

**Boston Gas Company**  
**d/b/a National Grid**

Financial Statements

For the years ended March 31, 2015 and 2014

**BOSTON GAS COMPANY**

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## Independent Auditor's Report

To the Board of Directors  
of Boston Gas Company

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

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

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

### ***Auditor's Responsibility***

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on 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 financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Boston Gas Company at March 31, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*PricewaterhouseCoopers LLP*

August 13, 2015

**BOSTON GAS COMPANY**  
**STATEMENTS OF INCOME**  
*(in thousands of dollars)*

	<b>Years Ended March 31,</b>	
	<b>2015</b>	<b>2014</b>
<b>Operating revenues</b>	<b>\$ 1,297,517</b>	<b>\$ 1,270,458</b>
<b>Operating expenses:</b>		
Purchased gas	569,512	597,646
Operations and maintenance	428,783	401,301
Depreciation and amortization	131,408	121,954
Other taxes	57,491	48,576
Total operating expenses	<b>1,187,194</b>	<b>1,169,477</b>
<b>Operating income</b>	<b>110,323</b>	<b>100,981</b>
<b>Other income and (deductions):</b>		
Interest on long-term debt	(32,999)	(33,576)
Other interest, including affiliate interest	(2,290)	10,082
Other (deductions) income, net	(3,438)	5,303
Total other deductions, net	<b>(38,727)</b>	<b>(18,191)</b>
<b>Income before income taxes</b>	<b>71,596</b>	<b>82,790</b>
<b>Income tax expense</b>	<b>29,190</b>	<b>31,999</b>
<b>Net income</b>	<b>\$ 42,406</b>	<b>\$ 50,791</b>

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

**BOSTON GAS COMPANY**  
**STATEMENTS OF COMPREHENSIVE INCOME**  
*(in thousands of dollars)*

	<b>Years Ended March 31,</b>	
	<b>2015</b>	<b>2014</b>
<b>Net income</b>	<b>\$ 42,406</b>	<b>\$ 50,791</b>
<b>Other comprehensive income (loss):</b>		
Unrealized gains (losses) on securities	7	(6)
Total other comprehensive income (loss)	7	(6)
<b>Comprehensive income</b>	<b>\$ 42,413</b>	<b>\$ 50,785</b>
<b>Related tax (expense) benefit:</b>		
Unrealized gains (losses) on securities	\$ (5)	\$ 4
Total tax (expense) benefit	\$ (5)	\$ 4

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

**BOSTON GAS COMPANY**  
**STATEMENTS OF CASH FLOWS**  
*(in thousands of dollars)*

	Years Ended March 31,	
	2015	2014
<b>Operating activities:</b>		
Net income	\$ 42,406	\$ 50,791
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	131,408	121,954
Provision for deferred income taxes	8,888	16,736
Bad debt expense	33,109	17,441
Allowance for equity funds used during construction	595	(1,737)
Net postretirement benefits (contributions) expense	(6,927)	1,026
Net environmental remediation payments	(3,676)	(7,176)
Changes in operating assets and liabilities:		
Accounts receivable and other receivable, net, and unbilled revenues	(34,183)	(88,687)
Inventory	(10,313)	25,806
Regulatory assets and liabilities, net	55,474	(3,419)
Derivative contracts	7,063	12,273
Prepaid and accrued taxes	7,273	34,732
Accounts payable and other liabilities	(69,222)	87,645
Other, net	(435)	986
Net cash provided by operating activities	<u>161,460</u>	<u>268,371</u>
<b>Investing activities:</b>		
Capital expenditures	(292,044)	(244,495)
Cost of removal	(20,126)	(20,399)
Net cash used in investing activities	<u>(312,170)</u>	<u>(264,894)</u>
<b>Financing activities:</b>		
Payments on long-term debt	(2,000)	(10,000)
Payments on capital lease obligation	-	(1,562)
Affiliated money pool borrowing and receivables/payables, net	155,210	7,826
Net cash provided by (used in) financing activities	<u>153,210</u>	<u>(3,736)</u>
Net increase (decrease) in cash and cash equivalents	2,500	(259)
Cash and cash equivalents, beginning of year	-	259
Cash and cash equivalents, end of year	<u>\$ 2,500</u>	<u>\$ -</u>
<b>Supplemental disclosures:</b>		
Interest paid	\$ (36,539)	\$ (33,867)
Taxes (paid to) refunded from Parent	(6,629)	10,809
<b>Significant non-cash items:</b>		
Capital-related accruals included in accounts payable	31,469	18,251

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

**BOSTON GAS COMPANY**  
**BALANCE SHEETS**  
*(in thousands of dollars)*

	March 31,	
	2015	2014
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 2,500	\$ -
Accounts receivable	326,427	301,073
Allowance for doubtful accounts	(43,755)	(29,954)
Accounts receivable from affiliates	2,941	77,168
Unbilled revenues	70,683	81,162
Inventory	50,662	40,349
Regulatory assets	126,112	144,541
Derivative contracts	59	4,549
Current portion of deferred income tax assets, net	6,350	-
Prepaid taxes	574	537
Other	68	132
Total current assets	542,621	619,557
<b>Property, plant, and equipment, net</b>	<b>2,491,337</b>	2,256,200
<b>Other non-current assets:</b>		
Regulatory assets	180,658	177,893
Accounts receivable from affiliates	4,792	6,983
Goodwill	396,322	396,322
Derivative contracts	-	112
Other	5,618	5,863
Total other non-current assets	587,390	587,173
<b>Total assets</b>	<b>\$ 3,621,348</b>	\$ 3,462,930

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

**BOSTON GAS COMPANY**  
**BALANCE SHEETS**  
*(in thousands of dollars)*

	March 31,	
	2015	2014
<b>LIABILITIES AND CAPITALIZATION</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 58,800	\$ 126,526
Accounts payable to affiliates	43,687	99,242
Current portion of long-term debt	10,000	2,000
Taxes accrued	21,059	16,926
Customer deposits	3,198	3,486
Interest accrued	8,249	9,904
Regulatory liabilities	75,494	55,523
Intercompany money pool	255,969	121,622
Derivative contracts	11,765	11,010
Current portion of deferred income tax liabilities, net	-	24,954
Other	26,168	23,028
Total current liabilities	514,389	494,221
<b>Other non-current liabilities:</b>		
Regulatory liabilities	549,563	506,565
Asset retirement obligations	15,037	15,510
Deferred income tax liabilities, net	450,075	404,727
Postretirement benefits	97,914	85,886
Environmental remediation costs	39,499	43,635
Derivative contracts	1,729	23
Other	32,143	23,777
Total other non-current liabilities	1,185,960	1,080,123
<b>Commitments and contingencies (Note 12)</b>		
<b>Capitalization:</b>		
Shareholder's equity	1,299,999	1,257,586
Long-term debt	621,000	631,000
<b>Total capitalization</b>	1,920,999	1,888,586
<b>Total liabilities and capitalization</b>	\$ 3,621,348	\$ 3,462,930

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



**BOSTON GAS COMPANY**  
**STATEMENTS OF CAPITALIZATION**  
*(in thousands of dollars)*

			March 31,	
			2015	2014
<b>Total shareholder's equity</b>			<b>\$ 1,299,999</b>	<b>\$ 1,257,586</b>
<b>Long-term debt:</b>				
	Interest Rate	Maturity Date		
<i>Unsecured notes:</i>				
Senior Note	4.49%	February 15, 2042	<b>500,000</b>	500,000
<i>Medium Term Notes ("MTN")</i>				
MTN Series 1994 B	8.50%	October 24, 2014	-	2,000
MTN Series 1995 C	7.10%	October 15, 2015	<b>5,000</b>	5,000
MTN Series 1994 B	6.93%	January 15, 2016	<b>5,000</b>	5,000
MTN Series 1994 B	6.93%	April 1, 2016	<b>10,000</b>	10,000
MTN Series 1992 A	8.33%	July 10, 2017	<b>8,000</b>	8,000
MTN Series 1992 A	8.33%	July 10, 2018	<b>10,000</b>	10,000
MTN Series 1994 B	6.93%	January 15, 2019	<b>10,000</b>	10,000
MTN Series 1989 A	8.97%	December 15, 2019	<b>7,000</b>	7,000
MTN Series 1990 A	9.75%	December 1, 2020	<b>5,000</b>	5,000
MTN Series 1990 A	9.05%	September 1, 2021	<b>15,000</b>	15,000
MTN Series 1992 A	8.33%	July 5, 2022	<b>10,000</b>	10,000
MTN Series 1995 C	6.95%	December 1, 2023	<b>10,000</b>	10,000
MTN Series 1994 B	6.98%	January 15, 2024	<b>6,000</b>	6,000
MTN Series 1995 C	6.95%	December 1, 2024	<b>5,000</b>	5,000
MTN Series 1995 C	7.25%	October 1, 2025	<b>20,000</b>	20,000
MTN Series 1995 C	7.25%	October 1, 2025	<b>5,000</b>	5,000
Total debt			<b>131,000</b>	133,000
Current portion of long-term debt			<b>(10,000)</b>	(2,000)
Long-term debt			<b>621,000</b>	631,000
<b>Total capitalization</b>			<b>\$ 1,920,999</b>	<b>\$ 1,888,586</b>

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

**BOSTON GAS COMPANY**  
**STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY**  
*(in thousands of dollars)*

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)		Retained Earnings	Total
			Unrealized Gain (Loss) on Available for Sale Securities	Total Accumulated Other Comprehensive Income (Loss)		
<b>Balance as of March 31, 2013</b>	\$ 51,418	\$ 962,872	\$ 80	\$ 80	\$ 192,633	\$ 1,207,003
Net income	-	-	-	-	50,791	50,791
Other comprehensive loss						
Unrealized losses on securities, net of \$4 tax benefit	-	-	(6)	(6)	-	(6)
Total comprehensive income						50,785
Share based compensation	-	(202)	-	-	-	(202)
<b>Balance as of March 31, 2014</b>	\$ 51,418	\$ 962,670	\$ 74	\$ 74	\$ 243,424	\$ 1,257,586
Net income	-	-	-	-	42,406	42,406
Other comprehensive income						
Unrealized gains on securities, net of \$5 tax expense	-	-	7	7	-	7
Total comprehensive income						42,413
<b>Balance as of March 31, 2015</b>	<u>\$ 51,418</u>	<u>\$ 962,670</u>	<u>\$ 81</u>	<u>\$ 81</u>	<u>\$ 285,830</u>	<u>\$ 1,299,999</u>

The Company had 514,184 shares of common stock authorized, issued and outstanding, with a par value of \$100 per share at March 31, 2015 and 2014.

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

**BOSTON GAS COMPANY**  
**NOTES TO THE FINANCIAL STATEMENTS**

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

Boston Gas Company d/b/a National Grid (“the Company”) is a gas distribution company engaged in the transportation and sale of natural gas to approximately 656,000 residential, commercial and industrial customers in the City of Boston, Essex County, and other communities in eastern and central Massachusetts.

The Company is an indirect wholly-owned subsidiary of KeySpan Corporation (“KeySpan” or the “Parent”). 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.

The accompanying 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. The financial statements reflect the ratemaking practices of the applicable regulatory authorities.

In 2014, Management recorded out-of-period adjustments that resulted in net reductions of net income of \$3.3 million. The adjustments primarily related to the correction of operations and maintenance expense and a capital tracker regulatory asset deferral. Further, in the current fiscal year, Management recorded out-of-period adjustments that resulted in a net increase to net income of \$1.6 million. The adjustments primarily related to the correction of a regulatory asset deferral impacting purchased gas, partially offset by errors in operating revenues and operations and maintenance expense. Management concluded that the impact of recording these adjustments was not material to the current fiscal year or any prior period.

The Company has evaluated subsequent events and transactions through August 13, 2015, the date of issuance of these financial statements, and concluded that there were no events or transactions that require adjustment to, or disclosure in, the financial statements as of and for the year ended March 31, 2015.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Use of Estimates**

In preparing 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 financial statements. Actual results could differ from those estimates.

**Regulatory Accounting**

The Massachusetts Department of Public Utilities (“DPU”) regulates the rates the Company charges its customers. In certain cases, the rate actions of the DPU can result in accounting that differs from non-regulated companies. In these cases, the Company defers costs (as regulatory assets) or recognizes 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 statements of income consistent with the treatment of the related costs in the ratemaking process.

## **Revenue Recognition**

Revenues are recognized for gas distribution services provided on a monthly billing cycle basis. The Company 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 DPU has approved a Revenue Decoupling Mechanism ("RDM"), which requires the Company to adjust its base rates semi-annually to reflect the over or under recovery of the Company's targeted base distribution revenues from the prior peak (November – April) and off-peak (May – October) seasons.

The Company's tariff includes a cost of gas adjustment factor ("CGAF") which requires the Company to adjust rates semi-annually or, based on certain criteria, adjust rates monthly for firm gas sales in order to track changes in the cost of gas and other operating expenses. The CGAF includes a prior period reconciliation for the over or under recovery of actual costs and collections incurred during the prior peak and off peak seasons.

## **Other Taxes**

The Company collects 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).

## **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 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 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 as well as 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.

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 DPU.

The Company had materials and supplies of \$16.8 million and \$15.5 million and gas in storage of \$33.9 million and \$24.8 million at March 31, 2015 and 2014, respectively.

### **Derivative Contracts**

The Company uses derivative contracts to manage commodity price risk. All derivative contracts are recorded in the accompanying 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 mechanism. 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 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”).

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 DPU. The average composite rates for the years ended March 31, 2015 and 2014 were 4.4% and 4.5%, respectively. The average service lives for each of the years ended March 31, 2015 and 2014 was 46 years.

Depreciation expense 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 \$537.5 million and \$501.3 million at March 31, 2015 and 2014, respectively.

#### *Allowance for Funds Used During Construction*

In accordance with applicable accounting guidance, the Company records AFUDC, which represents the debt and equity costs of financing the construction of new property, plant and equipment. AFUDC equity is reported in the statements of income as non-cash income in other (deductions) 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 \$0.6 million and \$1.7 million the years ended March 31, 2015 and 2014, respectively. The Company recorded AFUDC related to debt of \$0.2 million and \$1.0 million for the years ended March 31, 2015 and 2014, respectively. The average AFUDC rates for the years ended March 31, 2015 and 2014 were 0.3% and 4.1%, 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 the Company below its carrying amount. Goodwill is tested for impairment using a two-step approach. The first step compares the estimated fair value of the Company 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 the Company 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 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 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.

At March 31, 2015 a revaluation study of the asset retirement obligations for the Company resulted in a downward revaluation of estimated costs related to its asset retirement obligations. These changes are the result of changes in remediation costs and enhanced asset replacement programs.

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

	<b>Years Ended March 31,</b>	
	<b>2015</b>	<b>2014</b>
	<i>(in thousands of dollars)</i>	
Balance as of the beginning of the year	\$ 15,510	\$ 14,632
Accretion expense	930	878
Liabilities settled	(38)	-
Revaluations to present values of estimated cash flows	(1,365)	-
Balance as of the end of the year	<u>\$ 15,037</u>	<u>\$ 15,510</u>

Accretion expense 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 participates with other KeySpan subsidiaries in defined benefit pension plans administered by the Parent and has postretirement benefit other than pension ("PBOP") plans for its employees. The Company recognizes its portion of the Pension plans' and its PBOP plan's funded status in the accompanying balance sheets as a net liability or asset. The cost of providing these plans is recovered through rates; therefore, the net funded status is offset by a regulatory asset or liability. The Pension plans' assets are commingled and cannot be allocated to an individual company, while the PBOP plans continue to remain separate plans of the Company. The Company measures and records its PBOP funded status at the year-end date. PBOP plan assets are measured at fair value, using the year-end market value of those assets.

## **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 accumulated other comprehensive income ("AOCI"). The amendments require an entity to provide information either on the face of the 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 or 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 or cash flows.



### 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 balance sheets.

		March 31,	
		2015	2014
		<i>(in thousands of dollars)</i>	
<b>Regulatory assets</b>			
Current:			
Derivative contracts		\$ 13,435	\$ 6,372
Gas costs adjustment		104,860	130,572
Local distribution adjustment clause		3,256	6,231
Other		4,561	1,366
Total		<u>126,112</u>	<u>144,541</u>
Non-current:			
Asset retirement obligation		8,270	14,852
Environmental response costs		54,521	57,727
Postretirement benefits		93,493	82,676
Regulatory deferred tax asset		14,952	14,844
Other		9,422	7,794
Total		<u>180,658</u>	<u>177,893</u>
<b>Regulatory liabilities</b>			
Current:			
Profit sharing		36,161	28,915
Revenue decoupling mechanism		39,333	24,568
Other		-	2,040
Total		<u>75,494</u>	<u>55,523</u>
Non-current:			
Carrying charges		12,028	5,296
Cost of removal		537,535	501,269
Total		<u>549,563</u>	<u>506,565</u>
Net regulatory liabilities		<u>\$ 318,287</u>	<u>\$ 239,654</u>

**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.

**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.

**Derivative contracts:** The Company evaluates 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.

**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's rate plans provide for the recovery of previously-incurred costs over a seven year recovery period. The Company believes future costs, beyond the expiration of current rate plans, will continue to be recovered through rates.

**Gas costs adjustment:** The Company is 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 the DPU. These amounts will be recovered from customers over the next year.

**Local distribution adjustment clause:** A mechanism by which the Company is required to adjust its rates semi-annually to recover or refund sundry costs, including energy efficiency expenditures, pension and PBOP costs, residential assistance costs, service quality penalties, and miscellaneous other amounts due to or from customers through rates.

**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, the Company is 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.

**Regulatory deferred tax asset:** Represents unrecovered federal and state deferred taxes of the Company primarily as a result of regulatory flow through accounting treatment and tax rate changes. The income tax benefits or charges for certain plant related timing differences, such as equity AFUDC, are immediately flowed through to or collected from customers. The amortization of the related regulatory deferred tax asset, for these items, follows the book life of the underlying plant asset. In the year ended March 31, 2014, the Company recorded an increase in the regulatory deferred tax asset as a result of the increase in deferred tax liabilities stemming from a Massachusetts state income tax rate change. The Company will address the recovery period of the regulatory asset created by the Massachusetts rate change as well as an existing balance representing a historic, unrecovered rate change in its next rate case.

**Revenue decoupling mechanism:** As approved by the DPU, the Company has a RDM which allows for seasonal (peak/off peak) adjustments to the Company's 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.

The Company records carrying charges on regulatory balances related to postretirement benefits, RDM, gas costs and the local distribution adjustment clause, 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**

### **General Rate Case**

In November 2010, the DPU issued an order in the Company's 2010 rate case approving a revenue increase of \$41.5 million based upon a 9.75% rate of return on equity and a 50% equity ratio. In response, the Company filed a motion for recalculation of certain adjustments. The DPU awarded an increase of \$2.6 million of the additional \$4.9 million requested, effective November 1, 2011. The combined effect of the DPU's orders is a total revenue increase of \$44.1 million.

### **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 Company by the NGUSA service companies. Subsequently, the Company 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 gas and electric distribution affiliates who are eligible for fuel assistance.

### **PBOP Carrying Charges**

On June 1, 2011, in conjunction with the DPU's annual investigation of the Company's calendar year 2009 pension and PBOP rate reconciliation mechanism, the Massachusetts Attorney General argued that the Company 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 the Company 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 the Company 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 the Company recorded an \$8.3 million reduction to the regulatory asset in the accompanying financial statements.

### **Gas System Enhancement Plan**

On April 30, 2015, the DPU approved the Company's 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 Company's capital costs for the replacement of eligible leak prone pipe and ancillary equipment pursuant to the 2014 Gas Leaks Act passed in Massachusetts in 2014. 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 \$8.3 million.

## 5. PROPERTY, PLANT AND EQUIPMENT

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

	<b>March 31,</b>	
	<b>2015</b>	<b>2014</b>
	<i>(in thousands of dollars)</i>	
Plant and machinery	\$ 3,121,850	\$ 2,829,755
Land and buildings	67,887	65,079
Assets in construction	87,697	86,162
Software and other intangibles	75,723	75,723
Total property, plant and equipment	<b>3,353,157</b>	3,056,719
Accumulated depreciation and amortization	<b>(861,820)</b>	(800,519)
Property, plant and equipment, net	<b>\$ 2,491,337</b>	\$ 2,256,200

## 6. DERIVATIVE CONTRACTS

The Company utilizes derivative contracts, such as gas swap 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:

	<b>March 31,</b>	
	<b>2015</b>	<b>2014</b>
	<i>(in thousands)</i>	
Gas swap contracts	<b>16,710</b>	16,820
Gas purchase contracts	<b>2,981</b>	6,887
Total	<b>19,691</b>	23,707

## Amounts Recognized in the Accompanying Balance Sheets

	Asset Derivatives		Liability Derivatives	
	March 31,		March 31,	
	2015	2014	2015	2014
	<i>(in thousands of dollars)</i>		<i>(in thousands of dollars)</i>	
<u>Current assets:</u>			<u>Current liabilities:</u>	
Rate recoverable contracts:			Rate recoverable contracts:	
Gas swap contracts	\$ 11	\$ 4,438	Gas swap contracts	\$ 11,560 \$ 279
Gas purchase contracts	48	111	Gas purchase contracts	205 10,731
	<u>59</u>	<u>4,549</u>		<u>11,765</u> <u>11,010</u>
 <u>Other non-current assets</u>			 <u>Other non-current liabilities:</u>	
Rate recoverable contracts:			Rate recoverable contracts:	
Gas swap contracts	-	112	Gas swap contracts	1,729 23
	-	112		1,729 23
Total	<u>\$ 59</u>	<u>\$ 4,661</u>	Total	<u>\$ 13,494</u> <u>\$ 11,033</u>

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 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 \$18.0 million and \$4.3 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 \$13.5 million and \$0.8 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 \$13.8 million and \$1.0 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 Balance Sheets**  
*(in thousands of dollars)*

	Gross amounts of recognized assets <i>A</i>	Gross amounts offset in the Balance Sheets <i>B</i>	Net amounts of assets presented in the Balance Sheets <i>C=A+B</i>	Financial Instruments <i>Da</i>	Cash collateral received <i>Db</i>	Net amount <i>E=C-D</i>
<b>ASSETS:</b>						
<b>Derivative contracts</b>						
Gas swap contracts	\$ 11	\$ -	\$ 11	\$ -	\$ -	\$ 11
Gas purchase contracts	48	-	48	-	-	48
Total	<u>\$ 59</u>	<u>\$ -</u>	<u>\$ 59</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 59</u>
	Gross amounts of recognized liabilities <i>A</i>	Gross amounts offset in the Balance Sheets <i>B</i>	Net amounts of liabilities presented in the Balance Sheets <i>C=A+B</i>	Financial Instruments <i>Da</i>	Cash collateral paid <i>Db</i>	Net amount <i>E=C-D</i>
<b>LIABILITIES:</b>						
<b>Derivative contracts</b>						
Gas swap contracts	\$ 13,289	\$ -	\$ 13,289	\$ -	\$ -	\$ 13,289
Gas purchase contracts	205	-	205	-	-	205
Total	<u>\$ 13,494</u>	<u>\$ -</u>	<u>\$ 13,494</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 13,494</u>

**March 31, 2014**  
**Gross Amounts Not Offset in the Balance Sheets**  
*(in thousands of dollars)*

	Gross amounts of recognized assets <i>A</i>	Gross amounts offset in the Balance Sheets <i>B</i>	Net amounts of assets presented in the Balance Sheets <i>C=A+B</i>	Financial Instruments <i>Da</i>	Cash collateral received <i>Db</i>	Net amount <i>E=C-D</i>
<b>ASSETS:</b>						
<b>Derivative contracts</b>						
Gas swap contracts	\$ 4,550	\$ -	\$ 4,550	\$ -	\$ -	\$ 4,550
Gas purchase contracts	111	-	111	-	-	111
Total	<u>\$ 4,661</u>	<u>\$ -</u>	<u>\$ 4,661</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,661</u>
	Gross amounts of recognized liabilities <i>A</i>	Gross amounts offset in the Balance Sheets <i>B</i>	Net amounts of liabilities presented in the Balance Sheets <i>C=A+B</i>	Financial Instruments <i>Da</i>	Cash collateral paid <i>Db</i>	Net amount <i>E=C-D</i>
<b>LIABILITIES:</b>						
<b>Derivative contracts</b>						
Gas swap contracts	\$ 302	\$ -	\$ 302	\$ -	\$ -	\$ 302
Gas purchase contracts	10,731	-	10,731	-	-	10,731
Total	<u>\$ 11,033</u>	<u>\$ -</u>	<u>\$ 11,033</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 11,033</u>

**7. FAIR VALUE MEASUREMENTS**

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

	<b>March 31, 2015</b>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
	<i>(in thousands of dollars)</i>			
<b>Assets:</b>				
Derivative contracts				
Gas swap contracts	\$ -	\$ 11	\$ -	\$ 11
Gas purchase contracts	-	16	32	48
Available-for-sale securities	537	167	-	704
Total	<u>537</u>	<u>194</u>	<u>32</u>	<u>763</u>
<b>Liabilities:</b>				
Derivative contracts				
Gas swap contracts	-	13,289	-	13,289
Gas purchase contracts	-	143	62	205
Total	<u>-</u>	<u>13,432</u>	<u>62</u>	<u>13,494</u>
<b>Net assets (liabilities)</b>	<u>\$ 537</u>	<u>\$ (13,238)</u>	<u>\$ (30)</u>	<u>\$ (12,731)</u>

	<b>March 31, 2014</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
	<i>(in thousands of dollars)</i>			
<b>Assets:</b>				
Derivative contracts				
Gas swap contracts	\$ -	\$ 4,550	\$ -	\$ 4,550
Gas purchase contracts	-	1	110	111
Available-for-sale securities	449	239	-	688
Total	<u>449</u>	<u>4,790</u>	<u>110</u>	<u>5,349</u>
<b>Liabilities:</b>				
Derivative contracts				
Gas swap contracts	-	302	-	302
Gas purchase contracts	-	27	10,704	10,731
Total	<u>-</u>	<u>329</u>	<u>10,704</u>	<u>11,033</u>
<b>Net assets (liabilities)</b>	<u>\$ 449</u>	<u>\$ 4,461</u>	<u>\$ (10,594)</u>	<u>\$ (5,684)</u>

**Derivative Contracts:** The Company's Level 2 fair value derivative contracts primarily consist of over-the-counter ("OTC") gas swap contracts and gas purchase 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 consist of OTC 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 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

	<b>Years Ended March 31,</b>	
	<b>2015</b>	<b>2014</b>
	<i>(in thousands of dollars)</i>	
Balance as of the beginning of the year	\$ (10,594)	\$ 479
Total gains or losses included in regulatory assets and liabilities	(5,142)	(15,132)
Settlements	<u>15,706</u>	<u>4,059</u>
Balance as of the end of the year	<u>\$ (30)</u>	<u>\$ (10,594)</u>



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			
<i>(thousands of dollars)</i>							
Gas	Purchase contracts	32	(62)	(30)	Discounted Cash Flow	Unobservable Basis Points	\$1.340 - \$1.740/dth
	<b>Total</b>	<u>\$ 32</u>	<u>\$ (62)</u>	<u>\$ (30)</u>			

Commodity	Level 3 Position	Fair Value as of March 31, 2014			Valuation Technique(s)	Significant Unobservable Input	Range
		Assets	(Liabilities)	Total			
<i>(thousands of dollars)</i>							
Gas	Purchase contracts	\$ -	\$ (9,993)	\$ (9,993)	Discounted Cash Flow	LNG Forward Curve	\$6.620 - \$11.010/dth
Gas	Purchase contracts	110	(711)	(601)	Discounted Cash Flow	Unobservable Basis Points	\$2.534 - \$4.614/dth
	<b>Total</b>	<u>\$ 110</u>	<u>\$ (10,704)</u>	<u>\$ (10,594)</u>			

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 derivatives are forward liquefied natural gas ("LNG") commodity prices and unobservable basis points. 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 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 \$730.1 million and \$654.5 million, respectively.

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

## 8. EMPLOYEE BENEFITS

### Pension Benefits

The Company participates with certain other KeySpan subsidiaries in non-contributory defined benefit plans (the “Pension Plans”), covering substantially all employees.

#### *Pension Plans*

The Pension Plans provide union employees, as well as all non-union employees hired before January 1, 2011, with a retirement benefit. Supplemental non-qualified, non-contributory executive retirement programs provide additional defined pension benefits for certain executives. The Pension Plans’ costs are allocated to the Company based on plan participant data as determined by the Company’s actuaries. The Company contributed \$13.8 million and \$16.6 million for the years ended March 31, 2015 and 2014, respectively, to the trusts of its qualified Pension Plans. The Pension Plans’ assets are commingled and cannot be specifically allocated to an individual company. The Pension Plans’ costs and liabilities are first directly charged to the Company based on the Company’s employees that participate in the Pension Plans. Costs and liabilities associated with affiliated service companies’ employees are then allocated as part of the labor burden for work performed on the Company’s behalf. The Company’s net pension expense directly charged and allocated from affiliated service companies, net of capital, for the years ended March 31, 2015 and 2014 was \$18.0 million and \$22.8 million, respectively. KeySpan’s unfunded pension obligations at March 31, 2015 and 2014 were \$1.0 billion and \$704.2 million, respectively. The Company’s portion of KeySpan’s unfunded pension obligations which are included in postretirement benefits in the accompanying balance sheets at March 31, 2015 and 2014 was an overfunding of \$1.4 million and \$22.4 million, respectively.

#### *Defined Contribution Plan*

NGUSA has a defined contribution pension plan that covers substantially all employees. For the years ended March 31, 2015 and 2014, the Company recognized an expense in the accompanying statements of income of \$1.5 million and \$1.4 million, respectively, for matching contributions.

### Other Postretirement Benefits

The PBOP plans have not been merged with other KeySpan plans and, therefore, continue to remain separate plans of the Company. The PBOP plans provide health care and life insurance coverage to eligible retired employees. Eligibility is based on age and length of service requirements and, in most cases, retirees must contribute to the cost of their coverage. The PBOP assets are commingled with the KeySpan Master Union Trust Plan, the Company’s portion is approximately 8% for each of the years ended March 31, 2015 and 2014, respectively. PBOP expenses are included in operations and maintenance expense in the accompanying statements of income. The Company’s unfunded PBOP obligations were \$99.3 million and \$108.3 million at March 31, 2015 and 2014, respectively. These are included in postretirement benefits in the accompanying balance sheets.

### Components of Net Periodic PBOP Costs

	<b>Years Ended March 31,</b>	
	<b>2015</b>	<b>2014</b>
	<i>(in thousands of dollars)</i>	
Service cost	\$ 2,886	\$ 2,855
Interest cost	7,400	7,421
Expected return on plan assets	(4,819)	(4,263)
Amortization of prior service cost, net	76	40
Amortization of net actuarial loss	(300)	341
Total cost	<u>\$ 5,243</u>	<u>\$ 6,394</u>

### Amounts Recognized in Regulatory Assets

	<b>Years Ended March 31,</b>	
	<b>2015</b>	<b>2014</b>
	<i>(in thousands of dollars)</i>	
Net actuarial loss	\$ (3,002)	\$ 3,995
Amortization of net actuarial loss	300	(341)
Amortization of prior service cost, net	(76)	(40)
Total	<u>\$ (2,778)</u>	<u>\$ 3,614</u>

A portion of the estimated PBOP net actuarial loss and prior service cost of \$0.5 million and \$0.1 million, respectively, will be amortized from regulatory assets during the year ended March 31, 2016.

### Amounts Recognized in Regulatory Assets – not yet recognized as components of net actuarial loss

	<b>Years Ended March 31,</b>	
	<b>2015</b>	<b>2014</b>
	<i>(in thousands of dollars)</i>	
Net actuarial loss	\$ 15,428	\$ 18,130
Prior service cost	280	357
Total	<u>\$ 15,708</u>	<u>\$ 18,487</u>

## Reconciliation of Funded Status to Amount Recognized

The following table represents the PBOP obligation, assets, and funded status:

	<b>Years Ended March 31,</b>	
	<b>2015</b>	<b>2014</b>
	<i>(in thousands of dollars)</i>	
<b>Change in benefit obligation:</b>		
Benefit obligation as of the beginning of the year	\$ (175,137)	\$ (165,520)
Service cost	(2,886)	(2,856)
Interest cost on projected benefit obligation	(7,400)	(7,420)
Net actuarial gain (loss)	4,729	(6,606)
Benefits paid	8,869	8,210
Actual Medicare Part D subsidy received	1	(35)
Employer group waiver plan subsidy received	(1,187)	(910)
Benefit obligation as of the end of the year	<u>(173,011)</u>	<u>(175,137)</u>
<b>Change in plan assets:</b>		
Fair value of plan assets as of the beginning of the year	66,879	57,538
Actual return on plan assets	3,092	6,874
Company contributions	12,578	10,677
Benefits paid	(8,869)	(8,210)
Fair value of plan assets as of the end of the year	<u>73,680</u>	<u>66,879</u>
<b>Funded status</b>	<u>\$ (99,331)</u>	<u>\$ (108,258)</u>

The Company is the sponsor of the PBOP plans. A portion of the participants of these plans work for certain other affiliates. As such, a portion of the PBOP expenses and the unfunded obligation has been allocated to these affiliates. The Company has recorded an intercompany receivable of \$4.8 million and \$7.0 million as of March 31, 2015 and 2014, respectively, for the amount of the unfunded obligation due from these affiliates.

## Expected Benefit Payments

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

<i>(in thousands of dollars)</i>	
<u>Years Ending March 31.</u>	
2016	\$ 10,139
2017	10,407
2018	10,571
2019	10,657
2020	10,839
Thereafter	<u>56,064</u>
Total	<u>\$ 108,677</u>

## Assumptions Used for Employee Benefits Accounting

	Years Ended March 31,	
	2015	2014
<b>Benefit Obligations:</b>		
Discount rate	4.10%	4.80%
Expected return on plan assets	6.25% - 6.75%	7.00% - 7.25%
<b>Net Periodic Benefit Costs:</b>		
Discount rate	4.80%	4.70%
Expected return on plan assets	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.

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

<i>(in thousands of dollars)</i>	March 31, 2015	
1% Point increase		
Total of service cost plus interest cost	\$	767
Postretirement benefit obligation		8,850
1% Point decrease		
Total of service cost plus interest cost		(648)
Postretirement benefit obligation		(7,703)

The Company expects to make \$7.8 million in contributions to the PBOP plans during the year ending March 31, 2016.

## 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%	-	-
	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

## Fair Value Measurements

The following tables provide the fair value measurements amounts for the PBOP assets:

	March 31, 2015			
	Level 1	Level 2	Level 3	Total
	<i>(in thousands of dollars)</i>			
<b>PBOP Assets:</b>				
Cash and cash equivalents	\$ 557	\$ 777	\$ -	\$ 1,334
Accounts receivable	100	-	-	100
Accounts payable	(28)	-	-	(28)
Equity	9,564	30,486	3,196	43,246
Global tactical asset allocation	1,883	-	3,683	5,566
Fixed income securities	144	22,772	-	22,916
Futures contracts	-	(8)	-	(8)
Private equity	-	-	554	554
<b>Total</b>	<b>\$ 12,220</b>	<b>\$ 54,027</b>	<b>\$ 7,433</b>	<b>\$ 73,680</b>

	<b>March 31, 2014</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
	<i>(in thousands of dollars)</i>			
<b>PBOP Assets:</b>				
Cash and cash equivalents	\$ 625	\$ 1,194	\$ -	\$ 1,819
Accounts receivable	91	-	-	91
Accounts payable	(38)	-	-	(38)
Equity	9,069	27,849	1,925	38,843
Global tactical asset allocation	1,884	2,673	613	5,170
Fixed income securities	130	20,259	-	20,389
Futures contracts	3	-	-	3
Private equity	-	-	602	602
Total	<b>\$ 11,764</b>	<b>\$ 51,975</b>	<b>\$ 3,140</b>	<b>\$ 66,879</b>

The methods used to fair value 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 Securities:** Common stock 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:** 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

	<u>Years Ended March 31,</u>	
	<u>2015</u>	<u>2014</u>
	<i>(in thousands of dollars)</i>	
Balance as of the beginning of the year	\$ 3,140	\$ 2,786
Transfers out of Level 3	<b>(1,283)</b>	(3,561)
Transfers into Level 3	<b>2,651</b>	3,011
Actual gain or loss on plan assets:		
Realized gain	<b>320</b>	154
Unrealized gain (loss)	<b>494</b>	(32)
Purchases	<b>3,680</b>	2,176
Sales	<b>(1,569)</b>	(1,394)
Balance as of the end of the year	<u><b>\$ 7,433</b></u>	<u><b>\$ 3,140</b></u>



## 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 \$12.6 million and \$11.9 million, respectively.

## 9. CAPITALIZATION

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

<i>(in thousands of dollars)</i>	
<u>Years Ending March 31,</u>	
2016	\$ 10,000
2017	10,000
2018	8,000
2019	20,000
2020	7,000
Thereafter	576,000
Total	<u>\$ 631,000</u>

The Company is obligated to meet certain financial and non-financial covenants. During the years ended March 31, 2015 and 2014, the Company was in compliance with all such covenants.

## 10. INCOME TAXES

### Components of Income Tax Expense

	<u>Years Ended March 31,</u>	
	<u>2015</u>	<u>2014</u>
<i>(in thousands of dollars)</i>		
Current tax expense:		
Federal	\$ 11,396	\$ 10,650
State	8,906	4,613
Total current tax expense	<u>20,302</u>	<u>15,263</u>
Deferred tax expense (benefit):		
Federal	12,016	16,220
State	(3,121)	587
Total deferred tax expense	<u>8,895</u>	<u>16,807</u>
Amortized investment tax credits <sup>(1)</sup>	<u>(7)</u>	<u>(71)</u>
Total deferred tax expense	<u>8,888</u>	<u>16,736</u>
Total income tax expense	<u>\$ 29,190</u>	<u>\$ 31,999</u>

<sup>(1)</sup> 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 40.8% and 38.7%, 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
	<i>(in thousands of dollars)</i>	
Computed tax	\$ 25,058	\$ 28,824
Change in computed taxes resulting from:		
State income tax, net of federal benefit	3,742	3,380
Investment tax credits	(7)	(71)
Other items, net	397	(134)
Total	<u>4,132</u>	<u>3,175</u>
Federal and state income taxes	<u>\$ 29,190</u>	<u>\$ 31,999</u>

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.

In September 2013, the U.S. Department of the Treasury issued final tangible property regulations (“TPR”) 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 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 year 2015 federal tax return and has estimated a favorable §481(a) adjustment of \$5.6 million.

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, the Company’s deferred tax balances were remeasured to the 8% rate, resulting in an increase in deferred tax liabilities by \$12.0 million with an offset to the regulatory deferred tax asset. The application of this legislation is not expected to have a material impact on the Company's financial position, results of operations or cash flows.

## Deferred Tax Components

	March 31,	
	2015	2014
	<i>(in thousands of dollars)</i>	
<b>Deferred tax assets:</b>		
Allowance for doubtful accounts	\$ 18,815	\$ 12,880
Environmental remediation costs	17,593	20,040
Future federal benefit on state taxes	22,422	23,087
Postretirement benefits and other employee benefits	62,914	56,547
Regulatory liabilities - other	22,425	22,409
Other items	9,689	1,916
Total deferred tax assets <sup>(1)</sup>	<u>153,858</u>	<u>136,879</u>
<b>Deferred tax liabilities:</b>		
Property related differences	491,728	443,855
Regulatory assets - deferred gas costs	48,186	58,813
Regulatory assets - environmental response costs	23,444	25,491
Regulatory assets - postretirement benefits	27,127	36,636
Other items	7,098	1,759
Total deferred tax liabilities	<u>597,583</u>	<u>566,554</u>
Net deferred income tax liabilities	443,725	429,675
Deferred investment tax credits	-	7
Net deferred income tax liabilities and investment tax credits	443,725	429,682
Current portion of deferred income tax assets (liabilities), net	6,350	(24,955)
<b>Deferred income tax liabilities, net</b>	<u>\$ 450,075</u>	<u>\$ 404,727</u>

<sup>(1)</sup> 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 operating losses as of March 31, 2015:

Expiration of net operating losses:	Federal
	<i>(in thousands of dollars)</i>
3/31/2029	\$ 24,076
3/31/2030	15,775
3/31/2031	-
3/31/2032	15,578
3/31/2033	8,980
3/31/2034	14,412

## Unrecognized Tax Benefits

As of March 31, 2015 and 2014, the Company's unrecognized tax benefits totaled \$58.3 million and \$51.6 million, respectively, none of which would affect the effective tax rate, if recognized. The unrecognized tax benefits are included in other non-current liabilities in the accompanying balance sheets.

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

	<b>Years Ended March 31,</b>	
	<b>2015</b>	<b>2014</b>
	<i>(in thousands of dollars)</i>	
Balance as of the beginning of the year	\$ 51,554	\$ 55,347
Gross increases - tax positions in prior periods	522	5,610
Gross decreases - tax positions in prior periods	(2,555)	(3,024)
Gross increases - current period tax positions	8,813	7,283
Settlements with tax authorities	-	(13,662)
Balance as of the end of the year	<u>\$ 58,334</u>	<u>\$ 51,554</u>

As of March 31, 2015 and 2014, the Company has accrued for interest related to unrecognized tax benefits of \$1.5 million and \$3.1 million, respectively. During the years ended March 31, 2015 and 2014, the Company recorded interest income of \$1.6 million and \$0.1 million, respectively. The Company recognizes interest related to unrecognized tax benefits in other interest, including affiliate interest and related penalties, if applicable in other income, net, in the accompanying 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 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 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 following table indicates the earliest tax year subject to examination for each major jurisdiction:

<b>Jurisdiction</b>	<b>Tax Year</b>
Federal	August 24, 2007 *
Massachusetts	March 31, 2010

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

## **11. 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.

Within the Commonwealth of Massachusetts, the Company is aware of numerous former MGP sites and related facilities within the existing or former service territories of the Company. Investigation and remediation expenditures incurred for the years ended March 31, 2015 and 2014 were \$3.7 million and \$7.2 million, respectively.

Upon the acquisition of KeySpan 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 \$39.5 million and \$43.6 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 \$55.9 million and \$54.9 million, respectively. These costs are expected to be incurred over the next 57 years, and the discounted amounts have been recorded as reserves in the accompanying 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.

By rate orders, the DPU has provided for the recovery of site investigation and remediation costs. Accordingly, as of March 31, 2015 and 2014, the Company has recorded environmental regulatory assets of \$54.5 million and \$57.7 million, respectively.

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 recoverable from customers.

## **12. COMMITMENTS AND CONTINGENCIES**

### **Operating Lease Commitments**

The Company has various direct operating leases relating to office space. 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 statements of income was \$14.9 million and \$12.7 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 thousands of dollars)*

<u>Years Ending March 31.</u>	
2016	\$ 2,601
2017	1,612
2018	1,267
2019	1,112
2020	1,119
Thereafter	<u>8,470</u>
Total	<u><u>16,181</u></u>

### Capital Lease

In April 1999, the Company entered into a 15-year capital lease, which expired on June 30, 2014 for LNG facilities located in Massachusetts with an option to purchase the facilities upon the lease expiration. Under the terms of certain accounting standards, the timing of expense recognition on capitalized leases conforms to regulatory rate treatment. The Company included the rental payments on its capital leases in its cost of service for rate purposes. On November 6, 2013, the Company exercised the purchase option and completed the purchase of the facilities at a price of \$6.0 million on July 1, 2014.

Included in property, plant and equipment are assets under capital lease obligations with a cost of \$20.8 million at March 31, 2014. The amortization expense related to these assets was \$1.2 million for the year ended March 31, 2014. The last payment was made on January 1, 2014.

### Purchase Commitments

The Company has entered into various contracts for gas delivery, storage and supply services. Certain of these contracts require payment of annual demand charges. The Company is 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 thousands of dollars)*

<u>Years Ending March 31.</u>	<u>Gas</u>	<u>Capital Expenditures</u>
2016	\$ 144,182	\$ 15,564
2017	118,135	-
2018	82,209	-
2019	76,533	-
2020	58,921	-
Thereafter	<u>234,095</u>	-
Total	<u><u>\$ 714,075</u></u>	<u><u>\$ 15,564</u></u>

## 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.

## 13. RELATED PARTY TRANSACTIONS

### Accounts Receivable from and Accounts Payable to Affiliates

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

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

	<b>Accounts Receivable from Affiliates</b>		<b>Accounts Payable to Affiliates</b>	
	<b>March 31,</b>		<b>March 31,</b>	
	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
	<i>(in thousands of dollars)</i>		<i>(in thousands of dollars)</i>	
Colonial Gas Company	\$ -	\$ -	\$ 17,301	\$ 4,001
KeySpan Corporation	-	74,275	22,126	-
NGUSA Service Company	-	-	2,013	87,088
The Narragansett Electric Company	-	-	39	5,650
Other	2,941	2,893	2,208	2,503
Total	<u>\$ 2,941</u>	<u>\$ 77,168</u>	<u>\$ 43,687</u>	<u>\$ 99,242</u>

At March 31, 2015 and 2014, the non-current portion of accounts receivable from affiliates represents the PBOP liability of \$4.8 million and \$7.0 million, respectively, allocated to various affiliated entities as disclosed in Note 8, "Employee Benefits."

### Intercompany Money Pool

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

The Regulated Money Pool is funded by operating funds from participants. Collectively, NGUSA and KeySpan, have the ability to borrow up to \$3 billion from National Grid plc for working capital needs including funding of the intercompany money pools, if necessary. The Company had short-term intercompany money pool borrowings of \$256.0 million and \$121.6 million at March 31, 2015 and 2014, respectively. The average interest rates for the intercompany money pool were 0.3% and 0.7% for the years ended March 31, 2015 and 2014, respectively.

### **Service Company Charges**

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

Net charges from the service companies of NGUSA to the Company for the years ended March 31, 2015 and 2014 were \$195.3 million and \$185.4 million, respectively.

### **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 financial statements. The estimated effect on net income would be \$3.8 million before taxes and \$2.5 million after taxes, for each of the years ended March 31, 2015 and 2014, if these amounts were allocated to the Company.