of the service companies' merger and has reflected these amounts as a reduction of the Company's additional paid-in capital. Dividends are to be paid semi-annually at a rate of 3.3%. During each of the years ended March 31, 2015 and 2014, $10.3 million of dividends from NGUSA's service company have been recorded in other interest, including affiliate interest in the accompanying consolidated statements of income.

**Loan to Affiliate**

In December 2009, the Company and an affiliate of NGUSA entered into a loan agreement whereby the Company loaned the affiliate $80 million at an interest rate of 5.8%, due April 2035. The loan was issued for the purpose of the Company providing an investment in information systems technology which is being utilized by the Company and its subsidiaries. At March 31, 2015 and 2014, the outstanding balance on this loan was $80 million.

**Holding Company Charges**

NGUSA received charges from National Grid Commercial Holdings Limited (an affiliated company in the U.K.) for certain corporate and administrative services provided by the corporate functions of National Grid plc to its U.S. subsidiaries. These charges, which are recorded on the books of NGUSA, have not been reflected in these consolidated financial statements. The estimated effect on net income would be $15.8 million and $17 million before taxes and $9.5 million and $11 million after taxes, for the years ended March 31, 2015 and 2014, respectively, if these amounts were allocated to the Company.

## 15. DISCONTINUED OPERATIONS

On December 15, 2011, LIPA announced that it was not renewing the MSA contract beyond its expiration on December 31, 2013. The loss of the contract resulted in 1,950 employees transferring to a new employer. The results of the MSA are reflected as discontinued operations in the accompanying consolidated financial statements for the years ended March 31, 2015 and 2014.

Following the expiration of the MSA, the Company entered into a Settlement and Release Agreement ("SRA") with LIPA. Under the terms of this SRA, LIPA (1) fully released the Company from its obligations under certain promissory notes payable to LIPA, and (2) agreed to make a one-time lump sum payment to the Company of $91.5 million. In return, during the year ended March 31, 2014, the Company fully released LIPA from certain claims for reimbursement of pension and

PBOP costs. As a result, the Company recorded a gain of approximately $231 million, primarily related to the extinguishment of debt and recognition of a receivable for the lump sum cash payment during the year ended March 31, 2014.

In addition, during the year ended March 31, 2014, a $97 million net settlement gain and a $43 million net curtailment gain were recognized for the employees who transferred to a new employer. The new employer had assumed responsibility for the transferred employees' obligations under the PBOP.

The reconciliation below highlights the financial statements line items within income from discontinued operations, net of taxes for the MSA for the years ended March 31, 2015 and 2014:

| | **Years Ended March 31,** | |
|---|---|---|
| | **2015** | 2014 |
| | *(in millions of dollars)* | |
| Operating revenues | **$ 3** | $ 449 |
| Operations and maintenance | **(3)** | (560) |
| Other expenses | **(2)** | (19) |
| Loss before income taxes | **(2)** | (130) |
| Gain on disposal of discontinued operations | **-** | 371 |
| Total (loss) income before income taxes | **(2)** | 241 |
| Income tax (benefit) expense | **(2)** | 100 |
| **Income from discontinued operations, net of taxes** | **$ -** | $ 141 |

The reconciliation below highlights the carrying values of assets and liabilities related to discontinued operations that are disclosed in the accompanying consolidated balance sheets for the MSA at March 31, 2015 and 2014:

| | **March 31,** | |
|---|---|---|
| | **2015** | 2014 |
| | *(in millions of dollars)* | |
| **Assets** | | |
| Accounts receivable | **$ 100** | $ 206 |
| Allowance for doubtful accounts | **(70)** | (70) |
| Accounts receivable from affiliates | **171** | 221 |
| Unbilled revenues | **11** | 16 |
| Deferred income tax assets | **29** | 29 |
| Other | **-** | 1 |
| Total assets related to discontinued operations | **$ 241** | $ 403 |
| **Liabilities** | | |
| Accounts payable | **$ 19** | $ 9 |
| Accounts payable to affiliates | **75** | 183 |
| Intercompany money pool | **576** | 487 |
| Taxes accrued | **-** | 2 |
| Other | **-** | 8 |
| Total liabilties related to discontinued operations | **$ 670** | $ 689 |