nationalgrid

The Narragansett Electric Company

Financial Statements

For the year ended March 31, 2010

.

TABLE OF CONTENTS

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
PricewaterhouseCoopers Center
300 Madison Avenue
New York NY 10017
Telephone (646) 471 3000
Facsimile (813) 286 6000

Report of Independent Auditors

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

In our opinion, the accompanying balance sheets and related statements of income, of comprehensive income, of retained earnings, of capitalization and of cash flows present fairly, in all material respects, the financial position of Narragansett Electric Company (the "Company") at March 31, 2010 and 2009, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

July 29, 2010

The Narragansett Electric Company

BALANCE SHEETS

(in thousands of dollars)	**March 31, 2010**	March 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 13,149**	$ 17,632
Restricted cash	**68,443**	91,680
Accounts receivable:		
Customers	**219,483**	259,483
Affiliates, net	**5,755**	-
Allowance for uncollectible customer accounts	**(33,679)**	(36,261)
Unbilled revenues	**60,408**	78,260
Materials and supplies, at average cost		
Gas storage	**17,795**	10,553
Others	**8,576**	8,834
Current regulatory assets	**40,810**	68,662
Derivative instruments	**1,218**	6,557
Deferred federal and state income taxes	**3,447**	16,225
Prepaid and other current assets	**100,744**	6,906
Total current assets	**506,149**	528,531
Other investments	**6,273**	5,421
Property, plant and equipment		
Property, plant and equipment, at original cost	**2,171,767**	2,029,141
Less accumulated depreciation	**(736,651)**	(709,402)
Net property, plant and equipment	**1,435,116**	1,319,739
Deferred charges:		
Regulatory assets	**287,237**	281,153
Goodwill	**724,810**	724,810
Derivative instruments	**94**	1,302
Deferred charges and other assets	**5,913**	2,541
Total deferred charges	**1,018,054**	1,009,806
Total assets	**$ 2,965,592**	$ 2,863,497

The accompanying notes are an integral part of these financial statements

The Narragansett Electric Company

BALANCE SHEETS

(in thousands of dollars)	**March 31, 2010**	March 31, 2009
LIABILITIES AND CAPITALIZATION		
Current liabilities:		
Long-term debt due within one year	**$ 1,375**	$ 1,375
Accounts payable:		
Non-affiliates	**104,871**	119,848
Affiliates, net	**-**	2,582
Money pool	**70,975**	129,625
Short-term debt to parent	**-**	130,000
Accrued taxes	**9,130**	1,159
Accrued interest	**2,601**	1,336
Other accrued expenses	**43,766**	53,242
Derivative instruments	**41,211**	68,662
Current regulatory liabilities	**821**	6,557
Customer deposits	**7,856**	7,827
Dividends payable	**28**	28
Total current liabilities	**282,634**	522,241
Deferred credits and other liabilities:		
Regulatory liabilities	**213,251**	212,259
Deferred federal and state income taxes	**182,106**	103,115
Unamortized investment tax credits	**2,266**	2,810
Derivative instruments	**11,089**	7,199
Accrued pension and other postretirement benefits	**191,317**	205,456
Other reserves and deferred credits	**163,320**	141,465
Total deferred credits and other liabilities	**763,349**	672,304
Capitalization:		
Common stock, par value $50 per share, authorized and outstanding 1,132,487 shares	**56,624**	56,624
Additional paid-in capital	**1,353,559**	1,353,559
Retained earnings	**17,598**	318,147
Accumulated other comprehensive losses	**(116,340)**	(118,760)
Total common stockholders' equity	**1,311,441**	1,609,570
Cumulative preferred stock, par value $50 per share, authorized and outstanding 49,089 shares	**2,454**	2,454
Long-term debt	**605,714**	56,928
Total capitalization	**1,919,609**	1,668,952
Total liabilities and capitalization	**$ 2,965,592**	$ 2,863,497

The accompanying notes are an integral part of these financial statements

The Narragansett Electric Company

STATEMENTS OF INCOME

(in thousands of dollars)	For the Years Ended March 31, **2010**	2009
Operating revenue		
Electric	**$ 879,069**	$ 1,128,327
Gas	**464,325**	464,416
Total operating revenues	**1,343,394**	1,592,743
Operating expenses:		
Purchased electric energy:		
Non-affiliates	**478,213**	737,872
Contract termination charges from affiliate	**14,725**	24,323
Purchased gas	**300,528**	290,458
Other operations and maintenance	**346,417**	324,019
Depreciation and amortization	**68,198**	66,274
Taxes, other than income taxes	**87,533**	94,266
Total operating expenses	**1,295,614**	1,537,212
Operating income	**47,780**	55,531
Other income and (deductions):		
Interest on long-term debt	**(6,718)**	(5,694)
Other interest	**(4,357)**	(4,529)
Other income, net	**2,563**	(1,517)
Total other deductions	**(8,512)**	(11,740)
Income taxes expenses (benefits):		
Current income tax benefit	**(72,063)**	(26,808)
Deferred income tax expense and investment tax credit, net	**91,770**	39,486
Total income taxes	**19,707**	12,678
Net income	**$ 19,561**	$ 31,113

The accompanying notes are an integral part of these financial statements

The Narragansett Electric Company

STATEMENTS OF COMPREHENSIVE INCOME

(in thousands of dollars)	For the Years Ended March 31, **2010**	2009
Net income	**$ 19,561**	$ 31,113
Other comprehensive losses, net of taxes:		
Unrealized gains (losses) on securities	**444**	(262)
Hedging activity	**(6,585)**	-
Change in pension and other postretirement obligations	**8,654**	(39,995)
Reclassification adjustment for (loss) gains included in net income	**(93)**	9
Total other comprehensive losses	**2,420**	(40,248)
Comprehensive income (losses)	**$ 21,981**	$ (9,135)

Related tax (expense) benefit:		
Unrealized (losses) gains on securities	**$ (239)**	$ 141
Hedging activity	**3,546**	$ -
Change in pension and other postretirement obligations	**(4,660)**	21,536
Reclassification adjustment for gains (losses) included in net income	**50**	(5)
Total tax benefits	**$ (1,303)**	$ 21,672

STATEMENTS OF RETAINED EARNINGS

(in thousands of dollars)	For the Years Ended March 31, **2010**	2009
Retained earnings at beginning of year	**$ 318,147**	$ 287,144
Net income	**19,561**	31,113
Dividends declared on common stock	**(320,000)**	-
Dividends declared on preferred stock	**(110)**	(110)
Retained earning at end of year	**$ 17,598**	$ 318,147

The accompanying notes are an integral part of these financial statements

The Narragansett Electric Company

STATEMENTS OF CASH FLOWS

(in thousands of dollars)	For the Years Ended March 31, **2010**	2009
Operating activities:		
Net income	**$ 19,561**	$ 31,113
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**68,198**	66,274
Deferred income taxes and investment tax credit, net	**91,770**	39,486
Rate adjustments mechanisms	**(15,638)**	(36,191)
Changes in assets and liabilities:		
Accounts receivable, net and unbilled revenue	**55,270**	20,762
Accounts payable	**(18,572)**	(44,026)
Materials and supplies	**(6,984)**	7,332
Regulatory assets	**(14,150)**	(7,047)
Accounts payable - affiliates	**(8,337)**	4,430
Other current liabilities	**6,191**	(1,100)
Accrued pension and other post-retirement benefits	**(6,505)**	(7,608)
Treasury lock settlement	**(10,213)**	-
Other accrued expenses	**(61,343)**	(13,940)
Other reserves and deferred credits	**2,142**	(1,790)
Other, net	**4,192**	1,164
Net cash provided by operating activities	**105,582**	58,859
Investing activities:		
Plant expenditures	**(154,681)**	(121,925)
Change in restricted cash	**23,237**	(83,705)
Other	**(15,236)**	(7,483)
Net cash used in investing activities	**(146,680)**	(213,113)
Financing activities:		
Increase (decrease) in long-term debt	**548,625**	(6,645)
Debt issuance costs	**(3,250)**	-
Common stock dividends	**(320,000)**	-
Preferred stock dividends	**(110)**	(110)
Changes in intercompany short-term debt and money pool, net	**(188,650)**	170,000
Net cash provided by financing activities	**36,615**	163,245
Net (decrease) increase in cash and cash equivalents	**(4,483)**	8,991
Cash and cash equivalents at beginning of year	**17,632**	8,641
Cash and cash equivalents at end of year	**$ 13,149**	$ 17,632
Supplementary information:		
Interest paid less amounts capitalized	**$ 8,265**	$ 10,175
Federal income taxes paid to (refunded from) Parent	**$ 6**	$ (13,398)
Capital-related accruals included in Accounts payable	**$ 3,595**	$ (796)

The accompanying notes are an integral part of these financial statements

The Narragansett Electric Company

STATEMENTS OF CAPITALIZATION

(in thousands, except number of shares)

	March 31,			
	2010	2009	**2010**	2009
Common stockholders' equity	**Shares Issued**		**Amounts**	
Common stock, $50.00 par value	**1,132,487**	1,132,487	**$ 56,624**	$ 56,624
Additional paid-in capital			**1,353,559**	1,353,559
Retained earnings			**17,598**	318,147
Accumulated other comprehensive loss			**(116,340)**	(118,760)
Total common stockholder' equity			**$ 1,311,441**	$ 1,609,570
Cumulative preferred stock, $50.00 par value	**49,089**	49,089	**2,454**	2,454

Long-term debt	**Interest rates (%)**	**Maturity Date**	**Amounts**	
Unsecured notes:				
Senior Note	4.534	March 15, 2020	**$ 250,000**	$ -
Senior Note	5.638	March 15, 2040	**300,000**	-
First mortgage bonds				
FMB Series S	6.820	April 1, 2018	**14,464**	14,464
FMB Series N	9.630	May 30, 2020	**10,000**	10,000
FMB Series O	8.460	September 30, 2022	**12,500**	12,500
FMB Series P	8.090	September 30, 2022	**8,125**	8,750
FMB Series R	7.500	December 15, 2025	**12,000**	12,750
Unamortized discounts			**-**	(161)
Total long-term debt			**607,089**	58,303
Long-term debt due within a year			**1,375**	1,375
Total long-term debt, excluding current portion			**605,714**	56,928
Total capitalization			**$ 1,919,609**	$ 1,668,952

The accompanying notes are an integral part of these financial statements

The Narragansett Electric Company

Notes to Financial Statements

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization and Purpose

The Narragansett Electric Company (Narragansett Electric, the Company, we, us and our) is a retail distribution company providing electric service to approximately 487,000 customers and gas service to approximately 255,000 customers in 38 cities and towns in Rhode Island. The Company's service area covers approximately 99 % of Rhode Island. The properties of the Company include an integrated system of transmission and distribution lines, substations and gas distribution mains. The Company is a wholly-owned subsidiary of National Grid USA (NGUSA), a utility holding company with regulated subsidiaries engaged in the generation, transmission, distribution and sale of both natural gas and electricity in New England and New York State. 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 requirements 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, liabilities and disclosure contingent liability 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 29, 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 Federal Energy Regulatory Commission (FERC) has jurisdiction over certain of the Company's activities, including (i) regulating certain transactions among our affiliates; (ii) governing the issuance, acquisition and disposition of securities and assets; and (iii) approving certain utility mergers and acquisitions (See Note 2- Rates and Regulatory). The Company is subject to the regulations of the Rhode Island Public Utilities Commission (RIPUC) and the Rhode Island Division of Public Utilities and Carriers (Division) in addition to FERC.

D. Revenue Recognition

Revenues are based on billing rates authorized by the RIPUC. The Company follows the policy of accruing the estimated amount of revenues for electricity and gas delivered but not yet billed (unbilled revenues), to match costs and revenues more closely. The unbilled revenues at March 31, 2010 and 2009 were approximately $60.4 million and $78.3 million, respectively. The Company records revenues in an amount management believes to be recoverable pursuant to provisions of approved tariffs, settlement agreements and state legislation. The Company defers for future recovery from or refund to electric and gas customers the difference between revenue and expenses from energy conservation programs, standard offer service, transmission service, and contract termination charges (CTC).

E. Property, Plant and Equipment

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.

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 and an equity component. AFUDC is capitalized in “Property, Plant and Equipment” with offsetting credits to “Other interest” for the debt component and “Other income (expense), net” for the equity component. This method is in accordance with an established FERC rate-making practice under which 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 1.7 % and 5.9 % for the years ended March 31, 2010 and 2009, respectively.

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

	2010		2009	
	Provision	**Service Life**	Provision	Service Life
Asset Category:				
Electric	**3.3%**	**30**	3.4%	30
Gas	**3.0%**	**33**	4.1%	24

F. Goodwill

The balance of goodwill at March 31, 2010 and 2009 was $724.8 million representing the excess of acquisition cost over the fair value of net assets acquired related to the acquisition of the Company by National Grid plc. In accordance with the accounting guidance related to goodwill and other intangible assets, the Company reviews its goodwill annually for impairment and when events or circumstances indicate that the asset may be impaired. The Company utilized a discounted cash flow approach incorporating its most recent business plan forecasts in the performance of the annual goodwill impairment test. The result of the annual analysis determined that no adjustment to the goodwill carrying value was required.

G. Cash and Cash Equivalents

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

H. Restricted Cash

At March 31, 2010, restricted cash consists primarily of collateral paid to our counterparties for the outstanding derivative contracts (See Note 7-Derivative Contracts). Deposits are also recorded for property, health insurance, and worker’s compensation. In addition, $11 million was required by the Independent System Operator (ISO) to be on deposit.

Notes to Financial Statements

I. Income and Excise Taxes

Federal and state income taxes are recorded under the current accounting provision for the accounting and reporting of 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 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).

We report our collections and payments of excise taxes on a gross basis. Revenues include the collection of excise taxes, while operating taxes include the related expenses. For the years ended March 31, 2010 and 2009 excise taxes paid were $45.6 million and $56.5 million, respectively.

J. Comprehensive Income (Loss)

Comprehensive income (loss) is the change in the equity of a company, not including those changes that result from shareholder transactions. While the primary component of comprehensive income (loss) is reported net income or loss, the other components of comprehensive income (loss) consists of unrealized gains and losses associated with certain investments held as available for sales, changes in pension and other postretirement obligations and deferred gains and losses associated with hedging activity.

K. 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 sheet as a net liability or asset and required an offsetting adjustment to "Accumulated other comprehensive income" in shareholders' equity 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).

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 8 – Fair Value Measurement). The following is a fair value hierarchy:

Level 1 — quoted prices (unadjusted) are available 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. Reclassifications

Certain amounts from prior year have been reclassified in the accompanying financial statements to conform to the current year presentation. For the year ended March 31, 2009, the dividend declared on preferred stock was included as a component of net income. The 2009 presentation was changed to reflect the dividend on preferred stock as a direct charge against retained earnings.

N. 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 statements 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 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.

The Narragansett Electric Company

Notes to Financial Statements

NOTE 2. RATES AND REGULATORY

The Company's accounting records are maintained in accordance with the Uniform System of Accounts prescribed by the FERC. The financial statements reflect the ratemaking policies and actions of the RIPUC in conformity with GAAP for rate-regulated enterprises.

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, non-cash charge against income for any remaining regulatory assets and liabilities. 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.

Electric segment:
On June 1, 2009, the Company filed for an increase in base distribution rates. On February 9, 2010 the RIPUC approved an increase in distribution revenue of approximately $23.5 million. The Company's proposal for revenue decoupling, a capital addition recovery mechanism and recovery of actual pension and postretirement benefits other than pensions charged to income were not approved. Commodity-related bad debt recovery was approved at a fixed average write-off rate applied to commodity revenue, however, a full reconciliation mechanism was denied. The Company's new rates went into effect on March 1, 2010 retroactive to January 1, 2010. The RIPUC approved recovery of the increase in revenue generated by the new rates for January and February 2010 over a 13 month period. On April 21, 2010 the Company filed a petition for writ of certiorari with the Rhode Island Supreme Court appealing the RIPUC's decision.

During May 2010, Rhode Island enacted decoupling legislation that provides for the annual reconciliation of the revenue requirement allowed in the Company's base distribution rates to actual revenues received for both the electric and gas businesses. The new law also provides for submission and approval of an annual infrastructure spending plan that would provide for a reconciling allowance for anticipated capital spending on utility infrastructure and other costs related to maintaining system safety and reliability on an annual basis, without having to file a full base rate case. The annual infrastructure spending plan for the electric business also includes the annual costs of vegetation management and system inspection and resulting repairs. The infrastructure spending plans will be filed with the Commission before the end of the calendar year, for effect in the fiscal year commencing April 2011. The Company also expects to file separate proposals to implement decoupling for both electric and gas before the end of the calendar year.

The Company continues to be authorized to recover costs associated with procuring electricity for its customers, all transmission costs, and costs charged by the Company's affiliate, New England Power Company (NEP), for stranded costs associated with NEP's former electric generation investments.

Under the terms of NEP's FERC Electric Tariff No. 1, NEP operates the transmission facilities of its New England affiliates as a single integrated system and reimburses the Company for the cost of its transmission facilities in Rhode Island, including a return on those facilities. In turn, these costs are allocated among transmission customers in New England, including the Company, in accordance with the terms of the ISO New England Open Access Transmission Tariff. On December 18, 2008, the FERC approved an uncontested settlement agreement modifying NEP's Tariff No. 1 formula rate under which the Company is compensated for its ownership of transmission facilities. Under the settlement, the Company is compensated for its actual monthly transmission costs and its authorized return on equity ranges from 11.14 % to 12.64 % depending upon the classification of plant as "regional" or "local" and the date the plant was placed into service. On December 30, 2009, NEP filed with FERC a proposed amendment to the Company's revenue requirements under Tariff No.1 adjusting the Company's depreciation rates and postretirement benefits other than pensions according to recent depreciation and actuarial studies updating such costs. The result of the proposed rate change would be to increase the Company's compensation for its electric transmission facilities by approximately $0.1 million annually from the levels received during calendar year 2008. On March 29, 2010, FERC issued an order establishing hearing and settlement procedures for this filing and made the new rates effective January 1, 2010, subject to refund, pending the outcome of the proceeding. The Company cannot predict the outcome of this filing at this time.

On September 17, 2008, the Company, NEP, and Northeast Utilities jointly filed with FERC to recover financial incentives for the New England East-West Solution (NEEWS), pursuant to FERC's Transmission Pricing Policy Order, Order No. 679. NEEWS, estimated to cost a total of $2.1 billion, consists of a series of inter-related transmission upgrades identified in the New England Regional System Plan and is being undertaken to address a number of reliability problems in the tri-state area of Connecticut, Massachusetts, and Rhode Island. The Company's share of the NEEWS-related transmission investment is estimated to be $474 million and NEP's share is estimated to be $160 million. The Company is fully reimbursed for its transmission revenue requirements on monthly basis by NEP through NEP's Tariff No. 1. Effective as of November 18, 2008, FERC granted for NEEWS (1) an incentive ROE of 12.89 % (125 basis points above the approved base ROE of 11.64 %), (2) 100 % construction work in progress (CWIP) in rate base and (3) recovery of plant abandoned for reasons beyond the companies' control. Parties opposing the NEEWS incentives have sought rehearing of the FERC order. We cannot predict the outcome of this attempt for a rehearing. As of March 31, 2010, the Company's NEEWS-related CWIP totaled $42.4 million and NEEWS-related in-service investment totaled $12.5 million.

Under Rhode Island law, the Company is allowed to recover all of its costs for commodity service. Commodity service for customers not taking supply from a competitive supplier is referred to as Standard Offer Service (SOS). The Company is obligated to meet renewable energy standards for all electric supply, and is required to obtain a minimum statutorily designated percentage. This requirement can be met by the purchase of renewable energy certificates which relate electricity procured from generating units whose output is certified by the RIPUC to satisfy obligations under applicable renewable energy standards. On April 29, 2009, the Company filed its proposed Standard Offer Procurement Plan and its Renewable Energy Standards (RES) Procurement Plan, proposing plans for the procurement of SOS beginning January 1, 2010, following the expiration of the existing long-term contracts. On September 30, 2009, the RIPUC approved the Company's Standard Offer Procurement Plan for 2010. Under the provisions of the approved procurement plan, the Company will procure SOS through a combination of full requirements service contracts and spot market purchases for Small Customers (residential and small commercial) and through three-month full requirements service contracts for Large Customers. In addition, all customers not receiving service from competitive suppliers will receive service from the Company under SOS. On March 1, 2010, the Company filed its SOS Procurement Plan and its RES Procurement plan for 2011. The 2011 SOS Procurement Plan introduces three customer groups, industrial, commercial and residential. Both the SOS Procurement Plan and the RES Procurement Plan for 2011 are pending approval of the RIPUC.

In 2009, Rhode Island enacted legislation (the 2009 legislation) promoting the development of renewable energy resources through long-term contracts for the purchase of capacity, energy, and attributes. On March 1, 2010, pursuant to the 2009 legislation and RIPUC rules enacted pursuant to the 2009 legislation, the Company filed its proposed timetable and method of execution of annual long-term contract solicitations scheduled to begin July 1, 2010.

The 2009 legislation permits the Company to recover all costs incurred under such contracts and permits the Company to recover remuneration equal to 2.75 % of the actual annual payments made under the long-term contracts for those projects that are commercially operating.

The 2009 legislation also includes a provision requiring the Company to solicit proposals for a smaller scale renewable energy generation project of up to eight wind turbines with aggregate nameplate capacity of up to 30 MW to benefit the Town of New Shoreham (Block Island). In response to the Company's request for proposals, Deepwater Wind Block Island LLC (Deepwater) submitted the sole bid for an off-shore wind farm off the coast of Block Island. As required by the legislation, the project includes a transmission cable to be constructed between Block Island and the mainland of Rhode Island. On December 9, 2009, the Company filed with RIPUC a signed Power Purchase Agreement (PPA) with Deepwater. On March 30, 2010, the RIPUC voted to reject the PPA indicating that the pricing terms were not commercially reasonable.

During May 2010, Rhode Island enacted legislation that authorized the Company to procure a commercially reasonable long-term contract for a renewable energy project fueled by landfill gas with a gross nameplate capacity of less than thirty-seven megawatts from the central landfill in Johnston, Rhode Island. The legislation provides for the Company to recover all costs under the agreement, including administration and implementation costs, and permits the Company to recover remuneration equal to 2.75% of the actual annual payments made under the agreement when it is commercially operating. On May 21, 2010, the Company entered into a power purchase agreement with Rhode Island LFG Genco LLC. Pursuant to the legislation, the agreement was submitted for approval to certain designated state agencies.

Gas segment:
The Company is allowed recovery of all of its gas commodity costs through a fully reconciling rate recovery mechanism.

On August 3, 2009, the Company made its Distribution Adjustment Charge filing, which proposed a downward adjustment to the approved rate base. The RIPUC approved the adjustment on October 27, 2009 which resulted in a $2 million reduction to the annual revenue requirement.

During May 2010, Rhode Island enacted decoupling legislation that provides for the Company proposing a mechanism that reconciles revenue received to an allowed annual revenue level determined on a per-customer basis as is typically employed by gas utilities. The legislation also provides for submission and approval of an annual infrastructure spending plan that would provide for a reconciling allowance for anticipated capital spending on utility infrastructure and other costs related to maintaining system safety and reliability as mutually agreed to with the Division. The legislation also allows for the expansion of gas energy efficiency programs.

The Narragansett Electric Company

Notes to Financial Statements

Financing petition:
On June 18, 2009, the Company filed an Application and Statement with the Division seeking authorization to issue and sell one or more series and/or issues of new long-term debt, pursuant to the General Laws of Rhode Island, Sections 39-3-15 and 39-3-17. On November 18, 2009, the Division Staff Advocacy Section and National Grid entered into a settlement agreement (Settlement Agreement) seeking approval of an initial issuance of $550 million in new long-term debt. After a hearing, the Division approved that Settlement Agreement on December 9, 2009, authorizing the issuance of up to $550 million of new long-term debt by March 31, 2010. The Company issued this debt on March 22, 2010 in two tranches. (See Note 4 – Debt: Long-Term Debt) Additionally, under the approved Settlement Agreement, the Company may seek Division permission to do additional debt issuances in an amount not to exceed an aggregate principal amount of $290 million on terms to be determined without the need for a new application or additional notice provided that the Company notifies the Division on or before March 31, 2011 of its intent to seek such permission.

The components of regulatory assets (liabilities) at March 31, are as follows:

(in thousands of dollars) - **ELECTRIC**	**2010**	2009
Current regulatory assets included in accounts receivable:		
Rate adjustment mechanisms	**$ 16,683**	$ 42,626
Current regulatory (liabilities) in other accrued expenses:		
Rate adjustment mechanisms	**(14,520)**	(28,233)
Total current regulatory assets, net	**2,163**	14,393
Non current regulatory assets:		
Unamortized loss on reacquired debt	**5,932**	6,764
Regulatory tax asset	**12,744**	12,573
Environmental response fund	**89,831**	85,683
2003 VERO deferral	**9,417**	11,928
Other	**3,580**	2,036
Total non-current regulatory assets	**121,504**	118,984
Non current regulatory (liabilities):		
Revaluation - Pension and PBOP	**(27,896)**	(29,951)
Environmental response costs	**(15,419)**	(17,625)
Storm cost reserves	**(18,006)**	(21,425)
Cost of removal	**(46,506)**	(44,891)
Other	**(3,036)**	(4,894)
Total non-current regulatory liabilities	**(110,863)**	(118,786)
Total non-current regulatory assets, net	**10,641**	198
Net regulatory assets	**$ 12,804**	$ 14,591

The Narragansett Electric Company

Notes to Financial Statements

(in thousands of dollars) - **GAS**	**2010**	2009
Current regulatory assets included in accounts receivable:		
Rate adjustment mechanisms	**$ 1,340**	$ 1,353
Other current regulatory assets:		
Regulatory derivatives	**40,810**	68,662
Current regulatory (liabilities) in other accured expenses:		
Rate adjustment mechanisms	**(7,724)**	(9,649)
Other current regulatory (liabilities):		
Regulatory derivatives	**(821)**	(6,557)
Total current regulatory assets, net	**33,605**	53,809
Non current regulatory assets:		
Environmental response fund	**34,385**	33,163
Regulatory tax assets	**26**	26
Postretirement benefits	**101,226**	101,566
Gas Futures - Gas Supply	**6,477**	8,481
NEG & KeySpan CTA	**8,217**	7,302
Regulatory derivatives	**11,089**	7,199
Other	**4,313**	4,432
Total non-current regulatory assets	**165,733**	162,169
Non current regulatory (liabilities):		
Revaluation - Pensions and PBOP	**-**	(286)
Cost of removal	**(100,343)**	(91,051)
Regulatory derivatives	**(94)**	(1,302)
Other	**(1,951)**	(834)
Total non-current regulatory liabilities	**(102,388)**	(93,473)
Total non-current regulatory assets, net	**63,345**	68,696
Net regulatory assets	**$ 96,950**	$ 122,505

(in thousands of dollars) - **COMBINED**	**2010**	2009
Current regulatory assets included in accounts receivable:		
Rate adjustment mechanisms	**$ 18,023**	$ 43,979
Other current regulatory assets:		
Regulatory derivatives	**40,810**	68,662
Current regulatory (liabilities) in other accrued expenses:		
Rate adjustment mechanisms	**(22,244)**	(37,882)
Other current regulatory liabilities:		
Regulatory derivatives	**(821)**	(6,557)
Total current regulatory assets, net	**35,768**	68,202
Non current regualtory assets:		
Unamortized losses on reacquired debt	**5,932**	6,764
Regulatory tax asset	**12,770**	12,599
Environmental response fund	**124,216**	118,846
2003 VERO deferral	**9,417**	11,928
Postretirement benefits	**101,226**	101,566
Gas future - gas supply	**6,477**	8,481
NEG & KeySpan CTA	**8,217**	7,302
Regulatory derivatives	**11,089**	7,199
Other	**7,893**	6,468
Total non-current regulatory assets	**287,237**	281,153
Non current regulatory (liabilities):		
Revaluation - Pension and PBOP	**(27,896)**	(30,237)
Environmental response costs	**(15,419)**	(17,625)
Storm cost reserves	**(18,006)**	(21,425)
Regulatory derivatives	**(94)**	(1,302)
Cost of removal	**(146,849)**	(135,942)
Other	**(4,987)**	(5,728)
Total non-current regulatory liabilities	**(213,251)**	(212,259)
Total non-current regulatory assets, net	**73,986**	68,894
Net regulatory assets	**$ 109,754**	$ 137,096

Cost of Removal and Asset Retirement Obligations:
The Company adheres to the accounting guidance related to asset retirement obligations associated with tangible long-lived assets. The Company does not have any material asset retirement obligations arising from legal obligations as defined under accounting guidance related to asset retirement obligations. However, under the Company's current and prior rate plans, it has collected through rates an implied cost of removal for its plant assets. This cost of removal collected from customers differs from the accounting guidance related to asset retirement obligations associated with tangible long-lived assets definition in that these collections are for costs to remove an asset when it is no longer deemed usable (i.e. broken or obsolete) and not necessarily from a legal obligation. These collections have been recorded at regulatory liability to reflect future use. The Company estimates it has collected over time approximately $147.2 million and $136.3 million for cost of removal and asset retirement obligations in excess of what the Company incurred through March 31, 2010 and 2009, respectively.

The Narragansett Electric Company

Notes to Financial Statements

NOTE 3. EMPLOYEE BENEFITS

Summary
The Company participates in a non-contributory defined benefit pension plan and Postretirement benefits other than pension (PBOPs) plan (the Plans) covering substantially all employees. The Plans cover the Company and certain other NGUSA subsidiaries.

The pension plan is a non-contributory, tax-qualified defined benefit plan which provides all employees with a minimum retirement benefit. Under the pension plan, a participant's retirement benefit is computed using formulas based on percentages of highest average compensation computed over five consecutive years. The compensation covered by the pension plan includes salary, bonus and incentive share awards. Non-union employees hired after July 15, 2002 participate under a non-contributory defined benefit cash balance design.

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

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

Pension Benefits:
The Company participates in the pension plans with certain other NGUSA subsidiaries. Pension plan assets are commingled and cannot be allocated to an individual company. Pension costs are allocated to the Company. At March 31, 2010 and 2009, the pension plans have a net underfunded obligation of $420.7 million and $469.8 million, respectively. The Company's net periodic pension cost for the years ended March 31, 2010 and 2009 were approximately $10.0 million and $2.5 million, respectively.

The Company is subject to deferral accounting requirements for pension expenses associated with its regulated gas operation. Any rarities between actual pension costs and amounts used to establishes rates are deferred and collected from or refunded to customers in subsequent periods. There is no deferred mechanism for pension expenses associated with Company's regulated electric operations.

Defined Contribution Plan:
The Company has a defined contribution pension plan (employee savings fund plan) that covers substantially all employees. Employer matching contributions of approximately $2.4 million and $2.5 million was expensed for the years ended March 31, 2010 and 2009, respectively.

Postretirement Benefits Other than Pension:
The Company participates in the PBOP plans with certain other NGUSA subsidiaries. PBOP costs are allocated to the Company. At March 31, 2010 and 2009, the PBOP plans have a net underfunded obligation of $477.3 million and $476.8 million, respectively. The Company's net period postretirement benefit cost for the years ended March 31, 2010 and 2009 were approximately $10.7 million and $9.5 million, respectively.

The Company is subject to deferral accounting requirements for PBOP expenses associated with its regulated gas operation. Any rarities between actual PBOP costs and amounts used to establishes rates are deferred and collected from or refunded to customers in subsequent periods. There is no deferred mechanism for PBOP expenses associated with Company's regulated electric operations.

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 $7.9 million.

This was partially offset by the reversal of a regulatory liability, net of related taxes, which reduced the net impact by approximately $0.1 million.

Special Termination Benefits (Voluntary Early Retirement Offer):
In connection with National Grid plc's acquisition of KeySpan Corporation (KeySpan), which was completed on August 24, 2007, National Grid plc and KeySpan offered certain non-union employees voluntary early retirement offer (VERO) packages in June 2007. Of the 560 employees enrolled in the VERO, 36 were the Company's employees. Employees enrolled in the VERO program will retire by October 1, 2010. The Company's share of the cost of the VERO program was estimated to be $10.2 million, which has been expensed through March 31, 2010. For the years ended March 31, 2010 and 2009, the Company expensed $2.1 million and $4.8 million, respectively.

During the year ending March 31, 2010, an additional VERO package was offered to further efforts to reduce staff through voluntary means. Employees enrolled in the early retirement program will retire between January 1, 2010 and December 31, 2010. The Company recorded $0.9 million of allocated costs associated with this VERO package.

During the year ending March 31, 2010, an additional VERO package was offered to 38 union employees in connection with National Grid plc's acquisition of KeySpan to further the effort to achieve necessary staff reduction through voluntary means. Of the 38 eligible employees, 33 enrolled in the VERO and were all employees of one affiliates of the Company. Employees enrolled in the early retirement program retired in fiscal year 2010. The Company recorded $0.3 million of allocated costs associated with this VERO package.

NOTE 4. DEBT

Short-term:
Open accounts advances are interest free loans from a parent; the applicable FERC order does not place a limit on the aggregate amount of open account advances that may be outstanding at any one time. At March 31, 2010 and 2009, open account advances due to the parent totaled zero and $130.0 million, respectively. Exclusive of open account advances, the Company has regulatory approval from the FERC to issue up to $400.0 million of short-term debt.

Long-term:
At March 31, 2010, the Company had outstanding $57.1 million of First Mortgage Bonds. Substantially all of the assets used in the gas business of the Company are subject to the lien of mortgage indentures under which the first mortgage bonds have been issued. Interest rates ranged from 6.82 % to 9.63 % Maturities range from April 2018 to December 2025. The First Mortgage Bonds have annual sinking fund requirement of approximately $1.4 million.

Notes Payable:
The Company had outstanding $550.0 millions of unsecured long-term debt as of March 31, 2010. Pursuant to the Settlement Agreement, the Company issued debt on March 22, 2010 in two tranches. $250 million of 10-year unsecured bonds were issued at a coupon rate of 4.534 % and $300 million of 30-year unsecured bonds were issued at a coupon rate of 5.638 %. The debt is not registered under the U.S. Securities Act of 1933 (Securities Act) and was sold in the United States only to qualified institutional buyers in reliance on Rule 144A under the Securities Act and to certain non-U.S. persons in transactions outside the United States in reliance on Regulation S under the Securities Act.

The proceeds from the financing were used to: (i) replenish internally generated cash funds that were provided by retained earnings and were used to finance past capital investments in long-lived utility plant assets and refund long-term debt that was issued to finance those investments; (ii) fund future capital expenditures; (iii) term out existing short-term debt so that these financing resources can be made available for ongoing working capital needs, and: (iv) pay dividends. The payment of dividends will result in a more optimal and cost efficient capital structure for the Company and result in an appropriate capital structure for the nature of its business and attendant risk profile.

On March 18, 2010, National Grid plc settled the derivative financial instrument that it had entered into in connection with such bond issuances for the purpose of locking-in the risk-free interest rate element of the bond issues. The $10.2 million on the "treasury lock" settlement will be amortized over the life of the bonds to match the corresponding rate treatment.

The aggregate maturities of long-term debt for the five years subsequent to March 31, 2010 are approximately:

(in thousands of dollars)

Fiscal Year	Amount
2011	$ 1,375
2012	1,375
2013	1,375
2014	1,375
2015	1,375
Thereafter	600,214
Total	$ 607,089

In connection with the acquisition of the Rhode Island gas assets of Southern Union Gas, the Company assumed first mortgage bonds, of which approximately $57.1 million remain outstanding. This assumed debt may not exceed 60 % of total capitalization or the rates on the debt will increase by 0.20 %, and the debt may not exceed 70 % of total capitalization or the bondholders may declare bonds due and payable. The Company is in compliance with this covenant.

Notes to Financial Statements

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	CWIP	Software Intangibles	Total
Balance at March 31, 2008	$ 1,700,196	$ 94,346	$ 27,845	$ 28,535	**$ 1,850,922**
Additions	133	-	222,197	-	**222,330**
Disposals	(20,241)	(697)	(2)	(2)	**(20,942)**
Reclassifications	180,528	250	(203,947)	-	**(23,169)**
Balance at March 31, 2009	$ 1,860,616	$ 93,899	$ 46,093	$ 28,533	**$ 2,029,141**
Accumulated depreciation at March 31, 2009	(659,402)	(35,177)	-	(14,823)	**(709,402)**
Net book value at March 31, 2009	$ 1,201,214	$ 58,722	$ 46,093	$ 13,710	**$ 1,319,739**
Balance at March 31, 2009	$ 1,860,616	$ 93,899	$ 46,093	$ 28,533	**$ 2,029,141**
Additions	-	-	158,276	-	**158,276**
Disposals	(14,912)	(812)	11	-	**(15,713)**
Reclassifications	120,517	185	(120,639)	-	**63**
Balance at March 31, 2010	$ 1,966,221	$ 93,272	$ 83,741	$ 28,533	**$ 2,171,767**
Accumulated depreciation at March 31, 2010	(684,205)	(36,146)	-	(16,300)	**(736,651)**
Net book value at March 31, 2010	$ 1,282,016	$ 57,126	$ 83,741	$ 12,233	**$ 1,435,116**

NOTE 6. INCOME TAXES

The following is a summary of the components of federal and state income tax expenses (benefits):

Year Ended March 31 (In thousands of dollars)	**2010**	2009
Components of federal and state income taxes:		
Current tax expense (benefit):		
Federal	**$ (72,063)**	$ (26,800)
State	**-**	(8)
Total current tax expense	**(72,063)**	(26,808)
Deferred tax expense:		
Federal	**$ 92,314**	$ 40,057
Investment tax credits [(1)]	**(544)**	(571)
Total deferred tax expense	**91,770**	39,486
Total income tax expense	**$ 19,707**	$ 12,678

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

Notes to Financial Statements

Income tax expense for the years ended March 31, 2010 and 2009 varied from the amount computed by applying the statutory rate to income before income taxes. A reconciliation between the expected federal income tax expense using the federal statutory rate of 35 % to the Corporation's actual income tax expenses for the fiscal years ended March 31, is presented in the following table:

(in thousands of dollars)	**2010**	2009
Computed tax at statutory rate	**$ 13,744**	$ 15,288
Increases/(reductions) in tax resulting from:		
Medicare charge attributable to Patient Protection & Affordable Care Act	**6,818**	(874)
Intercompany tax allocation	**-**	(873)
Audit and related reserve movements	**(700)**	-
Investment tax credit	**(544)**	(571)
Provision to return adjustment	**184**	(243)
Other items - net	**205**	(49)
Total	**$ 5,963**	$ (2,610)
Federal and state income taxes	**$ 19,707**	$ 12,678

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

(in thousands)	**2010**	2009
Pension, OPEB and other employee benefits	**$ 70,086**	$ 79,811
Reserve - Environmental	**41,435**	16,453
Allowance for uncollectible accounts	**11,766**	11,749
Other	**4,116**	12,746
Total deferred tax assets[1]	**127,403**	120,759
Property related differences	**(225,244)**	(160,941)
Regulatory assets - environmental	**(38,448)**	(10,276)
Regulatory assets - other	**(31,241)**	(16,883)
Property taxes	**(10,525)**	(5,936)
Other	**(604)**	(13,613)
Total deferred tax liabilities	**(306,062)**	(207,649)
Net accumulated deferred income tax liability	**(178,659)**	(86,890)
Current portion of net deferred tax asset	**3,447**	16,225
Non-current portion of net deferred income tax liability	**$ (182,106)**	$ (103,115)

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

The Company is member of the National Grid Holdings Inc. (NGHI) and subsidiaries consolidated federal income tax return. The Company has joint and several liabilities for any potential assessments against the consolidated group. In December 2009, NGHI, the parent company of NGUSA, made an income tax accounting method change (in accordance with Internal Revenue Code Section 481 (a)) to deduct 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 year ended March 31, 2010.

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 $19.0 million and $0, respectively, none of which would affect the effective tax rate, if recognized. The unrecognized tax benefits are included in "Deferred Credits and Other Liabilities - other reserves and deferred credits" on the Balance Sheets.

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

Reconciliation of unrecognized tax benefits		
At March 31, (in thousands of dollars)	**2010**	2009
Beginning balance	**$ -**	$ -
Gross increases related to current period	**19,013**	-
Ending balance	**$ 19,013**	$ -

As of March 31, 2010 and 2009, the Company does not have any interest accrued related to unrecognized tax benefits. The Company recognizes accrued interest related to unrecognized tax benefits in interest expense or interest income and the related penalties, if applicable, in operating expenses. No interest or penalties were recognized during years ended March 31, 2010 and 2009.

The Company is a member of a federal consolidated return with its parent, NGHI. Federal income tax returns have been examined and all appeals and issues have been agreed with the Internal Revenue Service (IRS) and the NGHI consolidated filing group through March 31, 2004

The IRS is currently auditing the federal NGHI consolidated income tax returns, which included the Company, for March 31, 2005 through March 31, 2007. The Company does not expect to make a cash tax payment to the IRS within the next twelve months related to the 2005 to 2007 settlement. However, the Company expects to increase its total gross unrecognized tax positions by $9.3 million. The years ended March 31, 2008 and 2009 remain subject to examination by the IRS.

NOTE 7. DERIVATIVE CONTRACTS

Financial:
The Company is exposed to certain risks relating to its ongoing business operations, primarily commodity price risk. Financial and physical forward contracts on gas and electricity are entered into to manage this price risk and reduce the cash flow variability associated with the forecasted purchases of natural gas and electricity associated with the gas and electric operations. Our strategy is to minimize fluctuations in gas and electric sales prices to our regulated customers. The accounting for these derivative instruments follows the accounting guidance for rate regulated enterprises. Therefore, subsequent changes in the fair value of these derivatives will be recorded as regulatory assets and regulatory liabilities. Gains and losses on these contracts are passed through to the Company's customers as provided for in agreement with the RIPUC.

Currently the Company utilizes the New York Mercantile Exchange (NYMEX) gas futures and gas swaps. The fair value of the gas derivative instruments at March 31, 2010 was a net liability of $50.1 million.

Notes to Financial Statements

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. These derivatives had a net fair value of $0.9 million at March 31, 2010.

Other Derivative Instruments:
Additionally the company employs a small number of derivative instruments related to storage optimization. These financial derivative instruments do not qualify for hedge accounting treatment. The fair value of these contracts at March 31, 2010 was immaterial. 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)	2,383
Financials	Gas swaps (dths)	22,966
	Gas futures (dths)	13,840
Total	**Gas (dths)**	**39,189**

The Narragansett Electric Company

Notes to Financial Statements

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:					
Gas futures contract - current asset	$ -	$ 3,511	Gas futures contract - current liability	$ (17,421)	$ (67,901)
Gas swaps contract - current asset	389	-	Gas swaps contract - current liability	(21,969)	(761)
Gas purchase contract - current assets	432	3,046	Gas purchase contract - current liability	(1,420)	-
Subtotal current assets	$ 821	$ 6,557	Subtotal current liabilities	$ (40,810)	$ (68,662)
Gas futures contract - deferred assets	93	-	Gas futures contract - deferred liability	(4,282)	(7,199)
Gas swaps contract - deferred asset	1	756	Gas swaps contract - deferred liability	(6,807)	-
Gas purchase contract - deferred asset	-	546	Gas purchase contract - deferred liability	-	-
Subtotal deferred assets	$ 94	$ 1,302	Subtotal deferred assets	$ (11,089)	$ (7,199)
Subtotal regulated contracts	$ 915	$ 7,859	Subtotal regulated contracts	$ (51,899)	$ (75,861)
Non regulated contracts					
Gas contracts:					
Gas swaps contract - current assets	$ 317	$ -	Gas swaps contract - current liability	$ (380)	$ -
Gas purchase contract - current assets	80	-	Gas purchase contract - current liability	(21)	
Subtotal non regulated contracts	$ 397	$ -	Subtotal non regulated contracts	$ (401)	$ -
Total	$ 1,312	$ 7,859	Total	$ (52,300)	$ (75,861)

Fair Values of Derivative Instruments - Statements of Income			
(in thousands of dollars)	YTD Movement	March 31, 2010	March 31, 2009
Regulated contracts			
Gas contracts:			
Gas futures contract - regulatory asset	$ 53,397	$ (21,703)	$ (75,100)
Gas swap contract - regulatory asset	(28,015)	(28,776)	(761)
Gas purchase contract - regulatory asset	(1,420)	(1,420)	-
Subtotal regulatory assets	$ 23,962	$ (51,899)	$ (75,861)
Gas futures contract - regulatory liability	(3,418)	93	3,511
Gas swap contract - regulatory liability	(366)	390	756
Gas purchase contract - regulatory liability	(3,160)	432	3,592
Subtotal regulatory liabilities	$ (6,944)	$ 915	$ 7,859
Subtotal regulated contracts	$ 17,018	$ (50,984)	$ (68,002)
Non regulated contracts			
Gas contracts:			
Gas swap - other income	$ (63)	$ (63)	$ -
Gas purchase - other income	59	59	-
Subtotal non regulated contracts	$ (4)	$ (4)	$ -
Total	**$ 17,014**	**$ (50,988)**	**$ (68,002)**

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 for which the Company does not post any collateral in the normal course of business, is $4.7 million. If the Company's credit rating were to downgrade by one notch, it would not be required to post any additional collateral. If the Company's credit rating were to down grade by three notches, it would be required to post $4.7 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, the Company has paid $45.6 million 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, NYMEX futures principally used to manage commodity prices associated with its natural gas operations.

The Company's level 1 fair value derivative instruments primarily consist of natural gas futures traded on the NYMEX. There is no liquidity or credit reserve associated with such trades, and no discounting as well.

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 contracts 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.

Available for sale securities are primarily equity investments based on quoted market prices and municipal bonds based on quoted prices of similarly traded assets in open markets.

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)				
Derivative contracts	Level 1	Level 2	Level 3	Total
Assets	$ 93	$ 717	$ 502	$ 1,312
Liabilities	(21,703)	(29,172)	(1,425)	(52,300)
Total derivative net liabilities	$ (21,610)	$ (28,455)	$ (923)	$ (50,988)
Available for sale securities				
Assets	$ 1,468	$ 1,950	$ -	$ 3,418
Total available for sale securities	$ 1,468	$ 1,950	$ -	$ 3,418

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 $613.3 million.

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	$ 3,617
Transfers into Level 3	-
Transfers out of Level 3	-
Total gains or losses	-
included in earnings (or changes in net assets)	34
included in regulatory assets and liabilities	(4,758)
Purchase	184
Sales	-
Balance at March 31, 2010	$ (923)

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. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

(in thousands of dollars)	Unrealized Gain (Loss) on Available-for- Sale Securities	Post-retirement liability	Hedging	Total Accumulated Other Comprehensive Income (Loss)
March 31, 2008 balance, net of tax	$ 301	$ (78,813)	$ -	$ (78,512)
Other comprehensive income (losses):				
Unrealized (losses) on securities	(262)	-	-	(262)
Change in postretirement benefits	-	(39,995)	-	(39,995)
Reclassification adjustment for gains included in net income	9	-	-	9
March 31, 2009 balance, net of tax	$ 48	$ (118,808)	$ -	$ (118,760)
Other comprehensive income (losses):				
Unrealized gains on securities	444			444
Hedging activities			(6,585)	(6,585)
Change in postretirement benefits	-	8,654	-	8,654
Reclassification adjustment for (losses) included in net income	(93)	-	-	(93)
March 31, 2010 balance, net of tax	$ 399	$ (110,154)	$ (6,585)	$ (116,340)

NOTE 10. COMMITMENTS AND CONTINGENCIES

Plant Expenditures:
Generally construction expenditures are consistent from year to year. However, the Company has undertaken a Reliability Enhancement Program to improve performance and reliability.

Legal Proceedings:
The Company is subject to various legal proceedings arising out of the ordinary course of its business. The Company does not consider any of such proceedings to be material to its business or likely to result in a material adverse effect on its results of operations or financial condition.

Hazardous Waste:
The normal ongoing operations and historic activities of the Company are subject to various federal, state and local environmental laws and regulations. Like many other industrial companies, the Company generates hazardous waste. Under federal and state Superfund laws, potential liability for the historic contamination of property may be imposed on responsible parties jointly and severally, without fault, even if the activities were lawful when they occurred.

The United States Environmental Protection Agency (EPA), the Massachusetts Department of Environmental Protection (DEP), and the Rhode Island Department of Environmental Management (DEM) have named the Company as a potentially responsible party for remediation of a number of sites at which hazardous waste is alleged to have been disposed. The Company's most significant liabilities relate to former manufactured gas plant (MGP) facilities formerly owned by the Blackstone Valley Gas and Electric Company and the Rhode Island gas distribution assets of New England Gas. The Company is currently investigating and remediating, as necessary, the MGP sites and certain other properties in accordance with plans we believe are satisfactory to the EPA, DEM and DEP.

The RIPUC has approved settlement agreements that provide for rate recovery of prudently and reasonably incurred remediation costs of former MGP and other hazardous waste sites in Rhode Island. Under the agreement for the former Blackstone Valley Gas and Electric Company sites, qualified costs related to these sites are paid out of a special fund established by the Company. Rate-recoverable contributions of approximately $3 million are added annually to the fund along with interest and any recoveries from insurance carriers and other third parties. Under the agreement, costs are amortized over a ten year period and subject to an annual cap linked to gas usage. The Company believes that obligations imposed on it because of the environmental laws will not have a material impact on its results of operations or financial condition due to rate recovery. At March 31, 2010, the Company's total reserve for estimated environmental activities is approximately $121 million. The Company has also reflected a regulatory asset of $124 million. Those reserves may need to be materially increased in the future if new sites are identified or currently unknown contamination is discovered, if other potentially responsible parties fail to pay their share, or if there are changes in laws or policies, or the enforcement thereof, relating to the investigation or remediation of those sites.

Electricity and Gas Supply, Storage and Pipeline Commitments:

The Company's electricity gas distribution subsidiaries have entered into various contracts for electricity and gas delivery, storage and supply services. Certain of these contracts require payment of annual demand charges in the aggregate amount of approximately $457.5 million. The Company and its electricity and gas distribution subsidiaries are liable for these payments regardless of the level of services required from third parties. Such charges are currently recovered from utility customers as gas costs. The Company's commitments under these long-term contracts, as of March 31, 2010, are summarized in the table below.

(in thousands of dollars)	
Fiscal years ended March 31,	Estimated payments
2011	$ 381,742
2012	33,198
2013	23,274
2014	13,565
2015	5,746
Total	**$ 457,525**

The Company's subsidiaries can purchase additional energy to meet load requirements from other independent power producers (IPPs), other utilities, energy merchants or on the open market through the New York Independent System Operator (NYISO) or the Independent System Operator for New England (ISO-NE) at market prices.

NOTE 11. RELATED PARTY TRANSACTIONS

Accounts Payable - Money Pool:

The Company participates with NGUSA and its affiliates in a system money pool. The money pool is administered by a NGUSA Service Company as the agent for the participants. Short-term borrowing needs are met first by available funds of the money pool. Borrowings from the money pool bear interest at the higher of (i) the monthly average rate for high-grade, 30-day commercial paper sold through dealers by major corporations as published in the Wall Street Journal, or (ii) the monthly average rate then available to money pool depositors from an eligible investment in readily marketable money market funds or the existing short-term investment accounts maintained by money pool depositors or the NGUSA Service Company during the period in question. In the event neither rate is one that is permissible for a transaction because of constraints imposed by the state regulatory commission having jurisdiction over a utility participating in the transaction, the rate is adjusted to a permissible rate as determined under the requirements of the state regulatory commission. Companies that invest in the money pool share the interest earned on a basis proportionate to their average monthly investment in the money pool. Funds may be withdrawn from or repaid to the money pool at any time without prior notice. The average interest rate for the money pool was 0.27 % and 1.96 % for the years ended March 31, 2010 and 2009, respectively. The Company had accounts payable to the money pool of approximately $71.0 million and $129.6 million at March 31, 2010 and 2009, respectively.

Accounts Receivable from/Payable to Affiliates:
Additionally, the Company engages in various transactions with NGUSA and its affiliates. Certain activities and costs, such as executive and administrative, financial (including accounting, auditing, risk management, tax and treasury/finance) human resources, information technology, legal and strategic planning are shared between the companies and allocated to each company appropriately. In addition, the Company has a tax sharing agreement with NGHI, a NGUSA affiliate, in filing consolidated tax returns. The Company had net accounts receivable from affiliates of $5.8 million at March 31, 2010 and net accounts payable to affiliates of $2.6 million at March 31, 2009, respectively, for those services.

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 on these financial statements. Were these amounts allocated to this subsidiary, the estimated effect on net income would be approximately $2.5 million before tax and $1.6 million after tax.

Service Company Charges:
The affiliated service companies of National Grid have furnished services to the Company at the cost of such services. These costs, including operating costs and capital expenditures, were approximately $134.1 million and $105.5 million for the years ended March 31, 2010 and 2009, respectively.

NOTE 12. CUMULATIVE PREFERRED STOCK

A summary of cumulative preferred stock at March 31, 2010 and 2009 are as follows (in thousands of dollars except for share data):

	Shares Outstanding		Amount		Dividends Declared		Call Price
	2010	2009	**2010**	2009	**2010**	2009	
$50 par value - 4.50% Series	**49,089**	49,089	**$ 2,454**	$2,454	**$ 110**	$110	$55.00
Total	**49,089**	49,089	**$ 2,454**	$2,454	**$ 110**	$110	

The annual dividend requirement for cumulative preferred stock was approximately $0.1 million at March 31, 2010 and 2009, respectively.

NOTE 13. RESTRICTIONS ON PAYMENT OF DIVIDENDS

As long as any preferred stock is outstanding, certain restrictions on payment of dividends on common stock would come into effect if the "junior stock equity" was, or by reason of payment of such dividend became less than 25% of "Total Capitalization." The junior stock equity at March 31, 2010 and 2009 were 68% and 96%, respectively, of total capitalization, and accordingly, the Company's retained earnings at March 31, 2010 were not restricted as to dividends on common stock under the foregoing provisions.