nationalgrid

Boston Gas Company

Financial Statements

For the year ended March 31, 2010

TABLE OF CONTENTS

BOSTON GAS COMPANY
BALANCE SHEETS

(In thousands of dollars)		**March 31, 2010**		March 31, 2009
ASSETS				
Current assets:				
Cash and cash equivalents	**$**	**194**	$	400
Restricted cash		**6,650**		20,800
Accounts receivable		**289,432**		293,221
Money-pool, affiliates		**2,443**		-
Allowance for uncollectible accounts		**(19,116)**		(19,725)
Unbilled revenues		**65,586**		77,365
Gas in storage, at average cost		**78,506**		85,630
Material and supplies, at average cost		**4,719**		4,365
Derivative contracts		**2,859**		256
Current regulatory assets		**58,892**		90,405
Prepayments and other assets		**9,267**		392
		499,432		553,109
Property, plant and equipment, net		**1,517,927**		1,406,105
Other investments		**2,546**		2,546
Deferred charges:				
Goodwill		**342,728**		342,728
Regulatory assets		**191,586**		174,984
Derivative contracts		**234**		643
Deferred charges and other assets		**3,213**		2,604
		537,761		520,959
Total assets	**$**	**2,557,666**	$	2,482,719

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

BOSTON GAS COMPANY
BALANCE SHEETS

(In thousands of dollars)		**March 31, 2010**		March 31, 2009
LIABILITIES AND CAPITALIZATION				
Current Liabilities				
Current portion of capital lease obligation	**$**	**1,308**	$	1,233
Current portion of long term debt		**20,000**		-
Accounts payable		**25,271**		31,334
Affiliates, net		**152,986**		229,700
Money-pool, affiliates		**-**		357,037
Interest accrued		**17,656**		16,840
Derivative contracts		**23,243**		45,037
Current regulatory liabilities		**2,945**		5,210
Deferred income tax		**29,005**		28,403
Other		**23,553**		21,090
		295,967		735,884
Deferred Credits and Other Liabilities				
Regulatory liabilities		**375,031**		340,327
Environmental liability		**30,115**		26,126
Deferred income tax		**218,895**		129,336
Pension obligation		**6,995**		9,887
Postretirement benefits obligation		**98,552**		76,354
Asset retirement obligations		**11,773**		11,540
Deferred derivative contracts		**1,313**		6,027
Other		**6,964**		14,558
		749,638		614,155
Capitalization				
Common stock, 514,184 shares issued stated at, $100 per share		**51,418**		51,418
Additonal paid-in capital		**870,323**		435,323
Retained earnings		**72,320**		62,939
Total common shareholders' equity		**994,061**		549,680
Long-term debt		**163,000**		183,000
Total Capitalization		**1,157,061**		732,680
Advance from KeySpan		**355,000**		400,000
Total Capitalization and Advance from KeySpan		**1,512,061**		1,132,680
Total Liabilities and Capitalization	**$**	**2,557,666**	$	2,482,719

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

BOSTON GAS COMPANY
STATEMENTS OF INCOME

(in thousands of dollars)	For the Years Ended March 31, 2010	2009
Operating revenues	$ **1,034,614**	$ 1,329,054
Operating expenses:		
Purchased gas for resale	**634,846**	921,299
Operations and maintenance	**211,775**	234,246
Depreciation and amortization	**102,893**	94,088
Operating taxes	**28,088**	25,195
Total operating expenses	**977,602**	1,274,828
Operating income	**57,012**	54,226
Interest charges	**(31,157)**	(37,191)
Other income (expenses)	**1,845**	9,216
Earnings before income taxes	**27,700**	26,251
Income taxes:		
Current	**(71,687)**	23,151
Deferred	**90,006**	(15,129)
Total income taxes	**18,319**	8,022
Net income	$ **9,381**	$ 18,229

BOSTON GAS COMPANY
STATEMENTS OF RETAINED EARNINGS

(in thousands of dollars)	For the Years Ended March 31, 2010	2009
Retained earnings at beginning of year	$ **62,939**	$ 44,710
Net income	**9,381**	18,229
Retained earnings at end of year	$ **72,320**	$ 62,939

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

BOSTON GAS COMPANY
STATEMENTS OF CASH FLOWS

(In thousands of dollars)	For the Years Ended March 31, 2010	2009
Operating Activities		
Net income	**$ 9,381**	$ 18,229
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	**102,893**	94,088
Deferred income tax	**90,006**	(15,129)
Changes in assets and liabilities		
Accounts receivable, net	**14,959**	50,028
Materials and supplies and gas in storage	**6,770**	(3,943)
Accounts payable and accrued expenses	**(12,957)**	(9,352)
Accrued interest	**816**	(1,123)
Environmental payments	**(3,791)**	(4,995)
Other	**2,258**	6,987
Net cash provided by operating activities	**210,335**	134,790
Investing Activities		
Capital expenditures	**(163,464)**	(150,408)
Other, includes cost of removal	**(13,800)**	(15,625)
Derivative margin calls	**14,150**	(20,800)
Net cash used in investing activities	**(163,114)**	(186,833)
Financing Activities		
Capital lease payments	**(1,233)**	(1,163)
Changes in affiliated, money-pool payable	**(46,194)**	49,600
Net cash (used in) provided by financing activities	**(47,427)**	48,437
Net decrease in cash and cash equivalents	**(206)**	(3,606)
Cash and cash equivalents at beginning of year	**400**	4,006
Cash and cash equivalents at end of year	**$ 194**	$ 400
Supplementary information:		
Interest paid	**$ 14,464**	$ 44,966
Income taxes refunded from Parent	**$ (4,995)**	$ -

(In thousands of dollars)	For the Years Ended March 31, 2010	2009
Non-Cash Transaction:*		
Capital contribution from parent	**$ 435,000**	$ -
Decreased in advanced from KeySpan	**(45,000)**	-
Changes in money-pool payable	**(390,000)**	-
Total	**$ -**	$ -

* See Note 10 - Related Party Transactions for additional details

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

BOSTON GAS COMPANY
STATEMENTS OF CAPITALIZATION

(In thousands, except number of shares)	March 31,			
	2010	2009	**2010**	2009
Common stockholders' equity	**Shares Issued**		**Amounts**	
Common stock, $100.00 par value	**514,184**	514,184	**$ 51,418**	$ 51,418
Additional paid-in capital			**870,323**	435,323
Retained earnings			**72,320**	62,939
Total common stockholder' equity			**$ 994,061**	$ 549,680

Long-term debt	Interest rates	Maturity Date	Amounts	
Notes payable				
MTN Series 1990 A	9.68%	December 15, 2010	**$ 10,000**	$ 10,000
MTN Series 1990 A	9.00%	February 22, 2011	**10,000**	10,000
MTN Series 1989 A	8.95%	June 1, 2011	**10,000**	10,000
MTN Series 1995 C	6.80%	November 30, 2012	**10,000**	10,000
MTN Series 1995 C	6.80%	December 2, 2013	**5,000**	5,000
MTN Series 1994 B	6.93%	January 15, 2014	**5,000**	5,000
MTN Series 1994 B	8.50%	October 24, 2014	**2,000**	2,000
MTN Series 1995 C	7.10%	October 15, 2015	**5,000**	5,000
MTN Series 1994 B	6.93%	January 15, 2016	**5,000**	5,000
MTN Series 1994 B	6.93%	April 1, 2016	**10,000**	10,000
MTN Series 1992 A	8.33%	July 10, 2017	**8,000**	8,000
MTN Series 1992 A	8.33%	July 10, 2018	**10,000**	10,000
MTN Series 1994 B	6.93%	January 15, 2019	**10,000**	10,000
MTN Series 1989 A	8.97%	December 15, 2019	**7,000**	7,000
MTN Series 1990 A	9.75%	December 1, 2020	**5,000**	5,000
MTN Series 1990 A	9.05%	September 1, 2021	**15,000**	15,000
MTN Series 1992 A	8.33%	July 5, 2022	**10,000**	10,000
MTN Series 1995 C	6.95%	December 1, 2023	**10,000**	10,000
MTN Series 1994 B	6.98%	January 15, 2024	**6,000**	6,000
MTN Series 1995 C	6.95%	December 1, 2024	**5,000**	5,000
MTN Series 1995 C	7.25%	October 1, 2025	**20,000**	20,000
MTN Series 1995 C	7.25%	October 1, 2025	**5,000**	5,000
Total long-term debt			**183,000**	183,000
Long-term debt due within a year			**20,000**	-
Total long-term debt excluded current portion			**163,000**	183,000
Advance from KeySpan			**355,000**	400,000
Total capitalization			**$ 1,512,061**	$ 1,132,680

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

BOSTON GAS COMPANY

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization and Purpose

Boston Gas Company d/b/a National Grid (Boston Gas, the Company, we, us and our) is a gas distribution company engaged in the transportation and sale of natural gas to residential, commercial and industrial customers. Our service territory includes Boston and other communities in eastern and central Massachusetts. The Company operates its utility business as a wholly-owned subsidiary of KeySpan New England, LLC (KNE LLC) and an indirect-owned subsidiary of KeySpan Corporation (KeySpan). KeySpan is a wholly-owned subsidiary of National Grid USA (NGUSA), a public utility holding company with regulated subsidiaries engaged in the generation, transmission, distribution and sale of both natural gas and electricity. NGUSA is a wholly-owned subsidiary of National Grid plc, a public limited company incorporated under the laws of England and Wales.

B. Basis of Presentation

The Company's accounting policies conform to general accepted accounting principles in the United States of America (GAAP), including the accounting principles for rate-regulated entities (See Note 2 – Rates and Regulatory), and are in accordance with the accounting requirement and ratemaking practices of the applicable regulatory authorities.

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

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 at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Company has evaluated events or transactions that occurred after March 31, 2010 through July 9, 2010 for potential recognition or disclosure in the financial statements. There were no subsequent events that needed to be recognized.

C. Accounting for the Effects of Rate Regulation

The Company's accounting records are maintained in accordance with the Uniform System of Accounts prescribed by the Massachusetts Department of Public Utilities (DPU). Our financial statements reflect the ratemaking policies and actions of the DPU in conformity with GAAP for rate-regulated enterprises. (See Note 2- Rates and Regulatory)

The Company applies the current accounting guidance for rate regulated enterprises. The guidance recognizes the ability of regulators, through the ratemaking process, to create future economic benefits and obligations affecting rate-regulated companies. Accordingly, the Company records these future economic benefits and obligations as regulatory assets and regulatory liabilities.

In the event the Company determines that its net regulatory assets are not probable of recovery, it would no longer apply the principles of the current accounting guidance for rate regulated enterprises and would be required to record an after-tax change for any remaining regulatory assets and liabilities. In such an event, the resulting charge would be material to the Company's reported financial condition and results of operations.

Management continues to believe that rates are based on the Company's incurred costs and investment levels and therefore should continue to apply the current accounting guidance for rate regulated enterprises

The following regulatory assets and regulatory liabilities were reflected on the balance sheets as of March 31, 2010 and 2009:

	March 31, 2010		March 31, 2009	
(In thousands of dollars)	**Current**	**Non-Current**	Current	Non-Current
Regulatory assets:				
Postretirement benefit costs	**$ 23,475**	**$ 138,816**	$ 27,859	$ 118,875
Environmental costs	**2,920**	**39,303**	2,563	37,800
Derivative contracts	**22,396**	**1,313**	43,232	6,679
Regulatory tax assets	**-**	**154**	-	-
Other	**10,101**	**12,000**	16,751	11,630
Total regulatory assets	**$ 58,892**	**$ 191,586**	$ 90,405	$ 174,984
Regulatory liabilities:				
Miscellaneous liability	**$ (2,895)**	**$ (3,352)**	$ (5,210)	$ (4,154)
Derivative contracts	**(50)**	**(234)**	-	-
Total Regulatory Liabilities	**$ (2,945)**	**$ (3,586)**	$ (5,210)	$ (4,154)
Net regulatory assets	**55,947**	**188,000**	85,195	170,830
Removal costs recovered	**-**	**(371,445)**	-	(336,173)
Total	**$ 55,947**	**$ (183,445)**	$ 85,195	$ (165,343)

The Company recovers certain asset retirement costs through rates charged to customers as a portion of depreciation expense. When depreciable properties are retired, the original cost plus cost of removal less salvage is charged to accumulated depreciation. At March 31, 2010 and 2009, we had removal costs recovered in excess of removal costs incurred totaling $371.4 million and $336.2 million, respectively. This amount is reflected as a regulatory liability on the balance sheets.

The regulatory items above are not included in utility rate base. We record carrying charges, as appropriate, on the regulatory items 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. We anticipate recovering these costs in our gas rates concurrently with future cash expenditures. If recovery is not concurrent with the cash expenditures, we will record the appropriate level of carrying charges. At March 31, 2010 and 2009, deferred gas costs of approximately $103.3 million and $52.7 million, respectively, are reflected in "Accounts receivable" on the balance sheet.

D. Revenue Recognition

Utility gas customers are billed on a monthly cycle basis. Revenues include unbilled amounts related to the estimated gas usage that occurred from the most recent meter reading to the end of each month. Substantially all of the Company's revenues are derived from sales to firm gas customers.

The Cost of Gas Adjustment Factor (CGAF) requires us semi-annually, or based on certain criteria, monthly to adjust rates for firm gas sales in order to track changes in the cost of gas distributed, with an annual adjustment of subsequent rates made for any over or under recovery of actual costs incurred. As a result, the cost of firm gas that has been distributed, but is unbilled at the end of a period, is deferred to the period in which the gas is billed to customers. We recover the gas cost portion of bad debt write-offs through the CGAF. In addition, through a Local Distribution Adjustment Factor (LDAF), we are allowed to recover the amortization of environmental response costs associated with former manufactured gas plant (MGP) sites, costs related to our various energy efficiency programs and other specified costs from our firm sales and transportation customers. We record amounts recoverable under LDAF as revenue when billed to customers.

E. Property, Plant and Equipment

Utility gas property is stated at original cost of construction. The cost of additions to property, plant and equipment and replacements of retirement units of property are capitalized. Costs include direct material, labor, overhead and Allowance for Funds Used during Construction (AFUDC). Replacement of minor items of utility plant and the cost of current repairs and maintenance are charged to expense. Whenever utility plant is retired, its original cost, together with the cost of removal, less salvage, is charged to accumulated depreciation (See Note 5 – Property, plant and equipment).

AFUDC - The Company capitalizes AFUDC as part of construction costs. AFUDC represents an allowance for the cost of funds used to finance construction and, for the Company, includes a debt component. AFUDC is capitalized in "Property, Plant and Equipment" with offsetting credits to "Other interest" for the debt component. The Company is permitted to recover prudently incurred capital costs through their ultimate inclusion in rate base and in the provision for depreciation. The composite AFUDC rate was 3.7% and 4.5%, respectively.

Depreciation - Depreciation is provided on a straight-line basis at rates designed to amortize the cost of depreciable property, plant and equipment over their estimated remaining useful lives. The composite depreciation rate, expressed as a percentage of the average depreciable property in service, is approximately 5.2% at March 31, 2010 and 2009. The cost of repair and minor replacement and renewal of property is charged to maintenance expense.

F. Goodwill

In accordance with current accounting guidance for goodwill and other intangible assets, the Company tests goodwill for impairment on an annual basis and on an interim basis when certain events or circumstances exist. Goodwill impairment is determined by comparing the estimated fair value of a reporting unit with its respective book value. If the estimated fair value exceeds the book value, goodwill at the reporting unit level is not deemed to be impaired. If the estimated fair value is below book value, however, further analysis is required to determine the amount of the impairment. Additionally, if the forecasted returns utilized in the analysis are not achieved, an impairment of goodwill may result. For example, within our calculation of forecasted returns, we have made certain assumptions around the amount of pension and environmental costs to be recovered in future periods. Should we not benefit from improved rate relief in these areas, the result could be a reduction in fair value of the Company, which in turn could give rise to an impairment of goodwill.

The Company utilizes a discounted cash flow approach incorporating its most recent business plan forecasts together with a projected terminal year calculation in the performance of the annual goodwill impairment test. Critical assumptions used in the Company's analysis include a discount rate of 6% and a terminal year growth rate of 3% based upon expected long-term average growth rates. Our forecasts assume long-term recovery and rate of returns that are in line with historical levels within the utility industry. The resulting fair value of the annual analysis determined that no adjustment of the goodwill carrying value was required.

G. Cash and Cash Equivalents

The Company classifies short-term investments with a maturity of 3 months or less at time of purchase as cash equivalents.

H. Restricted Cash

Restricted cash consists of collateral requirement to our counterparties for outstanding derivative contracts.

I. Income Taxes

Income taxes have been computed utilizing the asset and liability approach that requires the recognition of deferred tax assets and liabilities for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. Deferred investment tax credits are amortized over the useful life of the underlying property. Additionally, the Company follows the current accounting guidance relating to uncertainty in income taxes recognized in the financial statements in accordance with the accounting guidance related to the accounting for income taxes which applies to all income tax positions reflected on the Company's balance sheets that have been included in previous tax returns or are expected to be included in future tax returns. (See Note 6 – Income Taxes)

J. Pension and Other Postretirement Plan Assets

On March 31, 2007, NGUSA adopted certain accounting guidance that requires employers to fully recognize all postretirement plans' funded status on the balance sheets as a net liability and required an offsetting adjustment to regulatory assets upon implementation. Consistent with past practice and as required by the current accounting guidance, NGUSA values its pension and other postretirement assets using the year-end market value of those assets. Benefit obligations are also measured at year-end. (See Note 3 - Employee Benefits)

K. Derivative

We employ derivative instruments to hedge a portion of our exposure to commodity price risk. Whenever hedge positions are in effect, we are exposed to credit risk in the event of nonperformance by counter-parties to derivative contracts, as well as nonperformance by the counter-parties of the transactions against which they are hedged. We believe that the credit risk related to the futures, options and swap instruments is no greater than that associated with the primary commodity contracts which they hedge.

Firm Gas Sales Derivatives Instruments:

We utilize derivative financial instruments to reduce the cash flow variability associated with the purchase price for a portion of our future natural gas purchases. Our strategy is to minimize fluctuations in firm gas sales prices to our regulated firm gas sales customers. Since these derivative instruments are being employed to support our gas sales prices to regulated firm gas sales customers, the accounting for these derivative instruments is similar to our deferral accounting treatment of gas costs. Therefore, changes in the market value of these derivatives are recorded as deferred assets or liabilities on our balance sheet. Gains or losses on the settlement of these contracts are initially deferred and then refunded to or collected from our firm gas sales customers consistent with regulatory requirements.

Physically-Settled Commodity Derivative Instruments:

Certain of our contracts for the physical purchase of natural gas qualify as derivatives under certain accounting standards. As such, these contracts are recorded on the balance sheets at fair market value. However, since such contracts were executed for the purchases of natural gas that is sold to regulated firm gas sales customers, and pursuant to the requirements of certain accounting standards, changes in the fair market value of these contracts are generally recorded as a regulatory asset or regulatory liability on the balance sheets.

L. Fair Value Measurements

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 - exit price. The determination of fair value incorporates various factors required including not only the credits standing of the counterparties involved but also the impact of the Company's nonperformance risk on its liability. To increase consistency and comparability in fair value measurements, a fair value hierarchy was established that prioritizes the inputs to valuation techniques used to measure fair value into three levels. (See Note 3 - Employee Benefits and Note 8 – Fair Value Measurement) The following is a fair value hierarchy:

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.

Level 3 — unobservable inputs, such as internally-developed 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.

M. Reclassification

Certain amounts from prior years have been reclassified in the accompanying financial statements to conform to the current year presentation. Included in operations and maintenance expense on the Statements of income for the year ended March 31, 2010 is $1.5 million of payroll charges that relate to prior years. The Company has determined that this amount is immaterial to current and prior year financial statements and therefore prior year restatement was not considered necessary.

N. Inventory

Inventory is stated primarily at the lower of cost or market value under the average costs method. The Company's policy is to write-off obsolete inventory.

O. Recent Accounting Pronouncements

In May 2009, the Financial Accounting Standard Board (FASB) issued accounting guidance establishing the general standards of accounting for and disclosures of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. In particular, this FASB guidance requires enhanced disclosures about (a) events or transactions that may occur for potential recognition or disclosure in the financial statements in the period after the balance sheet date, (b) circumstances under which an entity should recognize such events, and (c) date through which an entity has evaluated subsequent events, including the basis for that date, and whether that date represents the date the financial statements were issued or available to be issued. This FASB guidance is effective for financial statement issued for interim and annual periods ending after June 15, 2009. The adoption of this guidance did not have an impact on the Company's financial statements.

In June 2009, the FASB issued an amendment to the accounting and disclosure requirements for transfers and servicing of financial assets and extinguishment of liabilities. The objective of the amendment is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; and effects of a transfer on its financial position, financial performance and cash flows; and transferor's continuing involvement, if any, in transferred financial assets. The new provisions must be applied as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009 and are to be applied to transfers occurring on or after the effective date.

In June 2009, FASB issued an amendment to the accounting and disclosure requirements for the consolidation of variable interest entities. The objective of the amendment is to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of the financial statements. The amendment requires an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity. The new requirements shall be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009.

In June 2009, the FASB issued the FASB Accounting Standards Codification (Codification). The Codification will become the single source for all authoritative GAAP recognized by the FASB to be applied for financial statements issued for periods ending after September 15, 2009. The Codification does not change GAAP and will not have an affect on our financial position, results of operations or liquidity. With the adoption of this new guidance, the Company has eliminated specific references in the notes to its financial statements and other documents and replaced them with more general topical references.

In January 2010, the FASB issued an amendment to the accounting guidance for fair value measurements that will provide for additional disclosures about (a) the different classes of assets and liabilities measured at fair value, (b) the valuation techniques and inputs used, (c) the activity in Level 3 fair value measurements, and (d) the transfers between Levels 1, 2, and 3. This FASB guidance is effective for financial statement issued for interim and annual periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years.

NOTE 2. RATES AND REGULATORY

The Company currently has a rate plan in place to 2013, unless terminated earlier. Under the rate plan, rates are adjusted each year with the approval of the DPU based on a price cap formula. The rate plan also provides for a true-up mechanism for pension and other postretirement benefit costs under which variations between actual pension and postretirement benefit other than pensions and amounts used to establish rates are deferred and collected from or refunded to customers in subsequent periods. This true-up mechanism allows for carrying charges on deferred assets and liabilities at the Company's weighted-average cost of capital. There is also an earnings sharing mechanism. If the return on equity (ROE) is greater than 14.2%, customers share 25% of the excess gain. Conversely, if the ROE is lower than 6.2%, customers bear 25% of the loss. On September 15, 2009, the Company filed its sixth annual request for an increase under the rate plan in the amount of $5.4 million, which was approved by the DPU in October 2009. On April 16, 2010, the Company, jointly with its affiliates, Colonial Gas and Essex Gas, the wholly-owned subsidiaries of KNE LLC, filed a request for an increase in base distribution rates. The Company and Essex Gas are proposing a combined increase of $79.2 million and Colonial Gas is proposing an increase of $26.8 million. The filing includes, among other things, a revenue decoupling proposal. The matter is pending before the DPU. An order is anticipated in early November 2010 with rates to become effective shortly thereafter.

On November 17, 2008, the Company, together with Colonial Gas and Essex Gas, filed a combined request for approval of a three year gas portfolio optimization agreement with ConocoPhillips. An order was issued on April 1, 2009 approving the agreement, including proposed margin sharing, but limiting the term to a period of one year. Under the terms of the agreement, customers will receive a minimum guaranteed payment plus a share of any revenues generated above the guarantee amount. On December 30, 2009, the Company, together with Colonial Gas and Essex Gas, filed a combined request for approval to extend the term of this agreement for one additional year, which was approved on April 6, 2010.

On December 16, 2009, the Company and Essex Gas filed a joint petition for authorization for legal consolidation under MGL Chapter 164, Section 96, with the DPU. In their petition, the companies requested that the DPU confirm that the Company, as the surviving corporation of the consolidation, will continue to have all of the franchise rights and obligations that were previously held by the Company and Essex Gas, and that further action pursuant to MGL Chapter 164, Section 21 is not required to consummate the consolidation. This matter is pending before the DPU. If the merger is approve, the Company's financial position, results of operations and cash flows will need to be recast both retrospectively and prospectively.

Green Communities Act:
As part of the Green Communities Act (GCA), the Massachusetts legislature required utilities to prepare three-year energy efficiency plans that would cover calendar years 2010 through 2012 and result in increased energy efficiency spending compared to amounts spent in prior years. Statewide three-year gas plans were approved by the newly created Energy Efficiency Advisory Council on October 27, 2009. The Company's 2010 through 2012 energy efficiency plan (offered as a single combined program with Colonial Gas and Essex Gas) was approved by the DPU on January 28, 2010, including a cost recovery mechanism. The proposed budget for the three gas companies in Massachusetts for the calendar years 2010 through 2012 is $203.4 million. A performance incentive mechanism was also approved by the DPU for which the DPU is now reviewing specific details. The Company expects to recovery the cost of the program and reduced revenue.

Prior to the passage of the GCA in July 2008, the Company provided energy efficiency initiatives for its customers under its 2009 combined program with Colonial Gas and Essex Gas with a budget approved by the DPU of approximately $20.0 million. The Company, together with Colonial Gas and Essex Gas, obtains cost recovery through each company's local LDAF. In addition, the companies can earn performance incentives depending on whether certain set goals are met, and are also entitled to seek recovery of lost base revenues. Lost base revenues may be recovered from a set point in time until the companies revenue decoupling proposal is approved by the DPU. On September 24, 2009, the Company, Colonial Gas and Essex Gas filed a request with the DPU to increase the 2009 budget by approximately $10.5 million, all of which is deferred as of March 31, 2010, because of overspending due to increased demand. This matter is pending before the DPU.

NOTE 3. EMPLOYEE BENEFITS

Pension:
The Company's qualified pension plans have been merged with other KeySpan pension plans into a consolidated Pension Plan. Pension costs are allocated to the Company. The KeySpan defined benefit pension plan has a net underfunded obligation of $740.2 million at March 31, 2010 and $825.3 million at March 31, 2009. Certain current year changes in the funded status of the KeySpan plan are allocated to the Company through an intercompany payable account. The gross actuarial expenses allocated to the Company were approximately $17.7 million and $10.7 million for the year ended March 31, 2010 and 2009, respectively. The Company is subject to deferral accounting requirements for pension expense. Any variation between actual pension costs and amounts used to establish rates are deferred and collected from or refunded to customers in subsequent periods through an adjustment clause. Funding for pensions is in accordance with requirements of federal law and regulations.

Pension benefits for salaried employees are based on salary and years of service, while pension benefits for union employees are based on negotiated benefits and years of service. Employees hired before 1993 who are participants in the pension benefit plans become eligible for postretirement health care benefits if they reach retirement age while working for the Company.

The table below details the end-of-year assumptions used for both the net periodic cost calculations and liability amounts.

At March 31,	**2010**	2009
Assumptions:		
Obligation discount	**6.10%**	7.30%
Asset return, net of expenses	**8.00%**	8.00%
Average annual increase in compensation	**3.50%**	3.50%

Postretirement Health Care Benefits:
The Company provides postretirement health care benefits, including medical and life insurance (collectively health care) benefits for substantially all of its employees. The plan is contributory for retirees, with respect to medical benefits and noncontributory with respect to life insurance benefits. The health care plan has not been merged with other KeySpan plans and therefore, continues to remain a separate plan of the Company.

The Company is subject to deferral accounting requirements, as previously ordered by the DPU, for postretirement health care costs. Any variation between actual postretirement health care costs and amounts used to establish rates are deferred and collected from or refunded to customers in subsequent periods through an adjustment clause. Any deferral is recorded as either a regulatory asset or regulatory liability on the balance sheet.

The net costs for postretirement health care costs charged to expense for the years ended March 31, 2010 and 2009 are as follows:

Year ended March 31, (In thousands of dollars)	**2010**	2009
Service cost-benefits earned during the year	**$1,601**	$1,600
Interest cost on benefit obligation	**8,088**	7,202
Expected return on plan assets	**(1,384)**	(1,181)
Amortization of net actuarial gain	**(556)**	-
Special termination benefits	**175**	-
Total	**$7,924**	$7,621

The following table sets forth the change in benefit obligation and plan assets and reconciliation of funded status of our health care plans and amounts recorded on the balance sheets as of March 31, 2010 and 2009:

Year ended March 31, (In thousands of dollars)		**2010**		2009
Change in benefit obligation:				
Benefit obligation at beginning of year	**$**	**(108,891)**	$	(124,631)
Service cost		**(1,601)**		(1,600)
Interest cost		**(8,088)**		(7,202)
Amendments		**(763)**		-
Actuarial (loss) gain		**(23,323)**		17,047
Benefits paid		**8,273**		7,495
Actual Medicare Part D subsidy received		**(415)**		-
Special termination benefits		**(174)**		-
Other		**(2,233)**		-
Benefit obligation at end of year		**(137,215)**		(108,891)
Change in plan assets:				
Fair value of plan assets at beginning of year		**13,489**		14,161
Actual return on plan assets		**5,849**		(3,478)
Employer contributions		**11,414**		10,301
Benefits paid		**(8,273)**		(7,495)
Fair value of plan assets at end of year		**22,479**		13,489
Funded status	**$**	**(114,736)**	$	(95,402)
Amounts recognized in the Balance Sheets consist of:				
Current liabilities	**$**	**(2,587)**	$	(2,457)
Noncurrent liabilities		**(112,149)**		(92,945)
Total	**$**	**(114,736)**	$	(95,402)
Amounts recognized in regulatory assets consist of:				
Net gain / (loss)	**$**	**(6,504)**	$	7,575
Prior service cost		**(763)**		-
Total	**$**	**(7,267)**	$	7,575
Estimated amount of regulatory assets to be recognized in next fiscal year through net periodic postretirement cost:				
Net gain	**$**	**104**	$	109
Prior service cost		**(89)**		-
Total	**$**	**15**	$	109

The accrued health care cost attributed to the Company employees at March 31, 2010 and 2009 is $98.6 million and $76.4 million, respectively, and is reflected on the balance sheets in postretirement benefit obligation. The remaining accrued health care costs at March 31, 2010 and 2009 of $13.6 million and $19.0 million attributed to the Company postretirement health care plan is reflected on KeySpan's balance sheet as it represents costs of previous Company employees who are now KeySpan employees and who continue to participate in this Plan.

To fund health care benefits under its collective bargaining agreements, the Company maintains a Voluntary Employee Beneficiary Association (VEBA) Trust to which it makes contributions from time to time. Both pension and health care plan assets are invested principally in common stock and fixed income assets.

The following are the weighted-average assumptions used in developing the projected and accumulated benefit obligations:

Year ended March 31,	**2010**	2009
Assumptions:		
Obligation discount	**6.10%**	7.30%
Asset return	**7.70%**	7.60%

The measurement of plan liabilities also assumes an 8.50% health care cost trend rate and a 9.25% prescription drug trend both grading down to 5.0% over five years, and 5.0% thereafter. A one-percentage-point increase or decrease in the assumed health care trend rate would have the following effects:

(In thousands of dollars)	**One-Percentage-Point Increase**	**One-Percentage-Point Decrease**
Net periodic healthcare expense	$ 610	$ (536)
Postretirement benefit obligation	$ 7,470	$ (6,639)

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid in the years indicated:

(In thousands of dollars)	**Gross Benefit Payments**	**Subsidy Receipts Expected ****
2010	$ 9,314	$ 441
2011	$ 9,932	$ 447
2012	$ 10,284	$ 450
2013	$ 10,741	$ 449
2014	$ 11,117	$ 442
Years 2015 -2019	$ 58,333	$ 1,952

** Rebates are based on calendar year in which prescription drug costs are incurred.
Actual receipt of rebates may occur in the following year.

Pension/Other Postretirement Benefit Plan Assets:
KeySpan's weighted average asset allocations at March 31, 2010 and 2009, by asset category, for both the pension and other postretirement benefit plans are as follows:

	Pension		**OPEB**	
Asset Category	**2010**	2009	**2010**	2009
Equity securities	**51%**	49%	**63%**	62%
Debt securities	**42%**	41%	**18%**	32%
Other	**7%**	10%	**19%**	6%
Total	**100%**	100%	**100%**	100%

Key Assumptions Used:
Several assumptions affect the pension and other postretirement benefit expense and measurement of their respective obligations. The following is a description of some of those assumptions:

Benefit plan investments:
KeySpan manages 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 plan liabilities and plan 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 the various fixed income market segments. Periodically, small investments are also held in private equity funds and/or venture capital funds with the objective of enhancing long-term returns while improving portfolio diversification. Investments are managed to maximize after tax returns, on earnings that are taxable, consistent with the broad asset class parameters established by the asset allocation study. Investment risk and return are reviewed by the investment committee on a quarterly basis.

Expected return on assets:
The expected rate of return for various passive asset classes is based on both 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 long-term assumptions. A small premium is added for active management and rebalancing of both equity and fixed income securities. These rates of return for each asset class are then weighted in accordance with a target asset allocation, and the resulting long-term rate of return on assets is applied to the market-related value of assets. For each of the fiscal year ended March 31, 2010 and 2009, KeySpan used an 8.00 % expected rate of return on assets for its pension plan. For fiscal year ended March 31, 2010 and 2009, KeySpan used a 7.7% and 7.6%, respectively, expected rate of return on other postretirement plans.

Discount rate:
KeySpan selects its discount rate assumption based upon rates of return on high quality corporate bond yields in the marketplace as of each measurement date (typically each March 31st). Specifically, KeySpan uses the Hewitt Top Quartile Discount Curve along with the expected future cash flows from the KeySpan retirement plans to determine the weighted average discount rate assumption. At March 31, 2010 and 2009, a discount rate assumption of 6.1 % and 7.3 % was deemed appropriate for the plans.

Health Care Reform:
In March 2010, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 became law. These laws' included provisions which resulted in the repeal, with effect from 2012, of the deduction for federal income tax purposes of the portion of the cost of an employer’s retiree prescription drug coverage for which the employer received a benefit under the Medicare Prescription Drug Improvement and Modernization Act of 2003. The consequential reduction in the deferred tax asset balance resulted in a net charge to the income statement of approximately $2.0 million.

No regulatory asset has been established with respect to this charge as any potential future recovery from customers of the increased cost of the Company's retiree health plans that results from the loss of this tax deduction has not been agreed under the terms of the Company's current rate plans.

Fair Value Measurements:
The Company used valuation techniques which maximized the use of observable inputs and minimized the use of unobservable inputs.

Following is a description of the valuation methodologies used at March 31, 2010 for plan assets measured at fair value.

- Interest bearing cash is valued at the investment principal plus all accrued interest.

- Temporary cash investment and short-term investments are valued at either the investment principal plus all accrued interest or the net asset value of shares held by the Plans at year end.

- Mutual funds and pooled separate accounts are valued at the net asset value of shares held by the Plan at year end.

- Common stocks, preferred stocks, and real estate investment trusts are valued using the official close (for NASDAQ only), last trade, bid of the ask offer price reported on the active market on which the individual securities are traded.

- Fixed income securities, convertible securities, collateral received from securities lending (which include corporate debt securities, municipal fixed income securities, US Government and Government agency securities which are in turn comprised of government agency securities, government mortgage-backed securities, index linked government bonds, and state and local bonds), Derivatives (except certain options traded on an exchange) and forward foreign exchange contracts (comprised of interest rate swaps, credit default swaps, index swaps, financial futures, and other derivatives), and investment of securities lending collateral (comprised of repurchase agreements, asset-backed securities, floating rate notes and time deposits) are valued with an institutional bid valuation or an institutional mid evaluation. A bid evaluation is an estimated price at which a dealer would pay for a security (typically in an institutional round lot). A mid evaluation is the average of the estimated price at which a dealer would sell a security and the 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 used when primary price vendors do not supply prices.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, 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 certain financial instruments could result in a different fair value measurement at the reporting date.

The table depicted below sets forth by level, within the fair value hierarchy, the Keyspan Master Union Trust Plan assets for retirement benefits other than pension, at fair value as of March 31, 2010. The Company has been allocated approximately 4.52% as its share in the investments shown below.

(in thousands of dollars)								
Asset Type		Level 1		Level 2		Level 3		Grand Total
Investments								
Cash & Cash Equivalents	$	33,142	$	545	$	-	$	33,687
Equity		106,721		143,080		12,023		261,824
Fixed Income Securities		78,830		77,748		-		156,578
Preferred Securities		68		-		-		68
Private Equity		-		9,220		36,272		45,492
Assets at fair value	$	218,761	$	230,593	$	48,295	$	497,649

The following table sets forth a summary of changes in the fair value of the Plan's level 3 assets for the year ended March 31, 2010:

(in thousands of dollars)	Equity	Fixed Income Securities	Preferred Securities	Private Equity	Total
Balance, beginning of year	$ 36,018	$ 138	$ 300	$ 20,524	$ 56,980
Realized gains (losses)	2,593	(380)	(255)	779	2,737
Unrealized losses relating to instruments held at reporting date	8,531	395	-	(861)	8,065
Purchases, sales, issuance, and settlements (net)	(35,119)	(153)	(45)	15,830	(19,487)
Balance, end of year	$ 12,023	$ -	$ -	$ 36,272	$ 48,295

NOTE 4. LONG-TERM DEBT AND CAPITAL LEASES

Advance from KeySpan:
At March 31, 2009 the Company had a $400 million advance payable due to KeySpan. During 2010, $45 million was repaid to KeySpan leaving a balance of $355 million at March 31, 2010. Interest charges equal interest incurred by KeySpan on debt borrowings issued by KeySpan. The interest rate was fixed at 7.625% on these borrowing for the years ended March 31, 2010 and 2009. Issuance expense is charged to us from KeySpan equal to the amortization of actual issuance costs incurred by KeySpan on its debt borrowings. KeySpan amortizes these costs over the life of the related KeySpan borrowings. There are no covenants or fixed maturity dates associated with the advance.

Notes payable:
At March 31, 2010, the Company had outstanding $183.0 million of secured medium and long-term notes with interest rates ranging from 6.80% to 9.75% and maturity dates ranging from 2010 through 2025.

Maturity schedule:
The following table reflects the maturity schedule for our debt repayment requirement at March 31, 2010:

For the years ended March 31,	
(in thousands of dollars)	**Long-term debt**
Repayments:	
2011	$ 20,000
2012	10,000
2013	10,000
2014	10,000
2015	2,000
Thereafter	131,000
	$ 183,000

The following table represents the rating of the Company's senior unsecured long-term debt at March 31, 2010:

	Standard & Poor's	Moody's Investor Services	Fitch Ratings
Senior Unsecured or long term debt	A-	Baa1	N/A

Capital lease:
In April 1999, the Company entered into a 15-year capital lease for liquefied natural gas facilities located in Massachusetts. A summary of the property held under capital lease as of March 31, 2010 and 2009 is as follows:

(in thousands of dollars)	**March 31, 2010**		March 31, 2009	
LNG Facilities	**$**	**14,835**	$	14,835
Less: Accumulated Depreciation		**9,126**		7,893
Total Capital Lease	**$**	**5,709**	$	6,942

Under the terms of certain accounting standards, the timing of expense recognition on capitalized leases conforms to regulatory rate treatment. The Company has included the rental payments on its capital leases in its cost of service for rate purposes.

Maturity Schedule:
The following table reflects the maturity schedule for our capital lease requirement at March 31, 2010:

(in thousands of dollars)	Capital Lease Obligations	
Repayments:		
2011	$	1,308
2012		1,388
2013		1,473
2014		1,540
	$	5,709

NOTE 5. PROPERTY, PLANT AND EQUIPMENT

The following table reflects the movements in our property, plant and equipment for the years ended March 31, 2010 and 2009:

(in thousands of dollars)	Plant and Machinery	Land and Buildings	Assets in Construction	Software Intangibles	Total
Balance at March 31, 2008	$ 1,590,467	$ 39,236	$ 62,194	$ 71,353	**$ 1,763,250**
Additions	-	-	148,091	-	**148,091**
Disposals	(5,945)	-	-	3,819	**(2,126)**
Reclassifications	146,702	4,538	(151,240)	-	**-**
Balance at March 31, 2009	$ 1,731,224	$ 43,774	$ 59,045	$ 75,172	**$ 1,909,215**
Accumulated depreciation at March 31, 2009	(423,520)	(19,815)	-	(59,775)	**(503,110)**
Net book value at March 31, 2009	$ 1,307,704	$ 23,959	$ 59,045	$ 15,397	**$ 1,406,105**
Balance at March 31, 2009	$ 1,731,224	$ 43,774	$ 59,045	$ 75,172	**$ 1,909,215**
Additions	-	-	163,947	-	**163,947**
Disposals	(9,643)	(336)	-	(419)	**(10,398)**
Reclassifications	185,743	7,358	(193,101)	-	**-**
Balance at March, 31, 2010	1,907,324	50,796	29,891	74,753	**2,062,764**
Accumulated depreciation at March 31, 2010	(458,182)	(21,159)	-	(65,496)	**(544,837)**
Net book value at March 31, 2010	$ 1,449,142	$ 29,637	$ 29,891	$ 9,257	**$ 1,517,927**

NOTE 6. INCOME TAXES

Following is a summary of the components of federal and state income tax expense (benefits):

Years ended March 31, (in thousands of dollars)	**2010**	2009
Components of federal and state income taxes:		
Current tax expense (benefit):		
Federal	**$ (66,333)**	$ 20,574
State	**(5,354)**	2,577
Total current tax expense	**(71,687)**	23,151
Deferred tax expense (benefit):		
Federal	**75,004**	(14,270)
State	**15,002**	(859)
Total deferred tax benefit	**90,006**	(15,129)
Total income tax expense	**$ 18,319**	$ 8,022

Income tax expense for 2010 and 2009 varied from the amount computed by applying the statutory rate to income before income taxes. A reconciliation of expected federal income tax expense, using the federal statutory rate of 35%, to the Company's actual income tax expense for 2010 and 2009 is presented in the following table:

Years ended March 31, (in thousands of dollars)		**2010**		2009
Computed tax	**$**	**9,695**	$	9,187
Increase (reduction) attributable to certain tax adjustments:				
State income taxes, net of federal income tax benefit		**6,271**		1,118
Medicare subsidy, including Patient Protection & Affordable Care Act effect, net		**1,679**		(56)
Provision to return adjustments		**592**		(1,570)
Allowance for equity funds used during construction		**(82)**		(709)
Other items - net		**164**		52
Total		**8,624**		(1,165)
Federal and state income taxes	**$**	**18,319**	$	8,022

Significant components of the Company's net deferred tax assets and liabilities at March 31 are presented in the following table:

(in thousands of dollars)		**2010**		2009
Employee benefits and compensation	**$**	**67,446**	$	51,485
Future federal benefit on state taxes		**11,925**		6,665
Reserve - Environmental		**11,063**		9,827
Allowance for uncollectible accounts		**8,049**		11,271
Other items		**162**		3,959
Total deferred tax assets [1]		**98,645**		83,207
Property related differences		**(223,923)**		(149,745)
Regulatory assets - Pension and OPEB		**(65,496)**		(58,946)
Deferred Gas Cost		**(37,957)**		(14,915)
Regulatory Assets - Environmental		**(13,292)**		(11,376)
Unbilled Revenue		**(5,123)**		(5,044)
Unamortized debt discount or premium		**(754)**		(920)
Total deferred tax liabilities		**(346,545)**		(240,946)
Net accumulated deferred income tax liability		**(247,900)**		(157,739)
Current portion of net deferred tax liability		**(29,005)**		(28,403)
Net accumulated deferred income tax liability (non-current)	**$**	**(218,895)**	$	(129,336)

[1] There were no valuation allowances for deferred tax assets at March 31, 2010 or 2009.

Subsequent to Keyspan acquisition by National Grid on August 24, 2007, Keyspan and its subsidiaries became members of the National Grid Holdings Inc. (NGHI) and subsidiaries consolidated federal income tax return. The Company is also a member of this return. The Company has joint and several liability for any potential assessments against the consolidated group. In December 2009, NGHI made an income tax accounting method change (in accordance with Internal Revenue Code Section 481(a)) for routine repair and maintenance of network assets pursuant to Internal Revenue Code Section 162 and Treasury Regulation §1.162-4 in its consolidated federal income tax return for the tax year ended March 31, 2009 which resulted in a current tax benefit during the fiscal year ended March 31, 2010.

As of March 31, 2010 and March 31, 2009, the Company's current federal income taxes balances payable to its parent are $17.9 million and $75.5 million, respectively.

ASC 740 clarifies the accounting for uncertain tax positions. ASC 740-10-25-6 provides that the financial effects of a tax position shall initially be recognized 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.

Due to the application of ASC 740, as of March 31, 2010 and 2009, the Company's unrecognized tax benefits totaled $69.8 million and $42.5 million, respectively, of which $3.8 million and $3.8 million would affect the effective tax rate, if recognized.

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

Reconciliation of Unrecognized Tax Benefits		
(in thousands of dollars)	**2010**	2009
Unrecognized tax benefit - beginning of year	**$42,499**	$46,139
Gross increases (decreases) related to prior period	**-**	(3,640)
Gross decreases (decreases) related to current period	**27,276**	-
Settlements	**-**	-
Lapse of statute of limitations	**-**	-
Unrecognized Tax Benefit - end of year	**$69,775**	$42,499

As of March 31, 2010 and March 31, 2009, the Company has accrued for interest related to unrecognized tax benefits of $10.2 million and $9.3 million, respectively. During fiscal years ended March 31, 2010 and March 31 2009, the Company recorded interest expense related to unrecognized tax benefits of $0.9 million and $1.8 million, respectively. The Company recognizes accrued interest related to unrecognized tax benefits in interest expense or interest income and related penalties, if applicable, in operating expenses. No penalties were recognized during fiscal years ended March 31, 2010 and March 31, 2009.

The IRS is in the process of examining Keyspan and subsidiaries consolidated federal income tax returns for the calendar years ended December 31, 2000 through 2006. The examination is expected to be concluded during fiscal year ending March 31, 2011. At that time, the Company expects to decrease its unrecognized tax benefits by $26.0 million. The tax returns for the short period ended August 24, 2007, as well as fiscal years ended March 31, 2008 and March 31, 2009 remains subject to examination by the IRS.

The State of New York is currently auditing calendar years ending December 31, 2002 through December 31, 2004 for Boston Gas Company. The tax returns for calendar years ended December 31, 2005 through December 31, 2006, the period ended August 24, 2007, and fiscal years ended March 31, 2008 and March 31, 2009 remain subject to examination.

NOTE 7. DERIVATIVE CONTRACTS

Financial:

The Company uses derivative financial instruments to reduce the cash flow variability associated with the purchase price for a portion of future natural gas purchases. Our strategy is to minimize fluctuations in firm gas sales price, to regulated firm gas sales customers in our service territory. The accounting for these derivative instruments follows the accounting guidance for rate regulated enterprises. Therefore, the fair value of these derivatives is recorded as current or deferred assets and liabilities, with offsetting positions recorded as regulatory assets or regulatory liabilities on the balance sheets. Gains or losses on the settlement of these contracts are initially deferred and then refunded to or collected from our firm gas sales customers during the appropriate winter heating season consistent with regulatory requirements. At March 31, 2010 and 2009, the fair value of these derivative instruments was a liability of $21.1 million and $46.7 million, respectively.

Physical:
Current accounting guidance for derivative instruments establishes criteria that must be satisfied in order for option contracts, forward contracts with optionality features or contracts that combine a forward contract and a purchased option contract to qualify as normal purchase and normal sales. Certain contracts for the physical purchase of natural gas do not qualify this exception. Since these contracts are for the purchase of natural gas sold to regulated firm gas sales customers, the accounting for these contracts follows the accounting guidance for rate regulated enterprises. At March 31, 2010 and 2009, the fair value of these derivatives was a liability of $2.3 million and $3.5 million, respectively.

Other Derivative Instruments:
Additionally, the Company employs a limited number of non-regulatory derivative instruments to economically hedge a small portion of its risk associated with storage optimization. The maximum length of time over which derivative financial instruments are in-place is through July 2010. The fair value of these contracts at March 31, 2010 was a liability of $2.0 million. We use market quoted forward prices to value these contracts.

The following are commodity volumes associated with those derivative contracts at March 31, 2010:

(In thousands)		
Physicals	Gas (dths)	12,374
Financials	Gas swaps (dths)	21,217
Total	**Gas (dths)**	**33,591**

The following are balance sheet and statement of income tables for the various commodities:

Fair Values of Derivative Instruments - Balance Sheets										
	Asset Derivatives					Liability Derivatives				
(in thousands of dollars)	March 31, 2010		March 31, 2009			March 31, 2010		March 31, 2009		
Regulated contracts										
Gas contracts:										
Current assets:					Current liabilities					
Gas swaps contract	$	10	$	-	Gas swaps contract	$	(21,124)	$	(41,909)	
Gas purchase contract		40		-	Gas purchase contract		(1,272)		(3,011)	
Subtotal current assets	$	50	$	-	Subtotal current liabilities	$	(22,396)	$	(44,920)	
Deferred asset:					Deferred liabilities					
Gas swaps contract	$	-	$	-	Gas swaps contract	$	-	$	(4,836)	
Gas purchase contract		234		643	Gas purchase contract		(1,313)		(1,191)	
Subtotal deferred assets	$	234	$	643	Subtotal deferred liabilities	$	(1,313)	$	(6,027)	
Subtotal regulated contracts	$	284	$	643	Subtotal regulated contracts	$	(23,709)	$	(50,947)	
Non regulated contracts										
Gas contracts:										
Current assets:					Current liabilities					
Gas swaps contract	$	2,791	$	256	Gas swap contract	$	(792)	$	(117)	
Gas purchase contract		18		-	Gas purchnase contract		(55)		-	
Subtotal non regulated contracts	$	2,809	$	256	Subtotal non regulated contracts	$	(847)	$	(117)	
Total	$	3,093	$	899	Total	$	(24,556)	$	(51,064)	

Fair Values of Derivative Instruments - (Statement of Income)						
	YTD Movement		March 31, 2010		March 31, 2009	
Regulatory contracts						
Gas Contracts:						
Gas Swaps Contract - Regulatory Asset	$	25,621	$	(21,124)	$	(46,745)
Gas Purchase Contract - Regulatory Asset		1,617		(2,585)		(4,202)
Gas Swaps Contract - Regulatory Liability		10		10		-
Gas Purchase Contract - Regulatory Liability		(369)		274		643
Subtotal	$	26,879	$	(23,425)	$	(50,304)
Non regulatory contracts						
Gas Contracts:						
Gas Swaps Contract - Other Revenues	$	1,860	$	1,999	$	139
Gas Purchase Contract - Other Revenues		(37)		(37)		-
Subtotal		1,823		1,962		139
Total	$	28,702	$	(21,463)	$	(50,165)

Movements in the fair value of regulated contracts are recorded on the balance sheets. Non-regulated contracts are recorded on the Statements of Income.

The aggregate fair value of all of the Company's derivative instruments with credit-risk-related contingent features that are in a liability position on March 31, 2010 is $20.8 million for which the Company has posted collateral of $6.7 million in the normal course of business. If the Company's credit rating were to be downgraded by one notch, it would be required to post $0.4 million additional collateral.

If the Company's credit rating were to be downgraded by three notches, it would be required to post $14.2 million additional collateral to its counterparties.

Credit and Collateral:
Derivative contracts are primarily used to manage exposure to market risk arising from changes in commodity prices and interest rates. In the event of non-performance by a counterparty to a derivative contract, the desired impact may not be achieved. The risk of counterparty non-performance is generally considered a credit risk and is actively managed by assessing each counterparty credit profile and negotiating appropriate levels of collateral and credit support. In instances where the counterparties' credit quality has declined, or credit exposure exceeds certain levels, we may limit our credit exposure by restricting new transactions with counterparties, requiring additional collateral or credit support and negotiating the early termination of certain agreements. At March 31, 2010 and 2009, the Company has paid $6.7 million and $20.8 million, respectively, to its counterparties as collateral associated with outstanding derivative contracts.

NOTE 8. FAIR VALUE MEASUREMENTS

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 - exit price. The determination of the fair value incorporates various factors required including not only the credit standing of the counterparties involved but also the impact of the Company's nonperformance risk on its liabilities. To increase consistency and comparability in fair value measurements, a fair value hierarchy was established that prioritizes the inputs to valuation techniques used to measure fair value into three levels.

Derivatives — The Company enters into primarily exchange traded, the New York Mercantile Exchange (NYMEX) futures principally used to manage commodity prices associated with its natural gas operations.

The Company's level 2 fair value derivative instruments primarily consist of gas over the counter (OTC) swaps as well as NYMEX swaps and forward physical gas deals where market data for pricing inputs is observable. The level 2 pricing inputs from NYMEX and Platts M2M (industry standard, non-exchange-based editorial commodity forward curves) when it can be verified by available market data from Intercontinental Exchange. Level 2 derivative instruments may utilize discounting based on quoted interest rate curve as well as have liquidity reserve calculated based on bid/ask spread. 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 0.95 or higher.

Level 3 fair value derivative instruments primarily consist of gas OTC forwards, options, and physical gas or power transactions where pricing inputs are unobservable, as well as other complex and structured transactions. Complex or structured transactions can introduce the need for internally-developed models based on reasonable assumptions. Industry-standard valuation techniques, such as Black-Scholes pricing model, Monte Carlo simulation, and Financial Engineering Associates (FEA) libraries are used for valuing such instruments. The value is categorized as level 3. Level 3 is also applied in cases when forward curve is extrapolated or derived from market observable curve with correlation coefficients less than 0.95, or optionality is present, or non-economical assumptions are made.

The following table presents assets and liabilities measured and recorded at fair value on the Company's balance sheets on a recurring basis and their level within the fair value hierarchy at March 31, 2010:

(in thousands of dollars)	Balance at March 31, 2010			
Derivative contracts	Level 1	Level 2	Level 3	Total
Assets	$ -	$ 2,813	$ 280	$ 3,093
Liabilities	-	(21,914)	(2,642)	(24,556)
Total derivative net liabilities	$ -	$ (19,101)	$ (2,362)	$ (21,463)

Long term debt is based on quoted market prices where available or calculated prices based on the remaining cash flows of the underlying bond discounted at the Company's incremental borrowing rate. The Company's balance sheet reflects the long term debt at carrying value; the fair value of this debt at March 31, 2010 is approximately $218.4 million.

Year to Date Level 3 Movement Table:
The following table presents the fair value reconciliation of Level 3 assets and liabilities measured at fair value on a recurring basis during the year ended March 31, 2010:

(in thousands of dollars)	
Balance at March 31, 2009	$ (3,575)
Transfers into Level 3	-
Transfers out of Level 3	50
Total gains or losses	
included in earnings (or changes in net assets)	540
included in other comprehensive income	-
included in regulatory assets and liabilties	10,288
Purchase	(9,665)
Sales	-
Balance at March 31, 2010	$ (2,362)
The amount of realized gains and (losses) included in net income attributed to the change in unrealized gains and (losses) related to derivative assets and liabilities at March 31, 2010	$ (357)

The Company transfers amounts from Level 2 to Level 3 as of the beginning of each period and amounts from Level 3 to Level 2 as of the end of each period.

NOTE 9. COMMITMENTS AND CONTINGENCIES

Asset Retirement Obligations:
The Company has various asset retirement obligations associated with its gas distribution facilities.

At March 31, 2010 and 2009, the following asset retirement obligations were recorded on the balance sheets at their estimated present values:

(in thousands of dollars)	**March 31, 2010**		March 31, 2009	
Asset retirement obligations				
Asbestos removal	**$**	**121**	$	129
Tanks removal and cleaning		**11**		11
Main cutting, purging and capping		**11,641**		11,400
Total Asset Retirement Obligations	**$**	**11,773**	$	11,540

Fixed Charges Under Firm Contracts:
We have entered into various contracts for gas delivery, storage and supply services. We are liable for these payments regardless of the level of service we require from third parties. Such charges are currently recovered from utility customers through the gas adjustment clause.

(in thousands of dollars)	**Gross Payments**	
2011	$	130,673
2012		118,866
2013		89,186
2014		59,964
2015		43,285
2016 and thereafter		41,950
Total	$	483,924

Legal Proceeding:
We are subject to various legal proceedings arising out of the ordinary course of our business. We do not consider any of such proceedings to be material to our business or likely to result in a material adverse effect on our results of operations, financial condition and cash flows.

Environmental Matters:
Within the Commonwealth of Massachusetts, we are aware of numerous former MGP sites and related facilities within the existing or former service territories of the Company. Agreements with other utilities are in place to share environmental cleanup costs on numerous of these sites.

We estimate the remaining cost of these MGP-related environmental cleanup activities will be $30.1 million at March 31, 2010, which amount has been accrued by us as a reasonable estimate of cost for known sites. Remediation costs for each site may be materially higher than noted, depending upon changing technologies and regulatory standards, selected end use for each site, and actual environmental conditions encountered. Expenditures incurred to date with respect to these MGP-related activities total $52.0 million.

By rate orders, the DPU provided for the recovery of site investigation and remediation costs and accordingly, at March 31, 2010 and 2009, we have reflected a regulatory asset of $42.2 million and $40.4 million, respectively, for the MPG sites.

NOTE 10. RELATED PARTY TRANSACTIONS

Accounts Receivable / Payable – Money-Pool:
We are engaged in various transactions with NGUSA and its affiliates. For the most part, the subsidiaries do not maintain separate cash balances. Financing for the Company's working capital and gas inventory needs is obtained through the Company's participation in a money- pool. In addition, all cash generated from billings is collected and held in the money-pool. Further, all payments to third parties for our payables, including labor, are made through the money-pool.

The money-pool is funded by operating funds from money-pool participants. In addition, KeySpan has the ability to borrow up to $3 billion from National Grid plc for working capital needs including the funding of the money-pool, if necessary. At March 31, 2010 and 2009, we had outstanding money-pool receivable position of $2.4 million and outstanding money-pool borrowings of $357.0 million, respectively. During the year, the Company restructured its total capitalization. Additional paid-in capital was increased by $435 million and concurrently the outstanding advance from KeySpan was reduced by $45 million and outstanding money pool borrowings were reduced by $390 million. The recapitalization will result in a more optimal and cost efficient capital structure for the Company. Interest rates associated with the money pool are designed to approximate the cost of third-party short-term borrowings. The average interest rate for the money pool was 0.91% and 2.62% for the years ended March 31, 2010 and 2009, respectively. All costs related to the gas inventory borrowings are recoverable from customers.

NGUSA and KeySpan subsidiaries also provide the Company with various services, including executive and administrative, customer services, financial (including accounting, auditing, risk management, tax, treasury/finance), human resources (including pension funding), information technology, legal, and strategic planning. The costs of these services are charged to the Company via inter-company billings and were $135.1 million and $154.2 million at March 31, 2010 and 2009, respectively. In addition, we have an intercompany tax payable to KeySpan of $17.9 million and $75.5 million at March 31, 2010 and 2009, respectively. Therefore the Company has an intercompany accounts payable of $153.0 and $229.7 million at March 31, 2010 and 2009, respectively.

Parent Company Charges:
For the year ended March 31, 2010, 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 in these financial statements. Were these amounts allocated to this subsidiary, the estimated effect on operating result would be approximately $1.8 million before tax and $1.2 million after tax.