Niagara Mohawk Power Corporation

Financial Statements

For the year ended March 31, 2010

Niagara Mohawk Power Corporation

PRICEWATERHOUSECOOPERS

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Report of Independent Auditors

To the Stockholders and Board of Directors of
Niagara Mohawk Power Corporation:

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 Niagara Mohawk Power Corporation (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

August 3, 2010

Niagara Mohawk Power Corporation

Balance Sheets

(In thousands of dollars)

		March 31, 2010		March 31, 2009
ASSETS				
Current assets				
Cash and cash equivalents	**$**	**9,616**	$	23,127
Restricted cash		**41,524**		34,300
Accounts receivable:				
Customers		**629,520**		626,464
Money pool		**98,596**		-
Allowance for uncollectible customer accounts		**(191,848)**		(188,446)
Unbilled revenues		**155,964**		153,049
Materials and supplies, at average cost:				
Gas storage		**16,054**		45,317
Other		**30,174**		28,983
Derivative contracts		**1,168**		3,336
Prepaid taxes		**230,348**		49,413
Deferred federal and state income taxes		**104,389**		158,339
Regulatory assets		**601,624**		508,644
Other		**71,170**		13,006
Total current assets		**1,798,299**		1,455,532
Other property and investments		**45,513**		41,312
Property, plant and equipment				
Property, plant and equipment, at original cost		**8,852,092**		8,410,904
Accumulated depreciation		**(2,676,228)**		(2,571,573)
Net property, plant and equipment		**6,175,864**		5,839,331
Deferred charges				
Regulatory assets:				
Merger rate plan stranded costs		**453,956**		981,025
Regulatory tax asset		**78,865**		90,908
Deferred environmental remediation costs		**539,900**		536,342
Pension and post-retirement benefit plans		**1,046,485**		1,148,944
Storm costs		**173,199**		175,881
Derivative contracts		**112,262**		52,697
Transportation marketer credit		**112,782**		106,925
Loss on reacquired debt		**30,349**		37,029
Other		**97,752**		110,552
Total regulatory assets		**2,645,550**		3,240,303
Goodwill		**1,289,132**		1,289,132
Derivative contracts		**77,966**		4,972
Other		**26,492**		47,983
Total deferred charges		**1,393,590**		1,342,087
Total assets	**$**	**12,058,816**	$	11,918,565

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

Niagara Mohawk Power Corporation

Balance Sheets

(In thousands of dollars)

	March 31, 2010	March 31, 2009
LIABILITIES AND CAPITALIZATION		
Current liabilities		
Accounts payable:		
Non-affiliates, net	$ **230,229**	$ 221,318
Affiliates, net	**113,747**	62,576
Money pool	**-**	650,600
Customer deposits	**36,887**	36,959
Accrued interest	**35,605**	71,214
Accrued taxes	**38,682**	105,713
Current portion of long-term debt	**350,000**	350,000
Derivative instruments	**82,905**	25,763
Regulatory liabilities	**41,520**	45,354
Other	**97,137**	100,823
Total current liabilities	**1,026,712**	1,670,320
Deferred credits and other liabilities		
Regulatory liabilities	**981,303**	922,919
Deferred federal and state income taxes	**1,682,599**	1,522,646
Accrued pension and other postretirement benefits	**900,713**	980,528
Liability for environmental remediation costs	**450,036**	462,164
Nuclear fuel disposal costs	**167,299**	167,050
Derivative instruments	**29,357**	26,935
Other reserves and other deferred credits	**286,035**	196,529
Total deferred credits and other liabilities	**4,497,342**	4,278,771
Capitalization		
Common stockholders' equity:		
Common stock ($1 par value)		
Authorized - 250,000,000 shares		
Issued and outstanding - 187,364,863 shares	**187,365**	187,365
Additional paid-in capital	**2,913,140**	2,913,140
Retained earnings	**1,007,597**	1,344,901
Accumulated other comprehensive losses	**(1,928)**	(4,458)
Total common stockholders' equity	**4,106,174**	4,440,948
Preferred equity:		
Cumulative preferred stock ($100 par value, optionally redeemable)		
Authorized - 3,400,000 shares		
Issued and outstanding – 289,847 shares	**28,985**	28,985
Long-term debt	**1,899,603**	649,541
Long-term debt to affiliates	**500,000**	850,000
Total capitalization	**6,534,762**	5,969,474
Total liabilities and capitalization	$ **12,058,816**	$ 11,918,565

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

Niagara Mohawk Power Corporation

Statements of Income

(In thousands of dollars)

	For the Years Ended March 31,	
	2010	2009
Operating revenue:		
Electric	**$ 3,116,564**	$ 3,217,783
Gas	**732,848**	904,028
Total operating revenues	**3,849,412**	4,121,811
Operating expenses:		
Purchased electricity	**897,206**	1,185,728
Purchased gas	**386,940**	608,674
Operations and maintenance	**1,076,231**	937,932
Depreciation and amortization	**225,137**	223,787
Amortization of stranded costs and rate plan deferrals	**638,831**	534,459
Taxes, other than income taxes	**231,973**	227,679
Total operating expenses	**3,456,318**	3,718,259
Operating income	**393,094**	403,552
Other income (deductions):		
Interest on long-term debt	**(49,194)**	(61,237)
Other interest, including affiliate interest	**(42,371)**	(86,780)
Other deductions, net	**(12,827)**	(5,454)
Total other deductions	**(104,392)**	(153,471)
Income tax expenses (benefits):		
Current income tax	**(92,605)**	156,436
Deferred income tax	**217,551**	(82,446)
Total income tax expense	**124,946**	73,990
Net income	**163,756**	176,091

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

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Niagara Mohawk Power Corporation

Statements of Comprehensive Income

(In thousands of dollars)

	For the Years Ended March 31,	
	2010	2009
Net income	**$ 163,756**	$ 176,091
Other comprehensive income (loss), net of taxes:		
Unrealized gains (losses) on securities	**3,200**	(3,587)
Change in pension and other postretirement obligations	**(314)**	226
Reclassification adjustment for (gains) losses included in net income	**(356)**	30
Total other comprehensive income (loss)	**2,530**	(3,331)
Comprehensive income	**$ 166,286**	$ 172,760
Related tax (expense) benefit:		
Investment activities	**$ (2,133)**	$ 2,392
Change in pension and other postretirement obligations	**209**	(150)
Reclassification adjustment for gain (loss) included in net income	**237**	(20)
Total tax (expense) benefit	**$ (1,687)**	$ 2,222

Statements of Retained Earnings

(In thousands of dollars)

	For the Years Ended March 31,	
	2010	2009
Retained earnings at beginning of year	**$ 1,344,901**	$ 1,169,870
Net income	**163,756**	176,091
Dividends declared on preferred stock	**(1,060)**	(1,060)
Dividends declared on common stock	**(500,000)**	-
Retained earnings at end of year	**$ 1,007,597**	$ 1,344,901

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

Niagara Mohawk Power Corporation

Statements of Cash Flows

(In thousands of dollars)

	For the Years Ended March 31, 2010	2009
Operating activities:		
Net income	**$ 163,756**	$ 176,091
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**225,137**	223,787
Amortization of stranded costs and rate plan deferrals	**638,831**	534,459
Deferred federal and state income taxes and investment tax credits, net	**217,551**	(82,446)
Changes in assets and liabilities:		
Accounts receivable, net and unbilled revenues	**(2,569)**	46,020
Materials and supplies	**28,072**	(39,619)
Accounts payable, affiliate	**51,171**	36,372
Prepaid regulatory fees	**(59,895)**	-
Accounts payable and accrued expenses	**(15,354)**	(80,080)
Prepaid/accrued interest and taxes	**(283,575)**	23,649
Pension and other postretirement benefits	**(79,815)**	(195,689)
Other, net	**(7,539)**	50,748
Net cash provided by operating activities	**875,771**	693,292
Investing activities:		
Construction additions	**(476,839)**	(427,160)
Net change in money pool to affiliates	**(98,596)**	-
Change in restricted cash	**(7,224)**	(29,459)
Other, net	**(49,404)**	9,048
Net cash used in investing activities	**(632,063)**	(447,571)
Financing activities:		
Dividends paid on common stock	**(500,000)**	-
Dividends paid on preferred stock	**(1,060)**	(1,060)
Proceeds from long-term debt	**1,250,000**	-
Reduction in long-term debt	**-**	(600,000)
Reduction in long-term debt to affiliates	**(350,000)**	-
Net change in money pool to affiliates	**(650,600)**	358,900
Debt issuance costs	**(5,559)**	
Net cash used in financing activities	**(257,219)**	(242,160)
Net (decrease) increase in cash and cash equivalents	**(13,511)**	3,561
Cash and cash equivalents at beginning of year	**23,127**	19,566
Cash and cash equivalents at end of year	**$ 9,616**	$ 23,127
Supplemental information:		
Interest paid	**$ 114,929**	$ 187,155
Income taxes paid to Parent	**$ 47,665**	$ 131,732
Capital related accruals included in accounts payable	**$ 24,193**	$ 2,592

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

Niagara Mohawk Power Corporation

Statements of Capitalization

(In thousands of dollars except number of shares)

		March 31,				March 31,	
	2010	2009		**2010**		2009
Common Stockholders' Equity						
Common stock, $1 par value	**187,364,863**	187,364,863	**$**	**187,365**	$	187,365
Additional paid-in capital				**2,913,140**		2,913,140
Retained earnings				**1,007,597**		1,334,901
Accumulated other comprehensive income (loss)				**(1,928)**		(4,458)
Total common stockholders' equity	**187,364,863**	187,364,863		**4,106,174**		4,430,948
Preferred Equity						
Cumulative preferred stock, $100 par value						
3.40%	**57,524**	57,524		**5,753**		5,753
3.60%	**137,152**	137,152		**13,715**		13,715
3.90%	**95,171**	95,171		**9,517**		9,517
Total preferred equity	**289,847**	289,847		**28,985**		28,985
Long-Term Debt	**Interest Rate**					
Notes Payable:						
Unsecured Senior Notes	3.55% - 4.88%			**1,250,000**		-
State Authority Financing - Tax exempt:						
NYSERDA Tax exempt [2]	5.15%			**75,000**		75,000
NYSERDA Tax exempt	Variable			**575,065**		575,065
Total State Authority Financing				**650,065**		650,065
Intercompany Notes:						
NM Holdings Note [1]	3.72% - 5.80%			**850,000**		1,200,000
Unamortized discounts				**(462)**		(524)
Total long-term debt				**2,749,603**		1,849,541
Long-term debt due within one year				**350,000**		350,000
Total long-term debt, excluding current portion				**2,399,603**		1,499,541
Total capitalization			**$**	**6,534,762**	$	5,959,474

(1) Currently callable with make-whole provision

(2) Fixed rate pollution control revenue bonds are callable through November 1, 2010 at 101%, and at par thereafter

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

Niagara Mohawk Power Corporation

Notes to Financial Statements

Note 1 – Significant Accounting Policies

A. Nature of Operations:
Niagara Mohawk Power Corporation (the Company, we, us, and our) was organized in 1937 under the laws of New York State and is engaged principally in the regulated energy delivery business in New York State. The Company provides electric service to approximately 1.6 million electric customers in the areas of eastern, central, northern and western New York and sells, distributes and transports natural gas to approximately 0.6 million gas customers in areas of central, northern and eastern New York. The Company is a wholly-owned subsidiary of Niagara Mohawk Holdings, Inc., which is wholly-owned by National Grid USA (National Grid), a utility holding company with regulated subsidiaries engaged in the transmission, distribution, and sale of both natural gas and electricity. National Grid 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 generally 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 Uniform System of Accounts prescribed by regulatory bodies having jurisdiction, primarily the New York State Public Service Commission (NYPSC) and Federal Energy Regulatory Commission (FERC).

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the consolidated 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 August 3, 2010 for potential recognition or disclosure in the financial statements. There were no subsequent events that needed to be recognized.

C. Revenue Recognition:
The Company bills its customers on a monthly cycle basis at approved tariffs based on energy delivered and a minimum customer service charge. Revenues are determined based on these bills plus an estimate for unbilled energy delivered between the cycle billing date and the end of the accounting period. These amounts are billed to customers in the next billing cycle following the December month end. Total unbilled revenues March 31, 2010 and 2009 were approximately $156 million and $153 million, respectively.

As approved by the NYPSC, the Company is allowed to pass through for recovery of commodity-related costs. Additionally, a transmission revenue adjustment mechanism is in place that reconciles actual and rate forecast transmission revenues for pass back to, or recovery from, customers. The commodity adjustment clause and the transmission revenue adjustment mechanism have remained in effect under the Merger Rate Plan (MRP) which became effective on January 31, 2002.

The Company's gas utility tariffs contain weather normalization adjustments that largely offset shortfalls or excesses of firm net revenues (revenues less gas costs and revenue taxes) during a heating season due to variations from normal weather. Revenues are adjusted each month the clause is in effect.

D. Property, Plant and Equipment:

The cost of additions to utility plant 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 in amounts equivalent to the cost of funds devoted to plant under construction for its regulated businesses. AFUDC represents the composite interest and equity costs of capital funds used to finance that portion of construction costs not yet eligible for inclusion in rate base. AFUDC is capitalized in “Property, plant and equipment, net” with offsetting credits to “Other interest, including affiliate interest” and “Other income and (deductions).” This method is in accordance with established rate-making practices under which our utility subsidiaries are permitted to earn a return on, and the recovery of, prudently incurred capital costs through their ultimate inclusion in rate base and in the provision for depreciation. AFUDC rates vary by company and regulatory jurisdiction. Capitalized interest for the years ended March 31, 2010 and 2009 was $0.3 million and $2.4 million, respectively, and is reflected as a reduction to interest expense.

The Company’s repair and maintenance costs are expensed as incurred unless they represent replacement of property to be capitalized.

Depreciation: The Company’s depreciation is computed on the straight-line basis using the average service lives. The Company performs depreciation studies to determine service lives of classes of property and adjusts the depreciation rates when necessary.

The provisions for depreciation, as a percentage of weighted average depreciable property, and the weighted average service life, in years, for each asset category for the years ended March 31 are presented in the table below:

	2010		2009	
	Provision	**Service Life**	Provision	Service Life
Asset Category:				
Electric	**2.7%**	**36**	2.8%	36
Gas	**2.3%**	**44**	2.3%	43
Common	**4.3%**	**23**	4.5%	22

E. 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.

F. Cash and Cash Equivalents:
The Company classifies short-term investments maturity of 90 days or less at time of purchase as cash equivalents.

G. Restricted Cash:
Restricted cash consists of health care claims deposits, New York State Department of Conservation securitization for certain site cleanup, mortgage lien release deposits, worker's compensation premium deposits and collateral for derivative transactions.

H. Income and Excise Taxes:
Federal and state income taxes are recorded under the current accounting provisions 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.

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 $34 million and $42 million, respectively.

I. Derivatives:
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. (See Note 8 – Derivatives and Fair Value Measurements)

- **Firm Sales Derivatives Instruments.** We use derivative financial instruments to reduce cash flow variability associated with the purchase price for a portion of future natural gas and electricity purchases associated with our gas and electric distribution operations. Our strategy is to minimize fluctuations in firm gas and electricity sales prices to our regulated customers. The accounting for these derivative instruments follows current 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 and 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 consistent with regulatory requirements.

- **Physically-Settled Commodity Derivative Instruments.** Certain of our contracts for the physical purchase of natural gas and certain power supply contracts were assessed as no longer being exempt as normal purchases. As such, these contracts are recorded on the Balance Sheets at fair market value.

However, since such contracts were executed for regulated utility customers, and pursuant to the requirements for rate regulated enterprises, changes in the fair market value of these contracts are recorded as a regulatory asset or regulatory liability on the Balance Sheets.

J. Comprehensive Income (Loss):
Comprehensive income (loss) is the change in equity, 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 primary component of comprehensive income (loss) is unrealized gains and losses associated with certain investments held as available for sale. (See Note 10 - Changes in Equity Accounts)

K. 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. (See Note 3 – Employee Benefits and Note 8 – Derivatives and Fair Value Measurements)

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.

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

L. Pension and Other Postretirement Plan Assets:
In March 31, 2007, the Company adopted certain accounting guidance that requires employers to fully recognize all postretirement plans' funded status on the Balance Sheets 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, the Company 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 for additional details on the Company's pension and other postretirement plans.)

M. Reclassifications:
Certain amounts from prior years have been reclassified on the accompanying consolidated 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. Inventory:
Inventory is stated primarily at the lower of cost or market value under the average cost method. The company's write-down policy is to write-off obsolete inventory.

O. Power Purchase Agreements:
The Company accounts for its power purchase agreements, which are not deemed to be derivatives or leases, as executory contracts. The Company assesses several factors in determining how to account for its power purchase contracts. These factors include:

- the term of the contract compared to the economic useful life of the facility generating the electricity;
- the involvement, if any, that the Company has in operating the facility;
- the amount of any fixed payments the Company must make, even if the facility does not generate electricity; and
- the level of control the Company has over the amount of electricity generated by the facility, and who bears the risk in the event the facility is unable to generate.

P. Recent Accounting Pronouncements:
In May 2009, the Financial Accounting Standards Board (FASB) issued accounting guidance establishing the general standards of accounting for and disclosure 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 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, the 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.

Note 2 – Rates and Regulatory

The Company's financial statements conform to FERC's Uniform System of Accounts, including the accounting principles for rate-regulated entities with respect to its regulated operations. The current accounting guidance for rate regulated enterprises recognizes the ability of regulators, through the ratemaking process, to create future economic benefits and obligations affecting rate regulated companies. Accordingly, the Company records regulatory assets (expenses deferred for future recovery from customers) and regulatory liabilities (revenues collected for future payment of expenses or for return to customers) on the balance sheet. The Company's regulatory assets were $3.3 billion and $3.7 billion as of March 31, 2010 and 2009, respectively. These regulatory assets are probable of recovery, as their deferral is authorized by the NYPSC. The Company is earning a return on most of its regulatory assets under its MRP or Gas Rate Plan Joint Proposal (discussed below). The Company believes that the prices it will charge for electric service in the future, including the Competitive Transition Charges (CTCs), will be sufficient to recover and earn a return on the MRP's stranded regulatory assets over their amortization periods, assuming no unforeseen reduction in load or bypass of the CTCs. The Company's electric business continues to be rate-regulated on a cost-of-service basis under the MRP and, accordingly, the Company continues to apply the pertinent accounting guidance applicable to rate regulated companies. In addition, the Company's Purchase Power Agreements entered into when the Company exited the power generation business continue to be the obligations of the regulated business. Further, eight of the Company's Independent Power Producer (IPP) contracts that were structured as index swap contracts at this time are no longer obligations of the Company as they expired in June 2008.

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. 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.

Niagara Mohawk Power Corporation

Notes to Financial Statements

The following table details the various categories of regulatory assets and liabilities:

At March 31 *(In thousands of dollars)*	**2010**	2009
Current regulatory assets:		
Rate adjustment mechanisms	**$ 72,225**	$ 6,150
Merger rate plan stranded costs	**529,399**	502,494
Current regulatory liabilities included in other accrued expenses:		
Rate adjustment mechanisms	**(11,674)**	(4,332)
Current regulatory liabilities:		
Rate adjustment mechanisms	**(41,520)**	(45,354)
Total current regulatory assets, net	**548,430**	458,958
Non-current regulatory assets:		
Merger rate plan stranded costs	**453,956**	981,025
Regulatory tax asset	**78,865**	90,908
Deferred environmental restoration costs	**539,900**	536,342
Pension and postretirement benefit plans	**1,046,485**	1,148,944
Storm costs	**173,199**	175,881
Derivative instruments	**112,262**	52,697
Transportation marketer credit	**112,782**	106,925
Loss on reacquired debt	**30,349**	37,029
Other	**97,752**	110,552
Total non-current regulatory assets	**2,645,550**	3,240,303
Non-current regulatory liabilities:		
Cost of removal reserve	**(404,007)**	(387,977)
Stranded costs and CTC related	**(82,650)**	(82,562)
Postretirement benefit	**(25,552)**	(25,552)
Medicare Act tax benefit deferral	**(15,308)**	(73,980)
Economic development fund	**(38,688)**	(28,528)
Unbilled gas revenue	**(20,040)**	(17,914)
Environmental insurance proceeds	**(4,741)**	(5,804)
Debt interest rate savings	**(92,534)**	(92,534)
Derivative instruments	**(79,134)**	(8,308)
Other	**(218,649)**	(199,760)
Total non-current regulatory liabilities	**(981,303)**	(922,919)
Total non-current regulatory assets, net	**1,664,247**	2,317,384
Net regulatory assets	**$ 2,212,677**	$ 2,776,342

Notes to Financial Statements

The following are descriptions of major types of regulatory assets and liabilities:

MRP Stranded Costs: Under the MRP, a regulatory asset was established that included the costs of the Master Restructuring Agreement (MRA), the cost of any additional IPP contract buyouts and the deferred loss on the sale of the Company's generation assets. The MRA represents the cost to terminate, restate or amend IPP contracts. The Company is also permitted to defer and amortize the cost of any additional IPP contract buyouts. Since February 1, 2002, the MRP stranded costs regulatory asset has been amortized over ten years, consistent with projected recovery through rates. However, as discussed below regarding the Company's base rate case filed January 29, 2010, the Company's proposed to extend the amortization period of stranded costs and additional three years in order to mitigate the impact of its proposed increase in transmission and distribution revenue to provide, in total, that delivery revenue would remain at the level reflected in the MRP.

Regulatory Tax Asset: The regulatory tax asset represents the expected future recovery from ratepayers of the tax consequences of temporary differences between the recorded book basis and the tax basis of assets and liabilities. This amount is primarily timing differences related to depreciation. These amounts are recovered and amortized as the related temporary differences reverse.

Deferred Environmental Restoration Costs: This regulatory asset represents deferred costs associated with the Company's share of the estimated costs to investigate and perform certain remediation activities at hazardous waste sites with which it may be associated. The Company's rate plans provide for specific rate allowances for these costs, with variances deferred for future recovery or pass-back to customers. The Company believes future costs, beyond the expiration of current rate plans, will continue to be recovered through rates.

Pension and Postretirement Benefit Plans: Costs of the Company's pension and postretirement benefits plans over amounts reflected in rates are deferred to a regulatory asset to be recovered in a future period. This regulatory asset includes the deferral of the fair value adjustments to the pension and postretirement benefit plans other than pensions (PBOPs) (the Plans) as of the January 30, 2002 acquisition of the Company by National Grid. This deferral totaled $440 million at acquisition and is being amortized on a straight-line basis over the 10 years of the MRP. The Company has also recorded a regulatory asset as an offset to its yearly adjustment to the Plans recorded liability in the amounts of $764 million and $783 million at March 31, 2010 and March 31, 2009, respectively.

Cost of Removal Reserve and Asset Retirement Obligations: The Company adheres to the current accounting guidance relating to asset retirement obligations associated with tangible long-lived assets. Asset retirement obligations arising from legal obligations amounted to $11 million and $10 million at March 31, 2010 and 2009, respectively. 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 definition of an asset retirement obligation 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 to accumulated depreciation to reflect future use. The Company estimates it has collected over time approximately $404 million and $388 million for the cost of removal through March 31, 2010 and 2009, respectively.

The regulatory assets above also reflects $7.4 million the Company has on energy efficiency programs in excess of the current rate agreements. The Company believes these amounts will be recovered pursuant to future rate filings.

Major Rate Proceedings:

On August 3, 2009, the Company submitted a filing in compliance with the NYPSC's Opinion No. 01-6, Opinion and Order Authorizing Merger and Adopting Rate Plan, issued and effective December 3, 2001 in Case No. 01-M-0075 (Fourth CTC Reset Filing). The Fourth CTC Reset Filing complies with the Company's obligations under the MRP to: (i) reset its CTC in retail delivery rates to reflect changes in the forecast of commodity prices for the coming two years and (ii) adjust delivery rates to reflect deferral recoveries because the deferral account balance exceeded $100 million as of June 30, 2009. On December 21, 2009, the NYPSC issued its order on this matter and directed, among other things, that there would be no change in the deferral recoveries currently reflected in customer rates because of the difficult economic circumstances faced by customers.

On October 22, 2007, the Company made a compliance filing with the NYPSC regarding the implementation of the Follow-on Merger Credit associated with the acquisition by National Grid plc of KeySpan Corporation (KeySpan) in August 2007. In its compliance filing, the Company calculated the share of the KeySpan Follow-on Merger savings allocable to the Company for the period from September 2007 through December 2011 to be approximately $40 million. The Company subsequently agreed, in its comments filed in the Third CTC Reset proceeding on October 31, 2007, to lower rates submitted in its August 1, 2007 CTC Reset filing to reflect a proposal by the parties in that proceeding to apply the KeySpan Follow-on Merger Credit to the Company's electric customers over a two year period instead of over the four remaining years of the MRP, which was approved by the NYPSC in December 2007. On May 29, 2008, the NYPSC issued its decision with respect to the Company's October 22, 2007 compliance filing rejecting the Company's proposed calculation and requiring a Follow-on Merger Credit of $52 million for the August 24, 2007 through December 2011 period. On June 30, 2008, the Company filed a petition for rehearing of the May 29, 2008 order from the NYPSC. The NYPSC denied the Company's rehearing petition in an order dated February 24, 2009, holding that its May 2008 order was consistent with the explicit language of the MRP.

The NYPSC further issued a notice on June 25, 2008 seeking additional comment on Department of Public Service Staff's (Staff) Paper setting forth two Follow-on Merger savings issues that were not addressed in the compliance filing of October 22, 2007. In the notice, the NYPSC asked for comments on Staff's Paper and its two issues that called for the Company to credit an additional $35 million of synergy savings to electric and gas customers. Multiple Intervenors (a consortium of large commercial and industrial customers) filed comments in favor of a larger credit. Following settlement negotiations, on January 25, 2010, the Company, Staff, and Multiple Intervenors filed a joint proposal that, if adopted by the NYPSC, would resolve the issues raised in Staff's Paper by the Company crediting an additional $4 million to the Company's electric and gas customers. Statements in support of the joint proposal were filed on February 1, 2010 by the Company, Staff and Multiple Intervenors.

Stimulus filing in connection with American Recovery and Reinvestment Act of 2009: On October 27, 2009, the Company learned that it was not successful in receiving any stimulus funding under its Smart Grid Investment Grant (SGIG) application filed with the U.S. Department of Energy (DOE) as part of National Grid's proposed Smart Grid programs. The Company is a partner in the New York Independent System Operator (NYISO)–sponsored Phasor Measurement Unit (PMU) Project and Capacitor Project, and both of those projects received SGIG grants. Additionally, the Company is a partner in the Premium Power Corporation–sponsored Energy Storage Demonstration Project, which is a recipient of an award from DOE under the Smart Grid Demonstration (SGD) grant program. The Company is allowed to recover from customers the balance of the cost not covered by the SGIG grant in implementing the PMU Project and Capacitor Project and the SGD grant in implementing the Premium Power Project.

On January 15, 2010 the Company filed a modified Smart Grid Program (Smart Program) for NYPSC approval which modified the Company's previous July 2, 2009 filing by reducing the program scope and size to an approximate $123 million investment, inclusive of the Company's contribution to the aforementioned NYISO–sponsored projects and the Premium Power Energy Storage Demonstration Project. The Smart Program as currently proposed is comprised of a Smart Grid Spine and four Clean Energy Modules to be deployed in the Syracuse, New York area, as well as developmental work in the Company's Smart Technology Center, a workforce training component, the NYISO-sponsored projects, and the Premium Power Project. The NYPSC has yet to act on the Company's January 15, 2010 filing.

Service Quality Penalties: In connection with the MRP and Gas Rate Plan Joint Proposal (see below), the Company is subject to maintaining certain service quality standards. Service quality measures focus on eleven categories including safety targets related to gas operations, electric reliability measures related to outages, residential and business customer satisfaction, meter reads, customer call response times, and administration of the Low-Income Customer Assistance Program. If a prescribed standard is not satisfied, the Company may incur a penalty, with the penalty amount applied as a credit or refund to customers.

The MRP includes provisions related to frequency and duration of outages that causes the annual $4.4 million penalty associated with these standards to be doubled under certain circumstances when penalties have been incurred in the current year and two of the last four years. The Company had incurred no service quality penalties for year ended March 31, 2010 and 2009.

Asset Condition and Capital Investment Plan: On October 22, 2007, the Company filed with the NYPSC the first of required annual reports on its asset condition and capital investment plan for its electric transmission and distribution system. The Company's 2007 capital investment plan involved significant investment in capital improvements over the projections initially included in its MRP. On August 15, 2008, the NYPSC issued its order on the compliance filing. The NYPSC affirmed the Company's need to invest a minimum of $1.47 billion during the five year period 2007-2011 (calendar) and stated that further projects and investments "appear to be justified" with the possibility of further expansion over time. On January 29, 2010, the Company filed its capital investment plan with the latest five year projection for capital investment estimated at $2.86 billion for fiscal years 2011 and 2015. On the same date, the Company filed a proposal to revise its electric rates effective January 1, 2011. The rate case filing included a copy of the 2011-2015 capital investment plan. On May 3, 2010, the Company filed in its rate case corrections and updates filing a downward adjustment to the five-year infrastructure investment of approximately $116 million, resulting in a five-year projected capital plan estimated at $2.75 billion.

On December 21, 2007, the Company filed with the NYPSC a Petition for Special Ratemaking seeking authorization to defer for later rate recovery 50% of the revenue requirement impact during calendar year 2008 of specified capital programs and operating expenses that are directly associated with these programs. In the order approving the KeySpan merger, the NYPSC had found that the rate impacts associated with certain incremental investments during the remaining period of the MRP would be limited to not more than 50% of the total rate impact as ultimately determined by the NYPSC.

On September 5, 2008, the NYPSC issued its order on the Company's Petition for Special Ratemaking. The NYPSC stated that the Company's investment program could "conceptually" be considered incremental to the level of investment assumed in the MRP and therefore could be eligible for deferral. However, the NYPSC ordered the Company to supplement its petition with actual expense information once results for calendar year 2008 were known. The Company was directed to show in its supplemental filing that the Company will not over earn in 2008 after the deferrals are allowed, that the expenditures on which the deferrals are based are incremental to what was reflected in the MRP forecast, that such expenditures have been offset by all relevant cost savings and related benefits, and to the extent that actual expenditures for 2008 differed from amounts in the budgets that were previously filed with the NYPSC, that the basis for such differences be explained. Finally, the NYPSC ordered a schedule of reporting requirements on the investment program which the Company has been working with the NYPSC to develop. In April 2009, the Company filed for authority to defer 2008 actual incremental capital and associated operating expenditures. The NYPSC has not yet ruled on the Company's petition. In May 2010, the Company filed a request for recovery of incremental investment in 2009 in another Petition for Special Ratemaking to the NYPSC.

Financial Protections: The Company made a filing on November 19, 2007 proposing certain financial protections for the Company as required by the NYPSC in the order approving the KeySpan merger and made an additional filing with the NYPSC regarding these protections. The NYPSC adopted the protections in March 2008 which provide, among other things, for restrictions on the payment of common dividends if certain credit ratings are not maintained by the Company or National Grid plc; credits to the Company's deferral account of any incremental increase in interest expense due to a decline in the Company's bond rating; a prohibition with respect to certain types of cross-default provisions; and the implementation of a class of preferred stock having one share (the Golden Share), subordinate to any existing preferred stock, the holder of which would have voting rights that limit the Company's right to commence any voluntary bankruptcy, liquidation, receivership or similar proceeding without the consent of the holder of such share of stock. In the years ended March 31, 2010 and 2009, there was no impact on the Company's financial statements. On April 9, 2010, the Company petitioned the NYPSC for authorization to issue its Golden Share to GSS Holdings, Inc. (GSS) under the same arrangements in its sister utilities, The Brooklyn Union Gas Company d/b/a KeySpan Energy Delivery New York and KeySpan Gas East Corporation d/b/a KeySpan Energy Delivery Long Island, made with GSS, which terms were filed with the NYPSC on November 19, 2009.

Gas Rate Plan Joint Proposal: On May 15, 2009, the NYPSC approved a joint proposal (Joint Proposal) that provides for a two-year rate plan, with an annual increase of $39.4 million in the first year and specific, incremental adjustments in the second year to reflect changes in such costs as postretirement benefit plans other than pensions and environmental site investigation and remediation costs. Among other deferral mechanisms, the Joint Proposal provides for a true up to the actual amount, cost and timing of certain new long-term debt issuance, subject to the actual costs falling outside of a defined range. The Joint Proposal provides for a 10.2% return on equity and a 43.7% equity ratio, and an earnings-sharing mechanism that requires the Company to share earnings with customers to the extent its return on equity exceeds 11.35%. The Joint Proposal also includes a revenue decoupling mechanism, negative revenue adjustments for failure to meet certain service quality performance metrics and a commodity-related bad debt recovery mechanism that adjusts for fluctuations in commodity prices. The new rates went into effect on May 20, 2009. Pursuant to the Joint Proposal, on April 12, 2010, the Company filed for rate adjustments to be effective May 20, 2010 based on increases in certain costs. If approved, the rate adjustments will increase from gas operations by approximately $13.9 million.

Temporary State Assessment Pursuant to PSL Section 18-a: On June 4, 2009 the Company made a gas compliance filing and on June 30, 2009 the Company made an electric compliance filing with the NYPSC regarding the implementation of the Temporary State Energy & Utility Conservation Assessment per §18-a of the New York Public Service Laws of 2009. The combined General & Temporary Conservation Assessment will equal 2% of the prior calendar year's gross operating revenues derived from intra-state utility operations. Per order dated June 19, 2009, the NYPSC authorized recovery of the revenues required for payment of the Temporary State Assessment, including carrying charges, subject to reconciliation over five years, July 1, 2009 through June 30, 2014. In its initial compliance filing required by the Gas Rate Order, the Company filed a tariff to collect $25.1 million in incremental assessment expense from its customers over a 12-month period beginning May 20, 2009. In accordance with the order dated June 19, 2009, the Company was required to file a revised gas tariff authorizing imposition of a new surcharge amount for July 1, 2009 through June 30, 2010, recognizing that the Company had collected a portion of the revenues to date. The Company calculated the incremental gas assessment to be collected from customers, including carrying charges and an allowance for uncollectible amounts, to be $26.4 million for the period from July 1, 2009 through June 30, 2010. In its June 30, 2010 electric compliance filing, the Company calculated the incremental electric assessment to be collected from customers, including carrying charges and an allowance for uncollectible amounts, to be $83.1 million for the period from July 1, 2009 through June 30, 2010. The Company commenced collection of the Temporary State Assessment as of July 1, 2009 from electric customers.

Transmission Rate Case: In February 2008, the Company filed with FERC a formula transmission rate for customers that take service under the NYISO tariff. In July 2008, FERC issued an order accepting the proposed formula rate and approved a 50 basis point incentive return on equity applicable to all transmission facilities. This decision marked the first formula rate for a private transmission owner in New York. The rate took effect on October 1, 2008 subject to refund. The FERC directed hearing and settlement judge proceedings to resolve the remaining contested issues in the proceeding. On April 6, 2009, the Company filed a settlement agreement which was accepted by the FERC by its order issued on June 22, 2009, and which resolved all issues in the proceeding. The formula was projected to increase annual revenues by approximately $7.9 million. The settlement provides for an authorized return on equity of 11.5%, including any incentive return. The effective date for the settlement was January 30, 2009 with a phase-in of the settlement rate over the period January 30 through June 30. In July 2009, the Company refunded to customers a total of $7.1 million, inclusive of FERC required interest, for amounts collected in excess of the settlement rates for the period of October 2008 through June 2009. The increase in revenues resulting from the new formula rate are charged to wholesale transmission customers and credited back to retail electric distribution customers through the Transmission Revenue Adjustment Clause mechanism. In November 2009, the Company filed a proposed Stipulation and Agreement modifying the calculation of the Long-Term Debt Cost of Capital Rate so that the amount of the Company's long-term debt used in the calculation of the Capital Rate is based on the average of the beginning-of-the-year and the year-end long-term debt balances. As a result of the proposed change the Company's revenue is estimated to decline by approximately $0.4 million. The Company agreed to give customers the benefit of the change from July 1, 2009 forward. On February 13, 2010, the proposed Stipulation and Agreement was accepted by FERC.

Rate Filing: On January 29, 2010, the Company filed with the NYPSC a new electric base rate case for new rates proposed to go into effect on January 1, 2011, which would terminate the MRP one year early. In its filing, the Company proposed a three year rate plan commencing January 1, 2011 running through December 31, 2013. The Company designed its rate filing to produce, in the aggregate, no net increase in electric delivery rates over the course of the three-year rate plan. To achieve this result, the Company proposed to extend the amortization schedule for recovery of certain fixed stranded costs to offset the total increase in transmission and distribution revenue. In addition to new base rates, the Company's filing proposed mechanisms that would permit it to defer certain costs that vary from the level reflected in the Company's proposed rates, including a mechanism that would reconcile investment in system infrastructure. On May 3, 2010, the Company submitted corrections and updates to its original filing, including a revised capital expenditures forecast. The corrections and updates filing decreases the Company's proposal revenue requirement for 2011 from approximately $391 million to $369 million, an additional $51 million (total of $420 million) in 2012 and a reduction in revenues of $28 million (total of $392 million) in 2013. The Company continues to propose a three-year rate plan with no net increase in the electric delivery rates, as discussed above.

On July 14, NYPSC Staff filed its testimony in the pending rate case and recommended that NIMO should reduce electric rates by $14.1 million. The Company and the NYPSC Staff are continuing negotiations and at this point in time the Company can not predict the outcome of this rate proceeding.

Storm Costs: As provided in the MRP, certain storm restoration costs may be included in the deferral account for recovery. The Company is allowed to recover from customers the costs of major storms in which the costs and (or) number of customers affected exceed certain specific thresholds. Non-recoverable storm costs are composed of: (1) the first $8 million of costs, cumulatively, associated with major storms, and (2) the costs of each storm thereafter that do not qualify as a major storm as defined in the Company's rate plan. In its base rate filing, the Company is proposing to establish a fully reconciling storm fund for major storms.

Federal Income Tax Refund: The Company received federal income tax refunds covering the tax years of 1991 to 1995 in the amount of $25.6 million, inclusive of $13.3 million of interest, from the Internal Revenue Service (IRS) in March 2003 and August 2004, respectively. As required by NYPSC regulations, the Company made a filing with the NYPSC and proposed to credit $7.2 million to its customers and recorded the resulting regulatory liability and earnings impact in March 2009. The Company subsequently agreed with the parties in proceeding on several adjustments to the proposed disposition resulting in an additional $18.7 million credit to its customers**,** including approximately $7.3 million (through December 2009) in carrying charges due to the delay in filing the refund notice and $11.4 million in full settlement of all other outstanding issues. On March 19, 2010, the Company made a supplemental filing to provide procedures put in place by the Company to ensure that all future income tax refunds would be timely noticed. On April 16, 2010, the NYPSC issued an order adopting the submitted joint proposal. The Company will continue to accrue carrying charges for gas customers until such time as the deferred amounts are passed back to gas customers.

Note 3 - Employee Benefits

Summary

The Company participates in a non-contributory defined benefit pension plan and a postretirement benefit plans other than pension (PBOP) (the Plans). The Plans cover substantially all of the employees of the Company. The pension plan is a cash balance pension plan design and, under that design, pay-based credits are applied based on service time and interest credits are applied at rates set forth in the plan. In addition, a large number of employees hired by the Company prior to July 1998 are cash balance design participants who receive a larger benefit if so yielded under pre-cash balance conversion final average pay formula provisions. Employees hired by the Company following the July 1998 cash balance design conversion participate under cash balance design provisions only.

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

A supplemental nonqualified, non-contributory executive retirement program provides additional defined pension benefits for certain executives.

The NYPSC's Statement of Policy requires that prior service costs and gains and losses be amortized over a 10-year period calculated on a vintage year basis.

Funding Policy

Funding policy is determined largely by the Company's rate agreements with the NYPSC and amounts recovered in rates. However, for the pension plan, the contribution for any year will not be less than the minimum amounts that are required under the Pension Protection Act of 2006.

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Notes to Financial Statements

Plan Assets
The target asset allocation for the benefit plans are:

	Pension		Non-union - PBOPs		Union - PBOPs	
	2010	2009	**2010**	2009	**2010**	2009
U.S. equities	**20%**	25%	**30%**	30%	**34%**	49%
Global equities (including U.S.)	**7%**	7%	**-**	-	**12%**	-
Global tactical asset allocation	**10%**	14%	**-**	-	**17%**	-
Non-U.S. equities	**10%**	9%	**20%**	20%	**17%**	21%
Fixed income	**40%**	40%	**50%**	50%	**20%**	30%
Private equity	**5%**	5%	**-**	-	**-**	-
Real estate	**5%**	-	**-**	-	**-**	-
Infrastructure	**3%**	-	**-**	-	**-**	-
	100%	100%	**100%**	100%	**100%**	100%

The percentage of the fair value of total plan assets at March 31:

	Pension		Non-union - PBOPs		Union - PBOPs	
	2010	2009	**2010**	2009	**2010**	2009
U.S. equities	**23%**	27%	**31%**	34%	**36%**	48%
Global equities (including U.S.)	**9%**	7%	**-**	-	**11%**	-
Global tactical asset allocation	**13%**	13%	**-**	-	**17%**	-
Non-U.S. equities	**10%**	9%	**20%**	19%	**17%**	20%
Fixed income	**42%**	40%	**49%**	47%	**19%**	32%
Private equity	**3%**	4%	**-**	-	**-**	-
	100%	100%	**100%**	100%	**100%**	100%

The Company 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. Small investments are also held in private equity, with the objective of enhancing long-term returns while improving portfolio diversification. For the PBOP plan, since the earnings on a portion of the assets are taxable, those investments are managed to maximize after tax returns consistent with the broad asset class parameters established by the asset allocation study. Investment risk and return are reviewed by National Grid's investment committee on a quarterly basis.

The discount rate is the rate at which plan obligations can be settled. The discount rate assumption is based on rates of return on high quality fixed income investments in the market place as of each measurement date (typically March 31). Specifically, the National Grid companies use the Hewitt Top Quartile Discount Curve along with the expected future cash flows from the retirement plans to determine the weighted average discount rate assumptions.

The estimated rate of return for various passive asset classes is based both on analysis of historical rates of return and forward looking analysis of risk premiums and yields. Current market conditions, such as inflation and interest rates, are evaluated in connection with the setting of the long-term assumption. A small premium is added for active management and rebalancing of both equity and fixed income. The rates of return for each asset class are then weighted in accordance with the Plan's year end asset allocation, and the resulting long-term return on asset rate is then applied to the market-related value of assets.

Assumptions Used for Benefits Accounting
The following weighted average assumptions were used to determine the pension and PBOP benefit obligations and net periodic costs for the fiscal years ended March 31:

	Pension Benefits			
	Benefit obligation		Net periodic benefit cost	
	2010	2009	**2010**	2009
Discount rate	**6.10%**	7.30%	**7.30%**	6.50%
Rate of compensation increase	**3.50%**	3.50%	**3.50%**	3.50%
Expected long-term rate of return on assets	**8.00%**	8.00%	**8.00%**	8.00%

	PBOP			
	Benefit obligation		Net periodic benefit cost	
	2010	2009	**2010**	2009
Discount rate	**6.10%**	7.30%	**7.30%**	6.50%
Expected long-term rate of return on asset				
Union	**8.00%**	7.75%	**7.75%**	7.75%
Non-union	**6.75%**	6.75%	**6.75%**	6.75%
Health care cost trend rate				
Initial rate - Pre 65	**8.50%**	8.50%	**8.50%**	9.00%
Initial rate - Post 65	**8.50%**	9.50%	**9.50%**	10.00%
Initial rate - Rx	**9.25%**	n/a	**n/a**	n/a
Ultimate rate	**5.00%**	5.00%	**5.00%**	5.00%
Year ultimate rate is reached - Pre 65	**2017**	2015	**2015**	2014
Year ultimate rate is reached - Post 65	**2017**	2016	**2016**	2015
Year ultimate rate is reached - Rx	**2019**	n/a	**n/a**	n/a

The Company participates in pension and PBOP plans with another National Grid subsidiary. The expected contributions to the pension and PBOP plans during fiscal year 2011 are $180 million and $123 million, respectively. A portion of these contributions will be made by the Company.

Pension Benefits:
The Company's net periodic benefit cost for the years ended March 31, 2010 and 2009 included the following components:

(In thousands of dollars)	**2010**	2009
Service cost	**$ 20,856**	$ 23,142
Interest cost	**72,098**	68,740
Expected return on plan assets	**(84,800)**	(92,443)
Amortization of unrecognized prior service cost	**4,313**	3,716
Amortization of unrecognized loss	**47,835**	27,166
Net periodic benefit costs before settlement	**60,302**	30,321
Settlement loss	**132**	-
Special termination benefits (VERO)*	**2,514**	9,052
Net periodic benefit cost	**$ 62,948**	$ 39,373

*Special termination benefits consist of costs related to Voluntary Early Retirement Offer (VERO).

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The benefit obligation, assets and funded status of the pension plans cannot be presented separately for the Company as the Company participates in the Plan with an affiliated National Grid Service Company. The following table provides the total funded status at March 31 of the pension plans in which the Company participates:

(In thousands of dollars)		**2010**		2009
Change in benefit obligation:				
Benefit obligation at beginning of year	**$**	**(1,103,561)**	$	(1,176,992)
Service cost		**(24,369)**		(27,449)
Interest cost		**(77,621)**		(74,456)
Actuarial gain (loss)		**(188,349)**		50,731
Benefits paid		**108,082**		141,563
Settlements (lump sums)		**612**		-
Plan amendments		**(14,966)**		-
Special termination benefits (VERO)		**(5,541)**		(16,958)
Benefit obligation at end of year		**(1,305,713)**		(1,103,561)
Fair value of plan assets at beginning of year		**929,816**		1,159,404
Actual return (loss) on plan assets		**302,008**		(299,810)
Company contributions		**198,519**		211,785
Benefits paid		**(108,082)**		(141,563)
Settlements (lump sums)		**(612)**		-
Fair value of plan assets at end of year		**1,321,649**		929,816
Funded status	**$**	**15,936**	$	(173,745)

The accumulated benefit obligation for all defined benefit pension plans in which the Company participates was $1.2 billion and $1.0 billion for the years ended March 31, 2010 and 2009, respectively.

The following table details the amounts recognized in the Company's Balance Sheets.

(In thousands of dollars)		**2010**		2009
Amounts recognized in the Company's Balance Sheet consist of:				
Other current liabilities	**$**	**(2,980)**	$	(3,800)
Employee pension and other benefits	**$**	**45,932**	$	(135,847)

(In thousands of dollars)		**2010**		2009
Amounts recognized primarily in regulatory assets consist of:				
Net actuarial loss	**$**	**407,670**	$	476,040
Prior service cost		**41,871**		31,218
Net amount recognized	**$**	**449,541**	$	507,258

The estimated net actuarial loss and prior service cost for the defined benefit pension plans that will be amortized from regulatory assets and accumulated other comprehensive income (loss) into net periodic benefit cost during fiscal year 2011 is estimated to be $70 million and $5 million, respectively. The Company participates in the Plans with certain other National Grid subsidiaries. A portion of these amounts will be recorded as expense by the Company.

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Notes to Financial Statements

The following payments are expected to be paid from the pension plans:

(In thousands of dollars)	**Pension Benefits**
2011	**$ 106,736**
2012	**$ 104,735**
2013	**$ 116,540**
2014	**$ 116,399**
2015	**$ 121,694**
Thereafter	**$ 598,851**

Defined Contribution Plan
The Company also has a defined contribution pension plan (employee savings fund plan) that covers substantially all employees. Employer matching contributions of approximately $7 million were expensed for each of the fiscal years ended March 31, 2010 and 2009.

Postretirement Benefit Plans Other than Pensions:
The Company's total cost of PBOPs for the fiscal years ended March 31, 2010 and 2009 included the following components:

(In thousands of dollars)	**2010**	2009
Service cost	**$ 11,585**	$ 14,997
Interest cost	**82,915**	81,397
Expected return on plan assets	**(28,251)**	(40,444)
Amortization of unrecognized prior service cost	**13,206**	14,587
Amortization of unrecognized net loss	**35,955**	30,845
Net periodic benefit costs before settlement	**115,410**	101,382
Special termination benefits (VERO)*	**82**	96
Net periodic benefit cost	**$ 115,492**	$ 101,478

*Special termination benefits consist of costs related to VERO.

Notes to Financial Statements

The benefit obligation, assets and funded status of the PBOP plan cannot be presented separately for the Company as the Company participates in the Plan with another National Grid subsidiary. The following table provides the PBOP plans' funded status and the amounts recognized in the National Grid Consolidated Balance Sheets at March 31:

(In thousands of dollars)		**2010**		2009
Change in benefit obligation:				
Benefit obligation at beginning of year	**$**	**(1,255,018)**	$	(1,359,486)
Service cost		**(13,159)**		(17,352)
Interest cost		**(85,933)**		(84,276)
Actuarial gain (loss)		**(210,584)**		138,387
Medicare Part D subsidy received		**(4,600)**		(376)
Benefits paid		**85,761**		68,570
Plan amendments		**14,195**		-
Healthcare reform amendment		**(6,500)**		-
Special termination benefits (VERO)		**(143)**		(485)
Benefit obligation at end of year		**(1,475,981)**		(1,255,018)
Fair value of plan assets at beginning of year		**389,837**		546,657
Actual return (loss) on plan assets		**146,062**		(149,930)
Company contributions		**81,239**		61,680
Benefits paid		**(85,761)**		(68,570)
Fair value of plan assets at end of year		**531,377**		389,837
Funded status	**$**	**(944,604)**	$	(865,181)

Amounts recognized in the Company's Balance Sheets consist of:

(In thousands of dollars)		**2010**		2009
Amounts recognized on the Company's Balance Sheet consist of:				
Other current liabilities	**$**	**(4,600)**	$	(2,500)
Employee pension and other benefits liability	**$**	**(907,630)**	$	(838,808)

(In thousands of dollars)		**2010**		2009
Amounts recognized primarily in regulatory assets:				
Net actuarial loss	**$**	**288,167**	$	229,456
Prior service cost		**63,182**		88,897
Deferred taxes on subsidy		**(35,178)**		(41,359)
Net amount recognized	**$**	**316,171**	$	276,994

The estimated net actuarial loss and prior service cost for the PBOP plans that will be amortized from regulatory assets into net periodic benefit cost during fiscal year 2011 is estimated to be $48 million and $13 million, respectively. The Company participates in the Plans with certain other National Grid subsidiaries. A portion of these amounts will be recorded as expense by the Company.

As a result of the Medicare Act of 2003, the Company receives a federal subsidy for sponsoring a retiree healthcare plan that provides a benefit that is actuarially equivalent to Medicare Part D.

The following PBOP benefit payments expected to be paid and subsidies expected to be received from the U.S. Federal Government, which reflect expected future services, as appropriate, are:.

(In thousands of dollars)	Payments	Subsidies
2011	$ 79,961	$ 4,973
2012	$ 83,408	$ 5,568
2013	$ 86,607	$ 6,252
2014	$ 90,157	$ 6,909
2015	$ 93,804	$ 7,580
2016-2020	$ 521,506	$ 48,625

A one-percentage point change in assumed health care cost trend rates would have the following effects:

(In thousands of dollars)	2010
Increase 1%	
Total of service cost plus interest cost	$ 15,764
Postretirement benefit obligation	$ 204,376
Decrease 1%	
Total of service cost plus interest cost	$ (13,436)
Postretirement benefit obligation	$ (179,491)

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 Company's deferred tax asset balance resulted in a net charge to the income statement of approximately $60.6 million. This was offset by credits to the income statement arising from the release of associated regulatory liabilities, net of tax.

Special Termination Benefits (VERO):

In connection with National Grid plc's acquisition of KeySpan, which was completed on August 24, 2007, National Grid plc and KeySpan offered certain nonunion employees VERO packages in June 2007 in an effort to achieve necessary staff reductions through voluntary means. Of the 560 enrolled in the VERO, 45 were the Company's employees. Employees enrolled in the early retirement program will retire by October 1, 2010. The Company's share of the cost of the VERO program was estimated to be $37 million, which has been expensed through March 31, 2010. For the year ended March 31, 2010, the Company expensed $8 million.

During the year ended March 31, 2010, an additional VERO package was offered to 38 union employees in April 2009 as part of 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 a National Grid affiliate. Employees enrolled in the early retirement program retired in fiscal year 2010. The Company recorded $1 million of allocated costs associated with this VERO package.

During the year ended March 31, 2009, in December 2008, a third VERO package was offered by the Company. The VERO package was accepted by 42 union customer service employees who were all employees of the Company. Employees enrolled in this early retirement program retired as of December 31, 2008. The Company recorded $4.5 million associated with this VERO package.

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Fair Value Measurements

As discussed in Note 1, Significant Accounting Policies, current accounting guidance on fair value measurements establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements).

Following is a description of the valuation methodologies used at March 31, 2010 for pension and other postretirement benefit assets measured at fair value. The pension and other postretirement benefit assets can be invested in any of the following categories.

Cash and cash equivalent:
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.

Equity and preferred securities:
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 and future contracts:
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.

Private equity and real estate:
Commingled equity funds, commingled special equity funds, limited partnerships, real estate, venture capital and other investments are valued using evaluations (a good faith opinion as to what a buyer in the marketplace would pay for a security – typically in an institutional round lot-in a current sale), based on proprietary models, or based on the net asset value.

The asset classes listed in the tables below may also be held in the following investment vehicles:

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

103-12 investment entities (entities whose legal structure is in the form of a financial services product such as a collective trust or a limited partnership and whose underlying assets include “plan assets” of two or more plans that are not members of a related group of employee benefit plans in accordance with Department of Labor Regulation 2520.103-12) are valued using financial information received from the investment trustee, advisor and/or general partner. This information is received monthly and is based on the value of underlying securities. For some 103-12 investments, the financial information is provided in the quarterly statements that are typically provided more than 30 days after quarter end. Because of this time lag, investment units for these 103-12 investment entities are valued as of the Plan year end using the available statement from the prior quarter end.

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 pension plan investments at fair value as of March 31, 2010:

(In thousands of dollars) Type	Level 1	Level 2	Level 3	Total
Assets				
Investments				
Cash & cash equivalents	$ 663	$ 17,148	$ 2	$ 17,813
Convertible securities	-	11	-	11
Equity	297,181	323,059	24,579	644,819
Fixed income securities	155,781	374,866	19,104	549,751
Futures contracts	594	-	-	594
Preferred securities	1,637	-	-	1,637
Private equity	-	21,891	85,134	107,025
Net assets at fair value	$ 455,856	$ 736,975	$ 128,819	$ 1,321,650

The table depicted below sets forth by level, within the fair value hierarchy, the retirement benefits other than pension plan investments at fair value as of March 31, 2010:

(In thousands of dollars) Type	Level 1	Level 2	Level 3	Total
Assets				
Investments				
Cash & cash equivalents	$ 19,659	$ 13,981	$ 39	$ 33,679
Equity	111,312	195,437	13,331	320,080
Fixed income securities	92,200	52,026	-	144,226
Futures contracts	(9)	-	-	(9)
Preferred securities	551	-	-	551
Private equity	-	11,977	20,874	32,851
Net assets at fair value	$ 223,713	$ 273,421	$ 34,244	$ 531,378

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

(In thousands of dollars)	**Total**
Balance at March 31, 2009	$ 122,986
Realized gains	24,799
Unrealized losses relating to instruments held at reporting date	4,704
Purchases, sales, issuance, and settlements (net)	(23,670)
Balance at March 31, 2010	$ 128,819

The following table sets forth a summary of changes in the fair value of the retirement benefits other than pension plan's level 3 investments for the year ended March 31, 2010:

(In thousands of dollars)	**Total**
Balance at March 31, 2009	$ 39
Realized gains	16
Unrealized losses relating to instruments held at reporting date	1,037
Purchases, sales, issuance, and settlements (net)	33,152
Balance at March 31, 2010	$ 34,244

Note 4 - Long-term Debt

State Authority Financing Bonds: Substantially all of the Company's operating properties are subject to mortgage liens securing its mortgage debt. Several series of First Mortgage Bonds amounting to $650 million were issued to secure a like amount of tax-exempt revenue bonds issued by the New York State Energy Research and Development Authority (NYSERDA). Approximately $575 million of such securities bear interest at short-term adjustable interest rates (with an option to convert to other rates, including a fixed interest rate) ranging from 0.57% to 1.39%, for the twelve months ended March 31, 2010. The bonds are currently in the auction rate mode and are backed by bond insurance. Credit rating agencies have downgraded the ratings of the bond insurers. The resulting interest rates on the bonds revert to the maximum rate which depends on the current commercial paper rates and the senior secured rating of the Company or the bond insurer, whichever is greater. The effect on interest expense has not been material at this time. The Company also has $75 million of 5.15% fixed rate pollution control revenue bonds issued through NYSERDA which are callable at 101% through November 1, 2010 and at par thereafter. Pursuant to agreements between NYSERDA and the Company, proceeds from such issues were used for the purpose of financing the construction of certain pollution control facilities at the Company's generation facilities (which the Company subsequently sold) or to refund outstanding tax-exempt bonds and notes.

Intercompany Notes: The Company has several intercompany long-term notes outstanding with Niagara Mohawk Holdings, an affiliate of the Company, in the amount of $850 million and $1.2 billion at March 31, 2010 and 2009, respectively.

Notes Payable: In August 2009, the Company issued $750 million of unsecured long-term debt at 4.881% with a maturity date of August 15, 2019. Additionally, in September 2009 the Company issued $500 million of long-term debt at 3.553% with a maturity date of October 1, 2014. 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

Notes to Financial Statements

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.

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

(In thousands of dollars)		**Amount**
2011	$	350,000
2012		-
2013		500,000
2014		45,600
2015		500,000
Thereafter		1,354,465
Total		2,750,065

The current portion of capital lease obligations is reflected in the “Current liabilities – Other” line item on the Balance Sheets and was approximately $0.6 million at March 31, 2010 and 2009. The non-current portion of capital lease obligations is reflected in the “Non-current liabilities - Other” line item on the Balance Sheets and was approximately $2 million at March 31, 2010 and 2009, respectively.

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 thousand of dollars)	**Plant and Machinery**	**Land and Buildings**	**Vehicles and Equipment**	**Assets in Construction**	**Total**
Balance at March 31, 2008	$ 7,169,997	$ 456,549	$ 13,740	$ 429,759	$ 8,070,045
Additions	(18)	-	-	427,178	427,160
Disposals	(69,886)	(12,243)	(8,930)	-	(91,059)
Reclassifications	715,230	16,535	8,903	(735,910)	4,758
Balance at March 31, 2009	7,815,323	460,841	13,713	121,027	8,410,904
Accumulated Depreciation at March 31, 2009	(2,493,790)	(68,686)	(9,097)	-	(2,571,573)
Net book value at March 31, 2009	$ 5,321,533	$ 392,155	$ 4,616	$ 121,027	$ 5,839,331
Balance at March 31, 2009	7,815,323	460,841	13,713	121,027	8,410,904
Additions	266	-	-	501,032	501,298
Disposals	(55,937)	(1,989)	(2,666)	(3)	(60,595)
Reclassifications	359,328	(6,335)	1,107	(353,615)	485
Balance at March, 31, 2010	$ 8,118,980	$ 452,517	$ 12,154	$ 268,441	$ 8,852,092
Accumulated Depreciation at March 31, 2010	(2,588,362)	(78,384)	(9,482)	-	(2,676,228)
Net book value at March 31, 2010	$ 5,530,618	$ 374,133	$ 2,672	$ 268,441	$ 6,175,864

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Note 6 – Short-term Borrowings

The Company has regulatory approval from the FERC to issue up to $1.0 billion of short-term debt.

The Company had no short-term debt outstanding to third-parties at March 31, 2010 or 2009.

Note 7 – Income Taxes

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

	Fiscal Year Ended March 31,	
(In thousands of dollars)	**2010**	2009
Components of federal and state income taxes:		
Current tax expense (benefit):		
Federal	**$ (83,425)**	$ 149,393
State	**(9,180)**	7,043
Total current tax expense (benefit)	**(92,605)**	156,436
Deferred tax expense (benefit):		
Federal	**$ 136,044**	$ (88,489)
Investment tax credits [1]	**(2,219)**	(2,866)
State	**83,726**	8,909
Total deferred tax expense (benefit)	**217,551**	(82,446)
Total income tax expense	**$ 124,946**	$ 73,990

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

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 of expected federal income tax expense, using the federal statutory rate of 35%, to the Company's actual income tax expense for the years end March 31 is presented in the following table.

	Fiscal Year Ended March 31,	
(In thousands of dollars)	**2010**	2009
Computed tax	**$ 101,046**	$ 87,157
Increase (reduction) including those attributable to flow-through of certain tax adjustments:		
Medicare subsidy, including Patient Protection & Affordable Care Act, net	**47,240**	(9,187)
IRS audit and related reserve settlements	**(26,211)**	(4,159)
Intercompany tax allocation	**(22,636)**	(11,083)
State income tax, net of federal benefit	**26,347**	14,098
Investment tax credit	**(2,219)**	(2,866)
E.S.O.P. dividends	**(1,371)**	(1,388)
Temporary differences flowed through	**980**	4,563
Provision to return adjustments	**(66)**	(2,540)
Other items, net	**1,836**	(605)
Total	**$ 23,900**	$ (13,167)
Federal and state income taxes	**$ 124,946**	$ 73,990

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Notes to Financial Statements

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
Pension, OPEB and other employee benefits	**$ 428,913**	$ 489,295
Regulatory liabilities - Other	**220,625**	211,874
Reserve - Environmental	**189,465**	216,642
Allowance for uncollectible accounts	**82,873**	82,784
Future federal benefit on state taxes	**42,314**	30,174
Unbilled revenue	**17,004**	27,635
Other items	**39,969**	85,088
Total deferred tax assets[1]	**1,021,163**	1,143,492
Property related differences	**(1,296,465)**	(1,070,308)
Regulatory assets - Pension and OPEB	**(580,600)**	(540,803)
Regulatory assets - Merger rate plan stranded costs	**(349,497)**	(546,428)
Regulatory assets - Environmental	**(214,316)**	(214,373)
Investment tax credit	**(26,994)**	(29,213)
Other items	**(131,501)**	(106,674)
Total deferred tax liabilities	**(2,599,373)**	(2,507,799)
Net accumulated deferred income tax liability	**(1,578,210)**	(1,364,307)
Current portion (net deferred tax asset)	**104,389**	158,339
Net accumulated deferred income tax liability (non-current)	**$ (1,682,599)**	$ (1,522,646)

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

As of March 31, 2010, the Company has generated $303.5 million of state net operating losses which it expects to use to offset future year's taxable income. This net operating loss has a 20 year carryforward utilization period.

The Company is a member of the National Grid Holdings Inc. (NGHI) and subsidiaries consolidated federal income tax 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)) 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.

The Company adopted the provisions of the FASB guidance which clarifies the accounting for uncertain tax positions in the financial statements. This guidance 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.

With the application of this guidance, as of March 31, 2010 and 2009, the Company's unrecognized tax benefits totaled $185.4 million and $155.5 million, respectively, of which $0.8 million and $99.1 million, respectively, would affect the effective tax rate, if recognized. The unrecognized tax benefits are included in "Deferred credits and other liabilities – Other reserves and other 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 *(In thousands of dollars)*	**2010**	2009
Beginning balance	**$ 155,497**	$ 121,944
Gross increases related to prior period	**-**	20,815
Gross increases related to current period	**102,781**	20,634
Settlements with tax authorities	**(72,928)**	(7,896)
Ending balance	**$ 185,350**	$ 155,497

As of March 31, 2010 and 2009, the Company has accrued for total interest of $8.5 million and $58.8 million, respectively. During the years ended March 31, 2010 and 2009, the Company recorded interest (income) expense of ($20.6) million and $12.5 million, respectively. The Company recognizes interest accrued related to uncertain tax positions in interest expense or interest income and related penalties, if applicable, in operating expenses. No penalties were recognized during the years ended March 31, 2010 and 2009.

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. During the year ended March 31, 2009, the NGHI consolidated group settled certain proposed IRS audit adjustments related to the years ending March 31, 2003 and March 31, 2004 with the IRS Office of Appeals and made a payment of $41.7 million to the IRS.

The IRS is currently auditing the federal NGHI consolidated income tax returns for March 31, 2005 through March 31, 2007. The Company expects to make a cash tax payment to the IRS within the next twelve months related to the 2005-2007 settlement. At that time, the Company expects to decrease its total gross unrecognized tax benefits by $1.2 million. The years ended March 31, 2008 and 2009 remain subject to examination by the IRS.

During the years ended March 31, 2010, the State of New York began a new audit cycle covering the years ended March 31, 2006 through March 31, 2008. During the year ended March 31, 2009, New York State completed its audit of the years ending March 31, 2003 through March 31, 2004 for the Company. As a result of the federal and state audits, the Company paid $9.4 million and $4.8 million of its total gross unrecognized tax benefits in the years ended March 31, 2010 and March 31, 2009, respectively.

Note 8 – Derivatives and Fair Value Measurements

Financial Derivatives:
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 Company's forecasted purchases and sales 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, the fair value of these derivatives will be recorded as current and deferred asset and liabilities, with offsetting positions recorded as regulatory assets and 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 and electric sale customers consistent with regulatory requirements.

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Currently, the Company utilizes The New York Mercantile Exchange (NYMEX) gas futures and swaps as well as NYMEX electric futures and over-the-counter (OTC) swaps. The fair value of these derivative instruments at March 31, 2010 was a liability of $16.7 million and a gain of $4.5 million, respectively.

Prior to 2001 the Company owned 41% of the Nine Mile Point 2 nuclear power generation plant in upstate New York. As part of regulatory reform, the Company was required to divest its power generation assets in 2001 and Constellation Energy acquired the Company's share of the Nine Mile Point 2 nuclear power generation plant.

Pursuant to this divestiture, the Company agreed to purchase physical energy and capacity from the Nine Mile Point 2 nuclear generating station for a period of ten years, terminating in December 2011 (the "Nine Mile physical purchase contract"). The purchased power from this facility has been utilize to satisfy Company's electricity customers in the upstate New York area for the duration of this contract. Upon expiration of the Nine Mile physical purchase contract, the Company will buy power from the NYISO as a replacement for the power previously purchased directly from the Nine Mile Point 2 nuclear power generation plant.

The Company also has entered into a Revenue Sharing Arrangement ("RSA") with Constellation Energy, covering a period of 10 years from the expiration of the Nine Mile physical purchase contract. Pursuant to the RSA, the Company and Constellation Energy will share in the revenue that Constellation Energy earns on sales to the NYISO in proportion to the electric volumes that the Company had purchased under the Nine Mile physical purchase contract.

This contract has now been determined to be a financial derivative instrument since a futures market has now been established in upstate New York and although trading is relatively shallow, there is now a trend of market prices that can be used for modeling purposes. The value of this derivative at March 31, 2010 is $78.0 million. Since the power purchased under the RSA will be used to supply rate regulated electric sales customer, the accounting for this derivative follows the current accounting guidance for rate regulated enterprises noted above.

Physical Derivatives:
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 purchase option contract to qualify for the normal purchases and sales exception. Certain contracts for the physical purchase of natural gas associated with our regulated gas utilities do not qualify for normal purchases. The fair value of these derivative instruments at March 31, 2010 was a liability of $20.9 million.

As discussed above, the accounting for these derivative instruments follows the accounting guidance for the rate regulated enterprises. The following are commodity volumes associated with the above derivative contracts:

As of March 31, 2010		
		('000)
Physicals	Gas (dths)	28,316
	Gas swaps (dths)	11,420
	Gas futures (dths)	-
	Electric futures (Mwhs)	69
	Electric swaps (Mwhs)	3,072
Financials	Electric options (Mwhs)	30,294
	Gas (dths)	**39,736**
Total	**Electric (Mwhs)**	**33,435**

The following are balance sheet, income statement, and cash flow hedging 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	$ -	$ -	Gas Futures Contract - Current Liability	$ -	$ (10,178)
Gas Swaps Contract - Current Asset	6	-	Gas Swaps Contract - Current Liability	(16,699)	-
Gas Purchase Contract - Current Asset	1,162	3,336	Gas Purchase Contract - Current Liability	(17,197)	-
Current Asset	*1,168*	*3,336*	*Current Liability*	*(33,896)*	*(10,178)*
Gas Futures Contract - Deferred Asset	-	-	Gas Futures Contract - Deferred Liability	-	-
Gas Swaps Contract - Deferred Asset	-	-	Gas Swaps Contract - Deferred Liability	-	-
Gas Purchase Contract - Deferred Asset	-	4,972	Gas Purchase Contract - Deferred Liability	(4,921)	-
Deferred Asset	*-*	*4,972*	*Deferred Liability*	*(4,921)*	*-*
Gas Subtotal	***1,168***	***8,308***		***(38,817)***	***(10,178)***
Electric Contracts:					
Electric Futures Contract - Current Asset	-	-	Electric Futures Contract - Current Liability	(909)	(56)
Electric Swaps Contract - Current Asset			Electric Swaps Contract - Current Liability	(48,100)	(15,528)
Current Asset	-	-	*Current Liability*	(49,009)	(15,584)
Electric Options Contract - Deferred Asset	77,966	-	Electric Swaps Contract - Deferred Liability	(24,436)	(26,935)
Electric Subtotal	***77,966***	-		***(73,445)***	***(42,519)***
Total Derivatives	**$ 79,134**	**$ 8,308**		**$ (112,262)**	**$ (52,697)**

Fair Values of Derivative Instruments

(In thousands of dollars)	**YTD Movement**	March 31, 2010	March 31, 2009
Regulated Contracts			
Gas Contracts:			
Gas Futures Contract - Regulatory Asset	$ 10,178	$ -	$ (10,178)
Gas Swaps Contract - Regulatory Asset	(16,699)	(16,699)	-
Gas Purchase Contract - Regulatory Asset	(22,118)	(22,118)	-
Gas Futures Contract - Regulatory Liability	-	-	-
Gas Swaps Contract - Regulatory Liability	6	6	-
Gas Purchase Contract - Regulatory Liability	(7,146)	1,162	8,308
Gas Subtotal	*(35,779)*	*(37,649)*	*(1,870)*
Electric Contracts:			
Electric Futures Contract - Regulatory Asset	(853)	(909)	(56)
Electric Swaps Contract - Regulatory Asset	(30,073)	(72,536)	(42,463)
Electric Futures Contract - Regulatory Liability	-	-	-
Electric Swaps Contract - Regulatory Liability	77,966	77,966	-
Electric Subtotal	*47,040*	*4,521*	*(42,519)*
Total	**$ 11,261**	**$ (33,128)**	**$ (44,389)**

Movements in the fair value of regulatory contracts are recorded on the balance sheet rather than through the income statement.

The aggregate fair value 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 $ 94.3 million. If the Company's credit rating were to down grade 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 $ 94.3 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 paid $17.1 million to its counterparties as collateral associated with outstanding derivative contracts.

Derivatives — The Company enters into primarily exchange traded, the 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 and power futures and swaps 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 power OTC swaps and forward physical gas deals where market data for pricing inputs is observable. Level 2 pricing inputs are obtained 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 our gas OTC forwards, options, and physical gas 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 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 and corporate bonds based on quoted prices of similar traded assets in open markets.

Niagara Mohawk Power Corporation

Notes to Financial Statements

The following table presents assets and liabilities measured and recorded at fair value on the Company's Consolidated Balance Sheet on a recurring basis and their level within the fair value hierarchy during the twelve months ended March 31, 2010:

(In thousands of dollars)

Recurring Fair Value Measurements	Level 1	Level 2	Level 3	Balance at March 31, 2010
Derivatives				
Assets	$ -	$ 79	$ 79,055	$ 79,134
Liabilities	-	(90,153)	(22,109)	(112,262)
Net fair value - derivatives	-	(90,074)	56,946	(33,128)
Available for Sale Securities (AFS)				
Assets	19,614	6,584	-	26,198
Net fair value - AFS	19,614	6,584	-	26,198

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 external debt at March 31, 2010 is $1.9 billion.

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 twelve months ended March 31, 2010:

(In thousands of dollars)	Gas	Electric	Total
Beginning balance at March 31, 2009	$ 8,124	$ -	$ 8,124
Transfers into Level 3	-	-	-
Transfers out of Level 3	(32)	-	(32)
Total gains or losses			
included in earnings (or changes in net assets)	-	-	-
included in other comprehensive income	-	-	-
included in regulatory assets and liabilities	(29,799)	77,966	48,167
Purchases	687	-	687
Sales	-	-	-
Ending balance at March 31, 2010	$ (21,020)	$ 77,966	$ 56,946
The amount of total gains or losses for the period included in earnings (or changes in net assets) attribute to the change in unrealized gains or losses relating to assets still held at March 31, 2010	$ -	$ -	$ -

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 – Goodwill

Changes in the carrying amount of the Company's goodwill, net of accumulated impairment losses are as follows:

(In thousands of dollars)	For the Years Ended March 31, 2010	2009
Balance at beginning of year	$ 1,289,132	$ 1,291,911
Goodwill acquired during the year	-	-
Goodwill disposed during the year	-	-
Adjustments	-	(2,779)
Impairment	-	-
Balance at end of year	$ 1,289,132	$ 1,289,132

Note 10 – Changes in Equity Accounts

The following table details the components of accumulated other comprehensive income (loss) for the years ended March 31, 2010 and 2009:

(In thousands of dollars)	Unrealized Gains (Losses) On Available-for Sale Securities	Postretirement Benefit Liabilities	Total Accumulated Other Comprehensive Income (Loss)
March 31, 2008 balance, net of tax	$ (9)	$ (1,118)	$ (1,127)
Unrealized losses on securities	(3,587)	-	(3,587)
Change in pension and other postretirement obligations	-	226	226
Reclassification adjustment for loss included in net income	30	-	30
March 31, 2009 balance, net of tax	(3,566)	(892)	(4,458)
Unrealized gain on securities	3,200	-	3,200
Change in pension and other postretirement obligations	-	(314)	(314)
Reclassification adjustment for gain included in net income	(356)	-	(356)
March 31, 2010 balance, net of tax	$ (722)	$ (1,206)	$ (1,928)

Note 11 – Commitments and Contingencies

Asset Retirement Obligations:
The Company has various asset retirement obligations primarily associated with its gas distribution and electric generation activities. Generally, the Company's largest asset retirement obligations relate to: (i) legal requirements to cut (disconnect from the gas distribution system), purge (clean of natural gas and PCB contaminants) and cap gas mains within its gas distribution and transmission system when mains are retired in place; or dispose of sections of gas main when removed from the pipeline system; (ii) cleaning and removal requirements associated with storage tanks containing waste oil and other waste contaminants; and (iii) legal requirements to remove asbestos upon major renovation or demolition of structures and facilities.

Long-Term Contracts for the Purchase of Electric Power:
The Company has several types of long-term contracts for the purchase of electric power. The Company is liable for these payments regardless of the level of service required from third parties. In addition, the Company purchases additional energy to meet its load through the NYISO at market prices but is not legally obligated to do so. The Company's commitments under these long-term contracts, as of March 31, 2010, are summarized in the table below.

(In thousands of dollars)

Years Ended March 31,	Estimated Payments
2011	$ 122,294
2012	92,780
Thereafter	-

Gas Supply, Storage and Pipeline Commitments:
In connection with its regulated gas business, the Company has long-term commitments with a variety of suppliers and pipelines to purchase gas commodity, provide gas storage capability and transport gas commodity on interstate gas pipelines.

The table below sets forth the Company's estimated commitments at March 31, 2010 for each of the next five years and thereafter.

(In thousands of dollars)

Years Ended March 31,	Estimated Payments
2011	$ 206,159
2012	89,105
2013	49,594
2014	48,431
2015	46,762
Thereafter	-

The Company is liable for these payments regardless of the level of service required from third-parties.

Environmental Contingencies:
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's transmission and distribution businesses generate hazardous wastes. 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 U.S. Environmental Protection Agency (EPA), New York Department of Environmental Conservation (DEC), as well as private entities have alleged that the Company is a potentially responsible party under state or federal law for the remediation of numerous sites. The Company's most significant liabilities relate to former manufactured gas plant (MGP) facilities formerly owned or operated by the Company. The Company is currently investigating and remediating, as necessary, those MGP sites and certain other properties under agreements with the EPA and DEC.

The Company believes that obligations imposed on the Company because of the environmental laws will not have a material result on its operations or financial condition because the Company's MRP provides for the continued application of deferral accounting for variations in spending from amounts provided in rates related to these environmental obligations. As a result, the Company has recorded a regulatory asset representing the investigation, remediation and monitoring obligations it expects to recover from ratepayers.

The Company is pursuing claims against other potentially responsible parties to recover investigation and remediation costs it believes are the obligations of those parties. The Company cannot predict the success of such claims. As of March 31, 2010 and 2009, the Company had accrued liabilities related to its environmental obligations of $450 million and $462 million, respectively. The high end of the range of potential liabilities at March 31, 2010, was estimated at $628 million.

Nuclear Contingencies:
As of March 31, 2010 and 2009, the Company has a liability of $167 million in non-current liabilities for the disposal of nuclear fuel irradiated prior to 1983. In January 1983, the Nuclear Waste Policy Act of 1982 (the Nuclear Waste Act) established a cost of $.001 per kilowatt-hour (kWh) of net generation for current disposal of nuclear fuel and provides for a determination of the Company's liability to the DOE for the disposal of nuclear fuel irradiated prior to 1983. The Nuclear Waste Act also provides three payment options for liquidating such liability and the Company has elected to delay payment, with interest, until the year in which Constellation Energy Group Inc., which purchased the Company's nuclear assets, initially plans to ship irradiated fuel to an approved DOE disposal facility.

In March 2010, the DOE filed a motion with the Nuclear Regulatory Commission to withdraw the license application for a high-level nuclear waste repository at Yucca Mountain. In conjunction with this announcement, the US government announced that it has established a Blue Ribbon Commission to perform a comprehensive review and provide recommendations regarding the disposal of the nation's spent nuclear fuel and waste. Therefore, the Company cannot predict the impact that the recent actions of the DOE and the US government will have on our ability to dispose of the spent nuclear fuel and waste.

Sales and Use Tax Contingencies:
The Company is subject to periodic audits by the New York State Department of Taxation and Finance concerning the Company's payments of sales and use taxes. An audit for the period from June 2001 through November 2005 is still ongoing and the Company has received material assessments that it is disputing. The Company believes that the eventual outcome of the audit will not result in a material change to the income statement in future periods.

Legal Matters:
From time to time the Company is subject to various legal proceedings arising out of the ordinary course of business. The Company does not consider any such proceedings to be material to the business or likely to result in a material adverse effect on the financial statements.

Note 12 – Related Party Transactions

Accounts Payable /Receivable, Money Pool:
The Company participates with National Grid and its affiliates in a system money pool. The money pool is administered by a National Grid service company as the agent for the participants. Short-term borrowing needs are met first by available funds of the money pool participants. Borrowings from the money pool bear interest at the higher of (i) the monthly average of the 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 of the 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 National Grid 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 fiscal years 2010 and 2009, respectively. The Company had short-term money pool investment of $99 million at March 31, 2010 and short-term money pool debt outstanding of $651 million at March 31, 2009, from affiliated companies.

Accounts Payable to Affiliates:
Additionally, the Company has a net account payable to affiliates of $113.7 million and $62.6 million at March 31, 2010 and March 31, 2009, respectively, from various transactions with National Grid and its affiliates. In addition, 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 National Grid affiliates and allocated to each company appropriately. In addition, the Company has a tax sharing agreement associated with filing consolidated tax returns. The Company's share of the tax liability is allocated resulting in a payment to or from the Company.

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 $262 million and $210 million for the fiscal years ended March 31, 2010 and 2009, respectively.

Parent Company Charges:
For the year ended March 31, 2010, National Grid 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 National Grid, have not been reflected on these financial statements. Were these amounts allocated to this subsidiary, the estimated effect on net income would be approximately $8.5 million before tax and $5.5 million after tax.

Note 13 – Preferred Stock

The Company has certain issues of non-participating preferred stock which provide for redemption at the option of the Company. In fiscal year 2010 and 2009, the Company did not redeem any shares of its preferred stock.

Note 14 – Restriction on Common Dividends

The indenture securing the Company's mortgage debt provides that retained earnings shall be reserved and held unavailable for the payment of dividends on common stock to the extent that expenditures for maintenance and repairs plus provisions for depreciation do not exceed 2.25% of depreciable property as defined therein. These provisions have never resulted in a restriction of the Company's retained earnings.

The Company is limited by the MRP, NYPSC orders (see Note 2 – Rates and Regulatory) and FERC orders with respect to the amount of dividends the Company can pay. As long as the bond ratings on the least secure forms of debt issued by the Company and National Grid plc remain rated investment grade and do not fall to the lowest investment grade rating (with one or more negative watch downgrade notices issued with respect to such debt), the Company is allowed to pay dividends in an amount up to the pre-merger (between the Company and National Grid) retained earnings balance plus any earnings subsequent to the merger, together with other adjustments that are authorized under the MRP and other applicable regulatory orders.