nationalgrid

Massachusetts Electric Company

Financial Statements

For the years ended March 31, 2013 and March 31, 2012

MASSACHUSETTS ELECTRIC COMPANY

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Independent Auditor's Report

To the Shareholder and Board of Directors of Massachusetts Electric Company:

We have audited the accompanying financial statements of Massachusetts Electric Company (the "Company"), which comprise the balance sheets as of March 31, 2013 and March 31, 2012, and the related statements of income, comprehensive income, cash flows, capitalization and changes in shareholders' equity for the years then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the 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 Massachusetts Electric Company at March 31, 2013 and March 31, 2012, 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

October 18, 2013

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MASSACHUSETTS ELECTRIC COMPANY
BALANCE SHEETS
(in thousands of dollars)

	March 31, 2013	March 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 2,024**	$ 2,906
Restricted cash	**68,500**	68,500
Accounts receivable	**299,159**	272,525
Allowance for doubtful accounts	**(31,786)**	(35,912)
Accounts receivable from affiliates	**4,550**	6,135
Unbilled revenues	**87,222**	85,789
Materials and supplies	**20,037**	17,765
Current portion of deferred income tax assets	**-**	30,266
Regulatory assets	**155,403**	80,211
Prepaid taxes	**42,164**	3,430
Other current assets	**21,292**	3,449
Total current assets	**668,565**	535,064
Property, plant, and equipment, net	**2,408,734**	2,314,747
Deferred charges and other assets:		
Regulatory assets	**623,629**	592,523
Goodwill	**1,008,244**	1,008,244
Financial investments	**6,075**	5,617
Other deferred charges	**7,645**	7,275
Total deferred charges and other assets	**1,645,593**	1,613,659
Total assets	**$ 4,722,892**	$ 4,463,470

The accompanying notes are an integral part of these financial statements

MASSACHUSETTS ELECTRIC COMPANY
BALANCE SHEETS
(in thousands of dollars)

	March 31,	
	2013	2012
LIABILITIES AND CAPITALIZATION		
Current liabilities:		
Accounts payable	**$ 226,462**	$ 154,219
Accounts payable to affiliates	**76,548**	21,468
Taxes accrued	**1,914**	-
Customer deposits	**12,004**	11,102
Interest accrued	**18,005**	18,006
Intercompany money pool	**162,302**	86,938
Regulatory liabilities	**33,802**	80,462
Current portion of deferred income tax liabilities	**7,520**	-
Energy efficiency certificate obligations	**83,025**	54,431
Other current liabilities	**19,429**	17,456
Total current liabilities	**641,011**	444,082
Deferred credits and other liabilities:		
Regulatory liabilities	**351,886**	333,096
Asset retirement obligations	**1,596**	1,633
Deferred income tax liabilities	**568,282**	511,734
Postretirement benefits	**170,392**	202,114
Environmental remediation costs	**96,230**	95,954
Other deferred liabilities	**40,086**	55,043
Total deferred credits and other liabilities	**1,228,472**	1,199,574
Capitalization:		
Shareholders' equity	**2,035,781**	2,002,275
Long-term debt	**817,628**	817,539
Total capitalization	**2,853,409**	2,819,814
Total liabilities and capitalization	**$ 4,722,892**	$ 4,463,470

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

MASSACHUSETTS ELECTRIC COMPANY
STATEMENTS OF INCOME
(in thousands of dollars)

	Yeas Ended March 31,	
	2013	2012
Operating revenues	**$ 2,032,180**	$ 2,042,851
Operating expenses:		
Purchased electricity	**747,735**	860,134
Contract termination charges from affiliates	**21,752**	5,657
Operations and maintenance	**971,195**	832,024
Depreciation	**112,678**	109,362
Other taxes	**60,491**	53,025
Total operating expenses	**1,913,851**	1,860,202
Operating income	**118,329**	182,649
Other income and (deductions):		
Interest on long-term debt	**(48,597)**	(48,707)
Other interest, including affiliate interest	**(2,025)**	3,697
Other deductions, net	**10,382**	(4,785)
Storm penalties	**(18,734)**	(1,200)
Total other deductions, net	**(58,974)**	(50,995)
Income before income taxes	**59,355**	131,654
Income tax expense (benefit)		
Current	**(69,279)**	(45,674)
Deferred	**96,965**	97,442
Total income tax expense	**27,686**	51,768
Net income	**$ 31,669**	$ 79,886

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

MASSACHUSETTS ELECTRIC COMPANY
STATEMENTS OF COMPREHENSIVE INCOME
(in thousands of dollars)

	Years Ended March 31,	
	2013	2012
Net income	$ **31,669**	$ 79,886
Other comprehensive income:		
Unrealized gains on securities, net of $184 and $301 tax expense	**276**	451
Change in pension and other postretirement obligations, net of $20 and ($50) tax expense (benefit)	**31**	(74)
Reclassification of gains into net income, net of $91 and $175 tax benefit	**(137)**	(262)
Other comprehensive income	**170**	115
Comprehensive income	$ **31,839**	$ 80,001

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

MASSACHUSETTS ELECTRIC COMPANY
STATEMENTS OF CASH FLOWS
(in thousands of dollars)

	Years Ended March 31,	
	2013	2012
Operating activities:		
Net income	**$ 31,669**	$ 79,886
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	**112,678**	109,362
Bad debt expense	**23,495**	1,129
Provision for deferred income taxes	**96,965**	97,442
Net prepayments and other amortizations	**414**	479
Pension and other postretirement contributions	**(56,943)**	(24,642)
Pension and other postretirement expense	**32,381**	59,058
Net environmental remediation payments	**(6,462)**	(7,432)
Changes in operating assets and liabilities:		
Accounts receivable, net, and unbilled revenues	**(55,688)**	(49,521)
Materials and supplies	**(2,272)**	1,269
Accounts payable and accrued expenses	**68,119**	(36,071)
Regulatory assets and liabilities	**(160,444)**	(89,010)
Prepaid taxes and accruals	**(38,147)**	7,263
Accounts receivable from/payable to affiliates, net	**(5,398)**	(2,649)
Other liabilities	**14,419**	(20,528)
Standard offer recovery	**-**	1,557
Other, net	**(13,792)**	3,050
Net cash provided by operating activities	**40,994**	$ 130,642
Investing activities:		
Capital expenditures	**(172,395)**	(168,093)
Proceeds from sale of investments	**-**	2,075
Other, including cost of removal	**(8,575)**	(9,924)
Net cash used in investing activities	**(180,970)**	(175,942)
Financing activities:		
Dividends paid on preferred stock	**(100)**	(100)
Affiliated money pool borrowing and other	**137,427**	40,375
Share based compensation	**1,767**	390
Net cash provided by financing activities	**139,094**	40,665
Net increase in cash and cash equivalents	**(882)**	(4,635)
Cash and cash equivalents, beginning of period	**2,906**	7,541
Cash and cash equivalents, end of period	**$ 2,024**	$ 2,906
Supplemental disclosures:		
Interest paid	**$ 54,921**	$ 42,895
Income taxes refunded from Parent	**15,450**	8,948
Significant non-cash items:		
Capital-related accruals included in accounts payable	**9,104**	4,981

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

MASSACHUSETTS ELECTRIC COMPANY
STATEMENTS OF CAPITALIZATION
(in thousands of dollars)

			March 31,	
			2013	2012
Total shareholders' equity			**$ 2,035,781**	$ 2,002,275
Long-term debt:	Interest Rate	Maturity Date		
Notes payable - Unsecured senior notes	5.90%	November 15, 2039	**800,000**	800,000
State authority financing - Tax exempt pollution control revenue bonds	Variable	August 1, 2014	**20,000**	20,000
Unamortized discounts			**(2,372)**	(2,461)
Total long-term debt			**817,628**	817,539
Total capitalization			**$ 2,853,409**	$ 2,819,814

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

MASSACHUSETTS ELECTRIC COMPANY
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(in thousands of dollars, except number of shares data)

	Common Stock, par value $25 per share		Preferred Stock, par value $100 per share				Accumulated Other Comprehensive Income			
	Issued and Outstanding Shares	Amount	Issued and Outstanding Shares	Amount	Additional Paid-in Capital	Retained Earnings	Unrealized Gain (Loss) on Available for Sale Securities	Pension and Postretirement Benefits	Total Accumulated Other Comprehensive Income	Total
Balance as of March 31, 2011	2,398,111	$ 59,953	22,585	$ 2,259	$ 1,558,161	$ 296,775	$ 371	$ 4,465	$ 4,836	$ 1,921,984
Net income	-	-	-	-	-	79,886	-	-	-	79,886
Comprehensive income:										
Unrealized gains on securities, net of $301 tax expense	-	-	-	-	-	-	451	-	451	451
Change in pension and other postretirement obligations, net of $50 tax benefit	-	-	-	-	-	-	-	(74)	(74)	(74)
Reclassification of gains into net income, net of $175 tax benefit	-	-	-	-	-	-	(262)	-	(262)	(262)
Share based compensation	-	-	-	-	390					390
Dividends on preferred stock	-	-	-	-	-	(100)	-	-	-	(100)
Balance as of March 31, 2012	2,398,111	$ 59,953	22,585	$ 2,259	$ 1,558,551	$ 376,561	$ 560	$ 4,391	$ 4,951	$ 2,002,275
Balance as of March 31, 2012	2,398,111	$ 59,953	22,585	$ 2,259	$ 1,558,551	$ 376,561	$ 560	$ 4,391	$ 4,951	$ 2,002,275
Net income	-	-	-	-	-	31,669	-	-	-	31,669
Comprehensive income:										
Unrealized gains on securities, net of $184 tax expense	-	-	-	-	-	-	276	-	276	276
Change in pension and other postretirement obligations, net of $20 tax expense	-	-	-	-	-	-	-	31	31	31
Reclassification of gains into net income, net of $91 benefit	-	-	-	-	-	-	(137)	-	(137)	(137)
Share based compensation	-	-	-	-	1,767	-	-	-	-	1,767
Dividends on preferred stock	-	-	-	-	-	(100)	-	-	-	(100)
Balance as of March 31, 2013	2,398,111	$ 59,953	22,585	$ 2,259	$ 1,560,318	$ 408,130	$ 699	$ 4,422	$ 5,121	$ 2,035,781

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

MASSACHUSETTS ELECTRIC COMPANY

NOTES TO THE FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

A. Nature of Operations

Massachusetts Electric Company ("the Company") is an electric retail distribution company providing electric service to approximately 1.3 million customers in 171 cities and towns in Massachusetts. The properties of the Company consist principally of substations and distribution lines interconnected with transmission and other facilities of New England Power Company ("NEP"), an affiliated entity.

The Company 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 an indirectly-owned subsidiary of National Grid plc, a public limited company incorporated under the laws of England and Wales.

The Company has evaluated subsequent events and transactions through October 18, 2013, 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, 2013, except as disclosed in footnote 2, "Rates and Regulation".

B. Basis of Presentation

The financial statements for the years ended March 31, 2013 and March 31, 2012 are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"), including the accounting principles for rate-regulated entities. The financial statements reflect the rate-making practices of the applicable regulatory authorities.

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

Within the statements of cash flows, all amounts that are settled through the Regulated Money Pool (refer to Note 9, "Related Party Transactions") are treated as constructive cash receipts and payments, and therefore are presented as such.

C. Regulatory Accounting

The Federal Energy Regulatory Commission ("FERC") and the Massachusetts Department of Public Utilities ("DPU") provide the final determination of the rates that 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 or refunded through the rate-making process, which would result in a corresponding increase or decrease in future rates.

D. Revenue Recognition

The Company bills its customers on a monthly cycle basis at approved tariffs based on energy delivered, a minimum customer service charge, and, in some instances, their demand. Revenues are determined based on these bills plus an estimate for unbilled energy delivered between the cycle meter read date and the end of the accounting period. These amounts are billed to customers in the next billing cycle following the month-end. Revenues are subject to a Decoupling Adjustment Factor which requires the Company to adjust annually its base rates to reflect the over or under recovery of the Company's targeted base distribution revenues from the prior season. Revenue decoupling is a

rate-making mechanism that breaks the link between the Company's base revenue requirement and sales. This mechanism allows the Company to offer various energy efficiency measures to its customers without financial detriment to the Company resulting from reductions in electricity.

The Revenue Decoupling Mechanism ("RDM") 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 season.

The Company's revenue from the sale and delivery of electricity for the years ended March 31, 2013 and March 31, 2012 is as follows:

	March 31,	
	2013	2012
Residential	**73%**	72%
Commercial	**24%**	25%
Industrial	**3%**	3%

E. Property, Plant and Equipment

Property, plant and equipment is stated at original cost. The cost of additions to property, plant and equipment and replacements of retired units of property are capitalized. Costs include direct material, labor, overhead and allowance for funds used during construction ("AFUDC"). The cost of renewals and betterments that extend the useful life of property, plant and equipment are also capitalized. The cost of repairs, replacements and major maintenance projects, which do not extend the useful life or increase the expected output of the asset, are expensed as incurred. Depreciation is generally computed over the estimated useful life of the assets using the composite straight-line method. Depreciation studies are conducted periodically to update the composite rates and are approved by the DPU. Whenever 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 average composite rates and average service lives for the years ended March 31, 2013 and March 31, 2012 are as follows:

	March 31,	
	2013	2012
Composite rates - depreciation	**2.3%**	2.3%
Composite rates - cost of removal	**0.9%**	0.9%
Total composite rates	**3.2%**	3.2%
Average service life	**44 years**	44 years

The Company's depreciation expense includes estimated costs to remove property, plant and equipment, which is recovered through the rates charged to its customers. At March 31, 2013 and March 31, 2012, the Company had cumulative costs recovered in excess of costs incurred totaling $219.5 million and $196.6 million, respectively. These amounts are reflected as regulatory liabilities in the accompanying balance sheets.

In accordance with applicable regulatory accounting guidance, the Company records AFUDC, which represents the estimated debt and equity costs of capital funds necessary to finance the construction of new regulated facilities. The equity component of AFUDC is a non-cash amount within the statements of income. AFUDC is capitalized as a component of the cost of property, plant and equipment, with an offsetting credit to other income deductions, net for the equity component and other interest expense for the debt component in the accompanying statements of income. After construction is completed, the Company is permitted to recover these costs through inclusion in its rate base and corresponding depreciation expense.

The components of AFUDC capitalized and composite AFUDC rates for the years ended March 31, 2013 and March 31, 2012 are as follows:

	March 31,	
	2013	2012
	(in thousands of dollars)	
Debt	**$ 226**	$ 828
Equity	**167**	1,592
	$ 393	$ 2,420
Composite AFUDC rate	**0.9%**	4.8%

F. Goodwill

Goodwill represents the excess of the purchase price of a business over the fair value of the tangible and intangible assets acquired, net of the fair value of liabilities assumed and the fair value of any non-controlling interest in the acquisition. The Company tests goodwill for impairment annually on January 31, and whenever events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount.

The goodwill impairment analysis is comprised of two steps. In the first step, the estimated fair value of the reporting unit is compared with its carrying value. If the fair value exceeds the carrying value, goodwill is not impaired and no further analysis is required. If the carrying value exceeds the 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 Company calculated the fair value of the reporting unit in the performance of its annual goodwill impairment test for the fiscal year ended March 31, 2013 utilizing both income and market approaches, as described below. The Company ultimately determined the fair value of the business using 50% weighting for each valuation methodology, as it believes that each methodology provides equally valuable information.

- 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, 2013 to March 31, 2018; (b) a discount rate of 5.5%, 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 US 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 10.0, which the Company believes is appropriate based on comparison of its business with the benchmark companies.

The results of the first step of the goodwill impairment test indicated that the fair value of the reporting unit was less than its carrying value, and therefore performance of the second step of the goodwill impairment test was required. In the second step of the goodwill impairment test, the implied fair value of goodwill was determined by allocating the fair value of the reporting unit to all of its assets and liabilities and then computing the excess of the reporting unit's fair value over the amounts assigned to the assets and liabilities. Inherent in the Company's measurement of the implied fair value of goodwill is the assumption that any difference between the book value and fair value of the Company's long-term debt would not be recovered from customers under the Company's rate agreement. The

Company determined that the implied fair value of goodwill exceeded the carrying value of goodwill, and thus, no impairment or adjustment of the goodwill carrying value was necessary.

G. *Available-For-Sale Securities*

The Company holds available-for-sale securities which primarily include equities, municipal bonds and corporate bonds. These investments are recorded at fair value and are included in financial investments in the accompanying balance sheets.

H. *Cash and Cash Equivalents*

The Company classifies short-term investments that are highly liquid and have original maturities of three months or less as cash equivalents. Cash and cash equivalents are carried at cost which approximates fair value.

I. *Restricted Cash and Special Deposits*

Restricted cash consists of deposits to the Independent System Operator ("ISO") of New England, Inc., which serve to support the Company's obligations to the ISO as collateral.

Special deposits primarily include health care claims deposits of $3.2 million and $2.7 million at March 31, 2013 and March 31, 2012, respectively, and are included in other current assets in the accompanying balance sheets.

J. *Allowance for Doubtful Accounts*

The Company recognizes an allowance for doubtful accounts to record accounts receivable at estimated net realizable value. The allowance is calculated by applying a reserve factor to outstanding receivables. The reserve factor is based upon historical write-off experience and assessment of customer collectability.

K. *Materials and Supplies*

Materials and supplies are stated at the lower of weighted average cost or market and are expensed or capitalized into specific capital additions as used. At March 31, 2013 and March 31, 2012, the balance of materials and supplies was $20.0 million and $17.8 million, respectively. 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, 2013 or March 31, 2012.

L. *Income and Other 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. National Grid North America Inc. ("NGNA,"formerly National Grid Holdings Inc.), an indirectly-owned subsidiary of National Grid plc and the intermediate holding company of NGUSA, files consolidated federal tax returns including all of the activities of its subsidiaries. Each subsidiary company is included in the consolidated group and 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 included subsidiaries. Benefits allocated by NGNA are treated as capital contributions.

Deferred income taxes reflect the tax effect of net operating losses, capital losses and general business credit carryforwards and the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial statement and income tax purposes, as determined under enacted tax laws and rates. 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. Additionally, the Company follows the current accounting guidance relating to uncertainty in income taxes which applies to all income tax positions reflected in the accompanying balance sheets that have been included in previous tax returns or are expected to be included in future tax returns. The accounting guidance for uncertainty in income taxes provides that the financial effects of a tax

position shall initially be recognized in the financial statements when it is more likely than not, based on the technical merits, that the position will be sustained upon examination, assuming the position will be audited and the taxing authority has full knowledge of all relevant information.

The Company collects from customers various taxes that are levied by state and local governments on the sale or distribution of electricity. The Company presents taxes that are imposed on customers (such as sales taxes) on a net basis (i.e., excluded from revenues) and presents excise taxes on a gross basis.

M. Employee Benefits

The Company follows the accounting guidance for defined benefit pension and postretirement benefit ("PBOP") plans for recording pension expenses and resulting plan asset and liability balances. The guidance requires employers to fully recognize all pension and postretirement plans' funded status on the balance sheets as a net liability or asset. In the case of regulated entities, the offset to such net liability or asset is recorded as a regulatory asset or liability when the balance will be recovered from or refunded to customers in future rates. The Company has determined that such amounts will be included in future rates and follows the regulatory format for recording the balances. The Company measures and records its pension and PBOP obligations at the year-end date. Pensions and PBOP assets are measured at fair value, using the year-end market value of those assets.

N. Fair Value Measurements

The Company measures 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.

O. New and Recent Accounting Guidance

Accounting Guidance Adopted in Fiscal Year 2013

Fair Value Measurements

In May 2011, the Financial Accounting Standards Board ("FASB") issued accounting guidance that amended existing fair value measurement guidance. The amendment was issued with a goal of achieving common fair value measurement and disclosure requirements in GAAP and International Financial Reporting Standards. Consequently, the guidance changes the wording used to describe many of the requirements in GAAP for measuring fair value, requires new disclosures about fair value measurements, and changes specific applications of the fair value measurement guidance. Some of the amendments clarify the FASB's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements including, but not limited to: fair value measurement of a portfolio of financial instruments; fair value measurement of premiums and discounts; and additional disclosures about fair value measurements. This guidance became effective for financial statements issued for annual periods (for non-public entities such as the Company) beginning after December 15, 2011. The Company

adopted this guidance for the fiscal year ended March 31, 2013, which only impacted its fair value disclosures. There were no changes to the Company's approach to measuring fair value as a result of adopting this new guidance.

Goodwill Impairment

In September 2011, the FASB issued accounting guidance related to goodwill impairment testing, whereby an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is not required. Otherwise, the entity is required to perform the two-step impairment test. This guidance became effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company adopted this guidance in its fiscal year ended March 31, 2013 and did not elect the option to perform a qualitative analysis.

Other Comprehensive Income

In June 2011, the FASB issued accounting guidance that eliminated the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. This new guidance seeks to improve financial statement users' ability to understand the causes of an entity's change in financial position and results of operations. As a result of this guidance entities are required to either present the statement of income and statement of comprehensive income in a single continuous statement or in two separate, but consecutive statements of net income and other comprehensive income. This guidance does not change the items that are reported in other comprehensive income or any reclassification of items to net income. In addition, the new guidance does not change an entity's option to present components of other comprehensive income net of or before related tax effects. This guidance became effective for non-public companies for fiscal years ending after December 15, 2012, and for interim and annual periods thereafter, and it is to be applied retrospectively. The Company adopted this guidance for the fiscal year ended March 31, 2013, with no impact on its financial position, results of operations, or cash flows.

Accounting Guidance Not Yet Adopted

Offsetting Assets and Liabilities

In December 2011, the FASB issued accounting guidance requiring enhanced disclosure related to offsetting assets and liabilities. Under the new guidance, reporting entities will be required to disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting agreement, such as for derivatives. In January 2013, the FASB issued additional guidance to clarify that the specific instruments and activities that should be considered in these disclosures will be limited to recognized derivatives, repurchase and reverse repurchase agreements, and securities lending transactions. This guidance is effective for fiscal years, and interim periods within those years, beginning after January 1, 2013, and is to be applied retrospectively. The Company will begin including the new required disclosures in its fiscal year 2014 quarterly financial statements as applicable and does not expect any impact on its financial position, results of operations, or cash flows.

Reclassifications From Accumulated Other Comprehensive Income

In February 2013, the FASB issued accounting guidance that requires an entity to report information about significant reclassifications out of accumulated other comprehensive income. The new guidance requires presentation either in a single footnote or parenthetically on the financial statements, of the effect of significant amounts reclassified out of accumulated other comprehensive income based on the corresponding line items in the statement of net income. For amounts that are not required to be reclassified in their entirety to net income in the same reporting period, an entity would cross-reference other disclosures that provide additional detail about those amounts. The amendments do not change the current requirements for reporting net income or other comprehensive income in the financial statements. For non-public entities, the amendments are effective prospectively for reporting

periods beginning after December 15, 2013. Early adoption is permitted. The Company is evaluating the impact, if any, on its financial position, results of operations, and cash flows.

Q. Financial Statement Revisions and Reclassifications

During 2013, management determined that the Company's previously issued financial statements for the year ended March 31, 2012 included errors related to the recording of certain accounting transactions. The Company corrected these errors by revising the prior period financial statements, the impacts of which are described below. Management has concluded that the errors did not have a material impact on any previously issued financial statements but would have been material if the corrections were recorded in the current year statement of income. Therefore, the previously reported amounts were revised within the financial statements for the year ended March 31, 2012.

The first error related to a correction of software depreciation charges allocated from NGUSA's service company. A cumulative adjustment of $0.4 million (net of income taxes) was recorded in the financial statements for the year ended March 31, 2012 as a reduction of net income to reflect the fiscal 2012 activity related to this error.

The second error related to a correction of deferred storm costs determined as a result of a full scope review of costs incurred over the prior 18 month period to be submitted for rate recovery. A cumulative adjustment of $2.4 million (net of income taxes) was recorded in the financial statements for the year ended March 31, 2012, of which $0.1 million was recorded as an adjustment to beginning retained earnings (as of March 31, 2011), and $2.3 million was recorded as a reduction of net income for the year ended March 31, 2012 to reflect the fiscal 2012 activity related to this error.

The third error related to incorrect recording of transactions related to distributed generation work performed by the Company, which should have been recorded as a contra-balance to utility plant, rather than as revenue. A cumulative adjustment of $1.2 million (net of income taxes) was recorded in the financial statements for the year ended March 31, 2012 as a reduction of net income to reflect the fiscal 2012 activity related to this error. In addition, this error resulted in reclassification of $2 million from cash flow from operating activities to cash flow from investing activities.

The fourth error related to insufficient property tax expenses being recorded relating to an updated assessment. A cumulative adjustment of $1.2 million (net of income taxes) was recorded in the financial statements for the year ended March 31, 2012 as a reduction of net income to reflect the fiscal 2012 activity related to this error.

The fifth error related to the incorrect accounting for share based awards. A cumulative adjustment of $1 million (net of income taxes) was recorded in the financial statements for the year ended March 31, 2012, of which $0.6 million was recorded as an adjustment to beginning retained earnings (as of March 31, 2011), and $0.4 million was recorded as an increase of net income for the year ended March 31, 2012 to reflect the fiscal 2012 activity related to this error.

In addition, certain misclassifications related to the presentation of current and deferred income taxes and uncertain tax positions have been reflected in the revisions below. The Company misclassified the current portion of deferred tax assets by $1.2 million and prepaid taxes by $29.9 million. These misclassifications in assets were offset by misclassifications in accrued taxes of $5.0 million, regulatory liabilities of $0.2 million, non-current deferred tax liabilities of $.9 million, and other deferred liabilities of $21.1 million. The adjustments for these balance sheet presentation errors in the prior fiscal year had an immaterial impact on the statement of income. In addition, amounts related to postemployment benefits of $12 million were reclassified from postretirement benefits and other reserves to other deferred liabilities. Further, amounts related to construction advances of $1.3 million were reclassified from cash flows from operating activities to cash flows from investing activities.

The following table shows the amounts previously reported as revised:

	As Previously Reported	Adjustments	As Revised
		(in thousands of dollars)	
	March 2012		March 2012
Balance Sheet			
Current assets			
Current portion of deferred income tax assets	$ 29,106	$ 1,160	$ 30,266
Prepaid taxes	32,023	(28,593)	3,430
Total Current assets	**562,497**	**(27,433)**	**535,064**
Property, plant, and equipment, net	2,316,747	(2,000)	2,314,747
Deferred charges and other assets			
Regulatory assets	607,375	(14,852)	592,523
Total Deferred charges and other assets	**1,628,511**	**(14,852)**	**1,613,659**
Current liabilities			
Accounts payable to affiliates	21,289	179	21,468
Taxes accrued	4,968	(4,968)	-
Total Current liabilities	**448,871**	**(4,789)**	**444,082**
Deferred credits and other liabilities			
Regulatory liabilities	343,872	(10,776)	333,096
Deferred income tax liabilities	511,970	(236)	511,734
Postretirement benefits	214,107	(11,993)	202,114
Other deferred liabilities	67,249	(12,206)	55,043
Total Deferred credits and other liabilities	**1,234,785**	**(35,211)**	**1,199,574**
Capitalization:			
Additional Paid-in Capital			
March 31, 2012	1,556,766	1,785	1,558,551
March 31, 2011	1,556,766	1,395	1,558,161
Retained Earnings			
March 31, 2012	382,631	(6,070)	376,561
March 31, 2011	298,282	(1,507)	296,775

	As Previously Reported	Adjustments	As Revised
		(in thousands of dollars)	
	March 2012		March 2012
Statement of Income			
Operating revenues	$ 2,044,851	$ (2,000)	$ 2,042,851
Operating expense:			
Operations and maintenance	828,415	3,609	832,024
Other taxes	51,125	1,900	53,025
Operating income	190,158	(7,509)	182,649
Income before income taxes	139,163	(7,509)	131,654
Income taxes			
Current	(45,567)	(107)	(45,674)
Deferred	100,281	(2,839)	97,442
Net income	84,449	(4,563)	79,886
Statement of Cash Flows			
Net income	$ 84,449	$ (4,563)	$ 79,886
Provision for deferred income taxes	100,281	(2,839)	97,442
Pension and other postretirement expense	62,140	(3,082)	59,058
Regulatory assets and liabilities	(92,601)	3,591	(89,010)
Prepaid taxes and accruals	(15,674)	22,937	7,263
Accounts receivable from/payable to affiliates	(4,325)	1,676	(2,649)
Other liabilities	888	(21,416)	(20,528)
Net cash provided by operating activities	134,338	(3,696)	130,642
Capital expenditures	(171,399)	3,306	(168,093)
Net cash used in investing activities	(179,248)	3,306	(175,942)
Share based compensation	-	390	390
Net cash used in financing activities	40,275	390	40,665

Note 2. Rates and Regulation

The following table presents the Company's regulatory assets and regulatory liabilities at March 31, 2013 and March 31, 2012:

	March 31,	
	2013	2012
Regulatory assets	*(in thousands of dollars)*	
Current:		
Renewable energy certificates	**65,404**	54,272
Rate adjustment mechanisms	**27,383**	25,642
Loss on reacquired debt	**587**	-
Storm costs	**41,884**	-
Transmission service	**15,710**	-
Other	**4,435**	297
Total	**155,403**	80,211
Non-current:		
Postretirement benefits	**319,231**	337,755
Loss on reacquired debt	**3,859**	5,293
Environmental response costs	**98,044**	96,580
Storm costs	**200,030**	143,937
Other	**2,465**	8,958
Total	**623,629**	592,523
Regulatory liabilities		
Current:		
Rate adjustment mechanisms	**30,125**	74,224
Transmission service	**-**	6,238
Other	**3,677**	-
Total	**33,802**	80,462
Non-current:		
Cost of removal	**219,514**	196,599
Environmental response fund	**70,001**	70,970
Postretirement benefits	**34,739**	39,522
Regulatory deferred tax liabilities	**23,702**	22,289
Other	**3,930**	3,716
Total	**351,886**	333,096
Net regulatory assets	**$ 393,344**	$ 259,176

Cost of removal: The Company's current and prior rate plans have collected through rates an implied cost of removal for its plant assets. This regulatory liability represents costs collected from customers for costs associated with removing and disposing of replaced or retired assets. For a vast majority of its electric distribution assets, the Company uses these funds to remove the asset so a new one can be installed in its place.

Environmental response costs: This regulatory asset represents deferred costs associated with the Company's share of the estimated costs to investigate and perform certain remediation activities at sites with which it may be associated. The Company believes future costs, beyond the expiration of current rate plans, will continue to be recovered through rates.

Environmental response fund: This amounts represents the amount of customer contributions and insurance proceeds recovered to pay for costs to investigate and perform certain remediation activities at sites with which it may be associated.

Postretirement benefits: The Company is allowed to recover non-capitalized pension and PBOP costs outside of base rates through a separate factor. As a result, the Company is authorized to recover all pension and PBOP expenses from its customers. The difference in the costs of the Company's pension and PBOP plans from the amounts billed through this separate factor as well as the non-cash accrual of net actuarial gains and losses is deferred to a regulatory asset or liability to be recovered or refunded over the following three years.

Rate adjustment mechanisms: The Company is subject to a number of rate adjustment mechanisms such as 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.

Renewable energy certificate costs: Massachusetts has implemented regulations to encourage the use of renewable energy which require load serving entities (LSEs) to purchase a minimum percentage of their electric supplies from qualified renewable energy sources. The Commonwealth of Massachusetts has given various incentives like renewable energy certificates (REC) to the producers of renewable energy. LSEs need to purchase RECs associated with renewable energy and not necessarily the energy itself to demonstrate compliance with the state regulations.

The Company does not self-generate any RECs but rather purchases them from various providers primarily via standalone contracts. Purchased RECs are recorded within prepaid and other current assets on the accompanying balance sheets. In addition, the Company records a compliance liability based on retail electricity sales, which are classified within other current liabilities or other deferred liabilities on the accompanying balance sheets based on the period of the compliance requirement. The costs associated with the RPS are recoverable from customers through rate adjustment mechanism. As a result, expenses associated with the compliance obligation are deferred as a regulatory asset and relieved through the rate adjustment mechanism. The Company does not expect to make any alternative compliance payment related to it calendar year 2012 requirement as it had sufficient RECs to meet its obligation.

Storm costs: This regulatory asset represents the incremental operation and maintenance costs to restore power to customers resulting from major storms. Additionally, the Company's rate order allows for the operation of a storm fund whereby the Company collects through rates an amount meant to offset incurred storm costs. The Company may use money in the fund for incremental storm costs that exceed a $1.25 million threshold per event, subject to the Department reviewing the costs and determining that they have been reasonably and prudently incurred. The regulatory asset recorded represents the excess of incremental operation and maintenance costs which have been incurred by the Company to restore power to customers resulting from major storms above the amount collected in the storm fund.

Transmission service: The Company arranges transmission service on behalf of its customers' and bills the costs of those services to customers pursuant to the Company's Transmission Service Cost Adjustment Provision. Any over or under recoveries of these costs are passed on to customers receiving transmission service through the Company over the subsequent twelve months.

Carrying Charges: The Company includes in rate base or records carrying charges on most regulatory balances related to renewable energy certificates, rate adjustment mechanisms, storm costs and environmental response costs 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. If recovery is not concurrent with the cash expenditures, the Company will record the appropriate level of carrying charges. Carrying charges are not earned on loss on reacquired debt and transmission service. Losses on reacquired debt have recovery periods ranging from five to thirty-four years.

The following table presents the carrying charges that were recognized in the accompanying statement of income during the years ended March 31, 2013 and March 31, 2012:

	March 31,	
	2013	2012
	(in thousands of dollars)	
Other interest (expense) income , including affiliate interest	**$ (1,358)**	$ 3,815
Other income, net	**12,591**	222
	$ 11,233	$ 4,037

Rate Matters

Rates for services rendered by the Company are subject to approval by the DPU. The DPU approved an RDM arising from the 2009 distribution rate case filed by the Company and its affiliate, Nantucket Electric Company ("Nantucket Electric"). In connection with the Company's first RDM filing made in November 2010 and supplemented in February 2011, the DPU opened a proceeding in March 2011, as requested by the Massachusetts Attorney General's Office ("Attorney General"), for an independent audit of the Company's 2009 capital investments which, in part, formed the basis for the Company's RDM rate adjustment. The selection of an auditor, following a competitive solicitation process that has been completed, is at the discretion of the DPU. The Company cannot currently predict the outcome of this proceeding.

As part of their last general rate case, the Company and Nantucket Electric received approval from the DPU to recover approximately $65.7 million of incremental costs associated with a December 2008 winter storm ("December 2008 Storm") subject to further DPU review, reconciliation and demonstration by the Company and Nantucket Electric that they reasonably and prudently incurred the costs. On April 1, 2011, the Company and Nantucket Electric filed an audit report of costs incurred to restore electric service following the December 2008 Storm. On December 7, 2011 the DPU issued an interlocutory order requiring the companies to file testimony in support of the reasonableness and prudency of the costs. On March 1, 2012 the companies filed testimony consistent with the requirements of the interlocutory order and reduced their request for recovery to $64.9 million. On July 3, 2012, the Attorney General issued rebuttal testimony challenging certain of the Company's costs. Hearings were held at the DPU in August 2012. Following the hearings, the Company and Nantucket Electric reduced their request for recovery to $64.8 million.

The Company and Nantucket Electric have deferred net costs of approximately $214 million as of March 31, 2013, net of customer contributions to the Company's Storm Contingency Fund, to restore power associated with several major weather events occurring since January 2010, pending ultimate approval by the DPU to charge its deferred costs to the Company's Storm Contingency Fund. This amount represents approximately $228 million of deferred storm costs, excluding net carrying costs of $16 million. On March 5, 2013, the Company and Nantucket Electric filed with the DPU a request for accelerated funding for the Company's Storm Contingency Fund of $40 million per year over a period of up to five years, or $200 million. On May 3, 2013, the DPU approved $40 million annually for up to three years, or $120 million. In its ruling, the DPU also directed the Company and Nantucket Electric to submit two filings of all documentation supporting its storm costs for DPU approval. The Company and Nantucket Electric submitted the first filing for $128 million of costs on May 31, 2013 for qualifying storms occurring during calendar years 2010 and 2011. The Company and Nantucket Electric must submit documentation of storm costs incurred during calendar year 2012 and January and February 2013 by December 31, 2013. The Company cannot currently predict the outcome of any proceedings related to storm recovery.

In addition to the rates and tariffs put into effect following its most recent rate case, the Company continues to be authorized to recover costs associated with the procurement of electricity for its customers, all transmission costs, and costs charged by the Company's affiliate NEP, for stranded costs associated with NEP's former electric generation investments.

The Company's affiliate, NEP, operates the transmission facilities of its New England affiliates as a single integrated system and reimburses the Company for the cost of limited transmission facilities owned by Massachusetts Electric, including a return on those facilities, under NEP's Tariff No. 1. In turn, these costs are

allocated among transmission customers in New England in accordance with the ISO New England transmission tariff. Massachusetts Electric is compensated for its actual monthly transmission costs with its authorized ROE ranging from 11.14% to 12.64% based on the prevailing ROE approved by the FERC for transmission rates in New England. Under this agreement, the Company received payments from NEP in the amount of $10.3 million and $8.5 million for the years ended March 31, 2013 and 2012, respectively.

On September 30, 2011, several state and municipal parties in New England, including the Attorney General, the Connecticut Public Utilities Regulatory Authority and the DPU ("Complainants"), filed with the FERC a complaint under Section 206 of the Federal Power Act against certain New England Transmission Owners, including NEP ("NETOs"), to lower the base ROE for transmission rates in New England from the FERC approved rate of 11.14%, to 9.2%. On May 3, 2012, the FERC set the matter for hearing and settlement procedures. A hearing on the initial complaint commenced on May 6, 2013 and concluded on May 10, 2013.

On August 6, 2013, a FERC Administrative Law Judge ("ALJ") issued an Initial Decision in the complaint proceeding, finding that the just and reasonable base ROE for the refund period is 10.6% and the just and reasonable base ROE for the prospective period is 9.7%, prior to any adjustments that would be applied by the FERC in a final order based on the change in 10-year US Treasury Bond rates from the date hearings closed to the date of the FERC's order. The refund period is the 15-month period from October 1, 2011 through December 31, 2012. The prospective period begins when the FERC issues its order on the Initial Decision. An ALJ's Initial Decision does not itself affect the ROE rate or create an obligation to issue refunds to customers. Instead, the FERC will act on the Initial Decision and adopt or modify the ALJ's recommendations in an order that is expected no sooner than early 2014. Although the ALJ's Initial Decision is non-binding upon the FERC, based on an evaluation of facts and circumstances, and consideration of the accounting guidance for contingencies, the Company has recorded a reduction of regulatory asset of $4.2 million for the portion that would be refunded to the customers through existing rate agreements.

On December 27, 2012, a new ROE complaint was filed against the NETOs by a coalition of consumers seeking to lower the base ROE for New England transmission rates to 8.7% effective as of December 27, 2012. The FERC has not yet acted on this complaint.

Other Regulatory Matters

In the general rate case involving the Company's Massachusetts gas distribution affiliates, the DPU opened an investigation to address the allocation and assignment of costs to the gas affiliates by the National Grid service companies. In June 2011, the Attorney General's Office requested that the DPU expand the scope of the audit to address the allocation and assignment of costs to the Company by the NGUSA service companies and to review NGUSA's cost allocation practices. NGUSA agreed to expand the scope of the audit to its Massachusetts electric distribution companies. On March 12, 2012 the DPU issued an order confirming that the scope of the audit would include the Massachusetts electric distribution companies. The Company issued the Request for Proposal ("RFP") in April 2012 and on May 21, 2012 informed the DPU that no bids were received. The Company revised the RFP and it is now pending before the DPU for approval. The Company cannot currently predict the outcome of this proceeding.

In January 2011, the DPU opened an investigation into the Company and Nantucket Electric's preparation and response to a December 2010 winter storm. The DPU has the authority to issue fines not to exceed approximately $0.3 million for each violation for each day that the violation persists. On September 22, 2011, the DPU approved a settlement between the Company and the Attorney General that included a $1.2 million refund to customers. The DPU also investigated the Company and Nantucket Electric's response to Tropical Storm Irene and the October 2011 winter storm in a consolidated proceeding. On December 11, 2012, the DPU issued an order in which it assessed the Company and Nantucket Electric a penalty of $18.7 million associated with the Company and Nantucket Electric's performance in responding to these two weather events, consisting of $8.1 million for Tropical Storm Irene and $10.6 million for the October 2011 winter storm. This amount is included in other deductions, net in the accompanying statements of income. The Company and Nantucket Electric have appealed this ruling, however credited customers during March 2013 subject to recoupment of the amount of penalty, if any, vacated by the court pursuant to the Company's appeal. In addition, in its order, the DPU ordered a management audit of the Company

and Nantucket Electric's emergency planning, outage management, and restoration. The Company cannot predict the outcome of the appeal or of the management audit.

Energy Efficiency and Renewables

Pursuant to the 2008 Green Communities Act, the Massachusetts Legislature mandated large scale and innovative ideas for implementing renewable and alternative energy sources, as well as increased energy efficiency spending. On January 28, 2013, the DPU approved the Company's second three-year energy efficiency plan which covers calendar years 2013 through 2015 and which significantly expands energy efficiency spending. The Company's approved electric energy efficiency budget for calendar years 2013 through 2015 is approximately $680 million. In addition to cost recovery, the Company has the opportunity to earn performance incentives over the 3-year period of the plan.

In October 2009 the DPU approved the Company and Nantucket Electric's proposal to construct, own, and operate approximately 5 MW of solar generation on five separate properties owned by the Company and/or its affiliates in Dorchester, Everett, Haverhill, Revere, and a location on the Sutton/Northbridge border. The actual capital cost of the projects amounted to $29 million. As each unit went into service, the Company and Nantucket Electric requested and received approval to recover the costs of each site with a return equal to the weighted average cost of capital approved by the DPU in the Company's most recent rate proceeding. The Company and Nantucket Electric requested rate adjustments under this mechanism for the Sutton/Northbridge facility in August 2010 for recovery of approximately $1.0 million, and for the Revere, Everett and Haverhill facilities in February 2011 for recovery of approximately $2.5 million. In February 2012, the Company and Nantucket Electric filed for recovery of approximately $1.4 million associated with the Dorchester facility. In each instance, the DPU issued an order approving recovery subject to its ongoing review and further investigation and reconciliation of the Company's costs for the sites. The DPU has issued final orders approving recovery for each of the sites.

In May 2010, the Company and Nantucket Electric announced that they entered into a 15-year power purchase agreement ("PPA") with Cape Wind Associates, LLC to purchase half of the energy, capacity and renewable energy credits generated by a proposed offshore wind project with capacity of up to 468 MW. The base price is specified at 18.7 cents per kilowatt hour beginning in 2014 and is subject to escalation by 3.5% in each annual period thereafter. The base price can be adjusted based on several factors, including eligibility for tax credits, the size of the facility, financing and construction costs, and performance. In November 2010, the DPU approved the PPA including the Company's proposed cost recovery mechanism with 4% remuneration on the contract cost, as provided for by the Green Communities Act. The Supreme Judicial Court of Massachusetts affirmed the DPU Order approving the PPA on December 28, 2011.Cape Wind expects the project to achieve initial commercial operation in May 2016. Construction of the project has not yet begun.

Note 3. Employee Benefits

The Company participates with other NGUSA subsidiaries in a qualified and non-qualified non-contributory defined benefit plan (the "Pension Plan") and PBOP plan (together with the Pension Plan (the "Plan")), covering substantially all employees. The Pension Plan is a defined benefit plan which provides union employees, as well as non-union employees hired before January 1, 2011, with a retirement benefit. Supplemental nonqualified, non-contributory executive retirement programs provide additional defined pension benefits for certain executives. The Company participates in the following plans: The Final Average Pay Pension Plan (FAPP), National Grid USA Companies' Executive SERP (Version I-FAPP) (ESRP), National Grid Deferred Compensation Plan, National Grid Executive Life Insurance Plan, Eastern Utilities Associates (EUA) Retirement Plans, Eastern Utilities Associates (EUA) Retirement Plans, National Grid Retirees Health and Life Plan I (Nonunion) and National Grid Retirees Health and Life Plan II (Union).

During the years ended March 31, 2013 and March 31, 2012, the Company made contributions of approximately $59.4 million and $24.6 million, respectively, to the Plan.

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

Plan's assets are commingled and cannot be allocated to an individual company. The Plan's costs are first directly charged to the Company based on the Company's employees that participate in the Plan. Costs 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 applies deferral accounting for pension and PBOP expenses associated with its regulated electric operations. Any differences between actual pension costs and amounts used to establish rates are deferred and collected from or refunded to customers in subsequent periods. Pension and PBOP expense is included in operations and maintenance expenses in the accompanying statements of income.

NGUSA companies' pension and PBOP plans that the Company participates in have unfunded obligations at March 31, 2013 and March 31, 2012 are as follows:

	March 31,	
	2013	2012
	(in thousands of dollars)	
Pension Plan	**$ 471,000**	$ 493,600
PBOP	**368,100**	384,800
	$ 839,100	$ 878,400

The Company's net pension and PBOP expenses directly charged and allocated from affiliated service companies, net of capital, for the years ended March 31, 2013 and March 31, 2012 are as follows:

	Years Ended March 31,	
	2013	2012
	(in thousands of dollars)	
Pension Plan	**$ 27,454**	$ 21,655
PBOP	**14,732**	18,812
	$ 42,186	$ 40,467

Defined Contribution Plan

The Company has a defined contribution pension plan that covers substantially all employees. For each of the years ended March 31, 2013 and March 31, 2012, the Company recognized an expense of approximately $3.2 million in the accompanying statements of income for matching contributions.

Other Benefits

The Company accrued $5.7 million and $1.9 million at March 31, 2013 and March 31, 2012, respectively, regarding workers compensation, auto and general insurance claims which have been incurred but not yet reported.

Note 4. Property, Plant and Equipment

At March 31, 2013 and March 31, 2012, property, plant and equipment at cost along with accumulated depreciation and amortization are as follows:

	March 31, 2013	March 31, 2012
	(in thousands of dollars)	
Plant and machinery	**$ 3,438,586**	$ 3,330,305
Land and buildings	**169,739**	161,772
Assets held for future use	**562**	562
Assets in construction	**84,400**	66,130
Total	**3,693,287**	3,558,769
Accumulated depreciation	**(1,284,553)**	(1,244,022)
Property, plant and equipment, net	**$ 2,408,734**	$ 2,314,747

Note 5. Fair Value Measurements

Available for Sale Securities

The Company measures available for sale securities at fair value. Available for sale securities primarily included equities, preferred securities and cash equivalents based on quoted market prices in active markets (Level 1), and municipal and corporate bonds based on quoted prices of similar traded assets in open markets (Level 2).

The following table presents available for sale securities 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, 2013 and March 31, 2012:

	March 31, 2013			
	Level 1	**Level 2**	**Level 3**	**Total**
		(in thousands of dollars)		
Assets:				
Available for sale securities	**$ 2,584**	**$ 3,491**	**$ -**	**$ 6,075**

	March 31, 2012			
	Level 1	**Level 2**	**Level 3**	**Total**
		(in thousands of dollars)		
Assets:				
Available for sale securities	$ 2,451	$ 3,166	$ -	$ 5,617

A transfer into Level 3 represents existing assets or liabilities that were previously categorized at a higher level for which the inputs became unobservable. 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 and out from Level 3 during the years ended March 31, 2013 and March 31, 2012, respectively.

Other Fair Value Measurements

The Company's balance sheets reflect the long-term debt at amortized cost. The fair market value of the Company's long-term debt was estimated based on the quoted market prices for similar issues or on the current rates offered to the Company for similar debt. The fair value of long-term debt at March 31, 2013 and March 31, 2012 was $1 billion and $964.5 million, respectively.

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

Note 6. Income Taxes

The components of federal and state income tax expense (benefit) are as follows:

	Years Ended March 31,	
	2013	2012
	(in thousands of dollars)	
Current tax expense (benefit):		
Federal	**$ (65,277)**	$ (47,293)
State	**(4,002)**	1,619
Total	**(69,279)**	(45,674)
Deferred tax expense:		
Federal	**82,002**	89,061
State	**15,848**	9,608
Total	**97,850**	98,669
Amortized investment tax credits [(1)]	**(885)**	(1,227)
Total deferred tax expense	**96,965**	97,442
Total income tax expense	**$ 27,686**	$ 51,768

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

A reconciliation between the expected federal income tax expense, using the federal statutory rate of 35% to the Company's actual income tax expense for the years ended March 31, 2013 and March 31, 2012 is as follows:

	Years Ended March 31,	
	2013	2012
	(in thousands of dollars)	
Computed tax	**$ 20,774**	$ 46,079
Change in computed taxes resulting from:		
State income tax, net of federal benefit	**7,700**	7,298
Investment tax credit	**(885)**	(1,227)
Other items - net	**97**	(382)
Total	**6,912**	5,689
Federal and state income taxes	**$ 27,686**	$ 51,768

Significant components of the Company's net deferred tax assets and liabilities at March 31, 2013 and March 31, 2012 are as follows:

	March 31,	
	2013	2012
	(in thousands of dollars)	
Deferred tax assets:		
Pensions, OPEB and other employee benefits	**$ 80,288**	$ 92,127
Reserve - environmental	**42,140**	41,578
Future federal benefit on state taxes	**30,109**	24,325
Regulatory liabilities - other	**17,475**	9,738
Allowance for uncollectible accounts	**13,192**	15,036
Net operating losses	**27,313**	-
Other items	**3,388**	4,466
Total deferred tax assets [1]	**213,905**	187,270
Deferred tax liabilities:		
Property related differences	**540,719**	469,876
Regulatory assets - pension and OPEB	**112,377**	114,800
Regulatory assets - storm costs	**97,624**	61,348
Other items	**29,947**	15,576
Total deferred tax liabilities	**780,667**	661,600
Net deferred income tax liabilities	**566,762**	474,330
Deferred investment tax credits	**9,040**	7,138
Net deferred income tax liabilities and investment tax credits	**575,802**	481,468
Current portion of net deferred income tax (liability) asset	**(7,520)**	30,266
Non-current deferred income tax liability and investment tax credits	**$ 568,282**	$ 511,734

[1] There were no valuation allowances for deferred tax assets at March 31, 2013 or March 31, 2012.

The following table presents the amounts and expiration dates of net operating losses as of March 31, 2013:

Expiration of net operating losses:	Federal
	(in thousands of dollars)
03/31/2024	$ 78,036

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.

Unrecognized Tax Benefits

As of March 31, 2013 and March 31, 2012, the Company's unrecognized tax benefits totaled $37.9 million and $50.1 million, respectively, of which none would affect the effective tax rate, if recognized. The unrecognized tax benefits are included in other deferred liabilities in the accompanying balance sheets.

The following table reconciles the changes to the Company's unrecognized tax benefits for the years ended March 31, 2013 and March 31, 2012:

	Years Ended March 31,	
	2013	2012
	(in thousands of dollars)	
Balance at the beginning of the year	**$ 50,108**	$ 72,160
Gross decreases related to prior period	**(12,100)**	(28,970)
Gross decreases related to current period	**(1,601)**	(66)
Gross increases related to prior period	**359**	-
Gross increases related to current period	**1,111**	6,984
Balance at the end of the year	**$ 37,877**	$ 50,108

As of March 31, 2013 and March 31, 2012, the Company has accrued for interest related to unrecognized tax benefits of $1.3 million and $1.8 million, respectively. During the years ended March 31, 2013 and March 31, 2012, the Company recorded interest income of $0.5 million and interest expense of $0.3 million, respectively. The net interest income recorded in fiscal 2013 is attributable to a remeasurement based on an oral agreement with the IRS related to certain disputed issues. The Company recognizes accrued interest related to unrecognized tax benefits in other interest expense and related penalties, if applicable, in non-operating expenses. No tax penalties were recognized during the years ended March 31, 2013 and March 31, 2012.

In fiscal year 2013, as a result of recent experience by NGNA's consolidated group subsidiaries, the Company has remeasured its tax reserves for certain matters that are similar to matters agreed with the IRS by affiliate group members. Therefore, the Company believes that such matters will be concluded on similar terms and has concluded that in its assessment the potential exposure has declined and has reclassified a portion of its reserve for uncertain tax positions, in the amount of $11,520, to deferred tax liability.

In fiscal year 2012, the Company adopted Revenue Procedure 2011-43, which provides a safe harbor method of accounting that taxpayers may use to determine whether expenditures to maintain, replace, or improve electric transmission and distribution property must be capitalized under Section 263(a) of the Internal Revenue Code and therefore has reversed $26 million of tax reserves related to unrecognized tax benefits recorded in prior years, with a corresponding offset in deferred tax liability.

It is reasonably possible that other events will occur during the next 12 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 their results of operations, financial position, or liquidity.

In fiscal year 2012, the IRS commenced an audit of NGNA and subsidiaries for the fiscal years ending March 31, 2008 and March 31, 2009. Fiscal years ended March 31, 2010 through March 31, 2013 remain subject to examination by the IRS.

The Company is a member of the National Grid USA Service Company Massachusetts unitary group since December 2010. The tax returns for the fiscal years ended March 31, 2010 through March 31, 2013 remain subject to examination by the State of Massachusetts.

The following table indicates the earliest tax year subject to examination:

Jurisdiction	Tax Year
Federal	March 31, 2005*
Massachusetts	March 31, 2010

*The Company is in the process of appealing certain disputed issues with the IRS Office of Appeals relating to its tax returns for March 31, 2005 through March 31, 2007. The Company does not anticipate a change in its unrecognized tax positions in the next twelve months as a result of filing the appeals. However, the Company's tax sharing agreement may result in a change to allocated tax as a result of current and future audits or appeals.

Note 7. Debt

Short-term Debt

The Company has regulatory approval from the FERC to issue up to $750 million of short-term debt. The Company had no short-term debt outstanding to third-parties as of March 31, 2013 or March 31, 2012.

Long-term Debt

Senior Note

In November 2009, the Company issued $800 million of unsecured long-term debt at 5.9% with a maturity date of November 15, 2039. In conjunction with this debt issuance, the Company incurred debt issuance cost of $6.8 million which is being amortized over the life of the debt.

Pollution Control Revenue Bonds

In 2004, the Company issued $20 million of pollution control revenue bonds maturing on August 1, 2014 with variable interest rates ranging from 0.35% to 0.90% for the year ended March 31, 2013 and rates ranging from 0.90% to 0.92% for the year ended March 31, 2012.

Bond Purchase Agreement

On March 31, 2012, the Company had a Standby Bond Purchase Agreement (“SBPA”) of $20.7 million, which expired in November 2012. The Company amended the SBPA to have a limit of $20 million and to expire on November 20, 2015. This agreement was available to provide liquidity support for $20 million of the Company’s long-term bonds in tax-exempt commercial paper mode. The Company has classified this debt as long-term due to its intent and ability to refinance the debt on a long-term basis if it is not able to remarket them. In addition, NGUSA has provided a letter of support which, in the event the SBPA is not in place, provides a sufficient means of funding on a long-term basis. At March 31, 2013 and March 31, 2012, there were no bond purchases made by the banks participating in this agreement.

The aggregate maturities of long-term debt subsequent to March 31, 2013 are as follows:

(in thousands of dollars) Year Ended March 31,	
2014	$ -
2015	20,000
2016	-
2017	-
2018	-
Thereafter	800,000
Total	$ 820,000

The Company is obligated to meet certain financial and non-financial covenants. During the years ended March 31, 2013 and March 31, 2012, respectively, the Company was in compliance with all such covenants.

Note 8. Commitments and Contingencies

Electricity Purchase and Capital Commitments

The Company has several types of long-term contracts for the purchase of electric power. The Company is liable for these payments regardless of the level of service required from third parties. The Company purchases any additional energy needed to meet its load requirements and can purchase the electricity through the ISO New England at market prices. In addition, the Company has various capital commitments related to the construction of plant, property and equipment.

The Company's commitments under these long-term contracts for years subsequent to March 31, 2013, are summarized in the table below:

(in thousands of dollars) Years Ending March 31,	**Energy Purchases**	**Capital Expenditures**
2014	$ 542,317	$ 116,243
2015	21,624	1,393
2016	-	11,856
2017	-	-
2018	-	-
Thereafter	-	-
Total	$ 563,941	$ 129,492

Asset Retirement Obligations

The Company has various asset retirement obligations associated with its distribution facilities. The following table represents the changes in the asset retirement obligations for the years ended March 31, 2013 and March 31, 2012:

	March 31,	
	2013	2012
	(in thousands of dollars)	
Balance as of beginning of year	**$ 1,633**	$ 1,822
Accretion expense	**77**	99
Liabilities settled	**(114)**	(388)
Liabilities incurred in the current year	**-**	100
Balance as of end of year	**$ 1,596**	$ 1,633

Guarantees

The Company unconditionally guarantees the full and prompt payment of the principal, premium, if any, and interest on certain tax exempt bonds issued by the Massachusetts Development Finance Agency in connection with Nantucket Electric's financing of its first and second underground and submarine cable projects. The Company would be required to make any principal, interest or premium payments if Nantucket Electric failed to pay. The carrying value of the debt guaranteed is approximately $52.3 million at March 31, 2013 and has maturities extending through 2042. This guarantee is absolute and unconditional.

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 condition, or cash flows.

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.

The United States Environmental Protection Agency (“EPA”) and the Massachusetts Department of Environmental Protection (“DEP”), as well as private entities, have alleged that the Company is a potentially responsible party (“PRP”) under state or federal law for a number of sites at which hazardous waste is alleged to have been disposed. The Company’s most significant liabilities relate to former manufactured gas plant (“MGP”) facilities. The Company is currently investigating and remediating, as necessary, those MGP sites and certain other properties under agreements with the EPA and DEP. Expenditures incurred for the years ended March 31, 2013 and March 31, 2012 were $6.8 million and $7.4 million, respectively.

At March 31, 2013 and March 31, 2012, the Company had total reserves for environmental remediation costs of $96.2 million and $96.0 million, respectively, which include reserves established in connection with the Company’s hazardous waste fund referred to below. These costs are expected to be incurred over the next 34 years. However, remediation costs for each site may be materially higher than estimated, depending upon 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 PRPs, but it is uncertain whether, and to what extent, such efforts will be successful.

The DPU has approved a settlement agreement that provides for rate recovery of remediation costs of former MGP sites and certain other hazardous waste sites located in Massachusetts. Under that agreement, qualified costs related to these sites are paid out of a special fund established as a regulatory liability in the accompanying balance sheets. Rate-recoverable contributions of approximately $4 million are made along with interest, lease payments, and any recoveries from insurance carriers and other third parties. Accordingly, as of March 31, 2013 and March 31, 2012,

the Company has recorded environmental regulatory assets of $98.0 million and $96.6 million, respectively, and environmental regulatory liabilities of $70.0 million and $71.0 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.

Note 9. Related Party Transactions

Accounts Receivable from Affiliates 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 payables to and receivables from certain of its affiliates in the ordinary course of business. The amounts payable to and receivable from its affiliates do not bear interest and are settled through the money pool. At March 31, 2013 and March 31, 2012, the Company had net outstanding accounts receivable from affiliates and accounts payable to affiliates balances as follows:

	Accounts Receivable from Affiliates		**Accounts Payable to Affiliates**	
	March 31, 2013	March 31, 2012	**March 31, 2013**	March 31, 2012
	(in thousands of dollars)		*(in thousands of dollars)*	
NGUSA	**$ 107**	$ 1,674	**$ -**	$ -
New England Power Co.	**-**	-	**23,565**	9,534
NGUSA Service Company	**-**	-	**45,883**	7,884
KeySpan Corp Services	**-**	-	**55**	2,900
Nantucket Electric	**-**	-	**2,180**	1,067
Niagara Mohawk Power Co.	**-**	874	**4,077**	-
The Narragansett Electric Co.	**159**	828	-	-
Metrowest Realty	**1,451**	1,423	-	-
Boston Gas Co.	**1,812**	817	-	-
Colonial Gas Co.	**388**	81	-	-
Other	**633**	438	**788**	83
	$ 4,550	$ 6,135	**$ 76,548**	$ 21,468

Money Pool

The settlement of the Company's various transactions with NGUSA and certain affiliates generally occurs via the money pool. As of November 1, 2012, NGUSA and its affiliates established a new Regulated Money Pool and an Unregulated Money Pool. Financing for the Company's working capital is obtained through participation in the Regulated Money Pool. The Company, as a participant in the Regulated Money Pool, can both borrow and lend funds. Borrowings from the Regulated and Unregulated Money Pools bear interest in accordance with the terms of the applicable money pool agreement. Since November 1, 2012, and because the Company now fully participates in the Regulated Money Pool rather than settling intercompany charges with cash, all changes in the intercompany moneypool balances and affiliate receivables and affiliate payables are reflected as investing or financing activities in the statement of cash flows.

The Regulated Money Pools is funded by operating funds from participants. Collectively, NGUSA and its subsidiary, KeySpan, have the ability to borrow up to $3 billion from National Grid plc for working capital needs including funding of the Money Pool, if necessary. The Company had short-term money pool borrowings of $162.3 million and $86.9 million at March 31, 2013 and March 31, 2012, respectively. The average interest rate for the money pool was approximately 0.6% and 0.2% for the years ended March 31, 2013 and March 31, 2012, respectively.

Related Party Reimbursement

In accordance with the Credit and Operating Support Agreement dated March 26, 1996, the Company will reimburse Nantucket Electric an amount equal to the difference between Nantucket Electric's actual net income for the year and the net income necessary for Nantucket Electric to earn an ROE equivalent to Nantucket Electric's DPU approved ROE for the fiscal year, currently 10.35%. This reimbursement shall constitute additional revenue to Nantucket Electric and an expense to the Company. To the extent Nantucket Electric's actual ROE for the year exceeds its allowed ROE, there will be no reimbursement. For the years ended March 31, 2013 and March 31, 2012, the Company reimbursed Nantucket Electric $3.8 million and $3.2 million, 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 typically 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, etc. Lastly, all other costs are allocated based on a general allocator.

Charges from the service companies of NGUSA to the Company for the years ended March 31, 2013 and March 31, 2012 were $391.1 million and $348.4 million, respectively.

Holding Company Charges

NGUSA received charges from National Grid Commercial Holdings Limited, an affiliated company in the UK, for certain corporate and administrative services provided by the corporate functions of National Grid plc to its US subsidiaries. These charges, which are recorded on the books of NGUSA, have not been reflected on these financial statements. Were these amounts allocated to the Company, the estimated effect on net income would be approximately $5.3 million before taxes, and $3.4 million after taxes, for each of the years ended March 31, 2013 and March 31, 2012.

Note 10. Cumulative Preferred Stock

The Company has non-participating cumulative preferred stock outstanding which can be redeemed at the option of the Company. A summary of cumulative preferred stock at March 31, 2013 and March 31, 2012 is as follows:

	Shares Outstanding		Amount		
	March 31,		**March 31,**		Call
Series	**2013**	2012	**2013**	2012	Price
	(in thousands of dollars, except per share and number of shares data)				
4.44% Series	**22,585**	22,585	**$ 2,259**	$ 2,259	104.068

The Company did not redeem any preferred stock during the years ended March 31, 2013 and March 31, 2012.

Note 11. Dividend Restrictions

Pursuant to the preferred stock arrangement, as long as any preferred stock is outstanding, certain restrictions on payment of common stock dividends would come into effect if the common stock equity was, or by reason of payment of such dividends became, less than 25% of total capitalization. Common stock equity at March 31, 2013 and March 31, 2012 was approximately 71.3% and 71.0%, respectively, of total capitalization. Accordingly, the Company was not restricted as to the payment of common stock dividends under the foregoing provisions at March 31, 2013 or March 31, 2012.