



KeySpan Gas East Corporation d/b/a

National Grid

Financial Statements

For the years ended March 31, 2011 and March 31, 2010

KEYSPAN GAS EAST CORPORATION

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Report of Independent Auditors

To Stockholder and Board of Directors of
KeySpan Gas East Corporation:

In our opinion, the accompanying balance sheets and the related statements of income, comprehensive income, retained earnings, capitalization and cash flows present fairly, in all material respects, the financial position of KeySpan Gas East Corporation at March 31, 2011 and March 31, 2010, and the results of its operations and its 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

June 24, 2011

KEYSPAN GAS EAST CORPORATION
BALANCE SHEETS

<i>(in thousands of dollars)</i>	March 31,	
	2011	2010
ASSETS		
Current assets		
Cash and cash equivalents	\$ 25	\$ 25
Accounts receivable	296,114	295,222
Allowance for doubtful accounts	(22,988)	(26,243)
Unbilled revenue	68,986	54,330
Gas in storage, at average cost	43,278	48,899
Material and supplies, at average cost	6,486	6,885
Derivative contracts - current	12,670	18,917
Regulatory assets	51,594	60,658
Prepaid and other current assets	29,574	28,039
Total current assets	<u>485,739</u>	<u>486,732</u>
Property, plant and equipment, net	<u>2,184,911</u>	<u>2,103,183</u>
Deferred charges and other assets		
Regulatory assets	698,096	659,899
Goodwill	1,018,407	1,018,407
Derivative contracts	37,173	47,008
Other deferred charges	4,328	1,708
Total deferred charges and other assets	<u>1,758,004</u>	<u>1,727,022</u>
Total assets	<u>\$ 4,428,654</u>	<u>\$ 4,316,937</u>

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

KEY SPAN GAS EAST CORPORATION
BALANCE SHEETS

<i>(in thousands of dollars, except per share and number of shares data)</i>	March 31,	
	2011	2010
LIABILITIES AND CAPITALIZATION		
Current liabilities		
Accounts payable	\$ 19,807	\$ 37,452
Accounts payable to affiliates, net	167,263	242,178
Taxes accrued	17,861	14,119
Customer deposits	9,195	8,652
Interest accrued	8,562	28,393
Regulatory liabilities	29,070	35,317
Intercompany money pool	228,148	284,534
Current deferred income tax liabilities	16,297	20,816
Derivative contracts - current	14,909	22,201
Other current liabilities	31,437	30,204
Total current liabilities	<u>542,549</u>	<u>723,866</u>
Deferred credits and other liabilities		
Regulatory liabilities	326,199	308,932
Asset retirement obligations	11,820	12,220
Deferred income tax liabilities	487,079	376,689
Postretirement benefits and other reserves	200,965	203,440
Environmental remediation costs	162,026	154,243
Derivative contracts	23,392	14,957
Other deferred liabilities	3,268	2,832
Total deferred credits and other liabilities	<u>1,214,749</u>	<u>1,073,313</u>
Capitalization		
Common stock, \$0.01per share		
100 shares issued and outstanding	-	-
Additional paid-in capital	2,014,878	2,014,878
Retained earnings	56,478	278,976
Total shareholders equity	<u>2,071,356</u>	<u>2,293,854</u>
Long-term debt	600,000	100,000
Long-term debt to affiliates	-	125,904
Total capitalization	<u>2,671,356</u>	<u>2,519,758</u>
Total liabilities and capitalization	<u>\$ 4,428,654</u>	<u>\$ 4,316,937</u>

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

KEY SPAN GAS EAST CORPORATION
STATEMENTS OF INCOME

<i>(in thousands of dollars)</i>	Years Ended March 31,	
	2011	2010
Operating revenues	\$ 1,170,039	\$ 1,209,970
Operating expenses		
Gas purchased for resale	579,308	641,031
Operations and maintenance	203,343	191,449
Depreciation and amortization	53,684	52,211
Amortization of regulatory assets	16,895	4,890
Other taxes	120,245	115,337
Total operating expenses	973,475	1,004,918
Operating income	196,564	205,052
Other income and (deductions)		
Interest on long-term debt	(5,600)	(31,843)
Interest charges, including affiliate interest	(29,398)	(35,790)
Other income	24,066	25,770
Total other deductions	(10,932)	(41,863)
Income taxes		
Current taxes	(26,640)	(50,943)
Deferred taxes	114,770	127,009
Total income taxes	88,130	76,066
Net income	\$ 97,502	\$ 87,123

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

KEY SPAN GAS EAST CORPORATION
STATEMENTS OF CASH FLOWS

<i>(in thousands of dollars)</i>	Years Ended March 31	
	2011	2010
Operating Activities		
Net income	\$ 97,502	\$ 87,123
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Depreciation and amortization	53,684	52,211
Amortization of regulatory assets and rate plan deferrals	16,895	4,890
Provision for deferred income tax	114,770	127,009
Other non-cash items	7,754	(14,751)
Net prepayments and other amortizations	(592)	(6,934)
Net pension and other postretirement expense	11,375	(3,648)
Net environmental charges	(41,219)	(72,628)
Changes in assets and liabilities:		
Accounts receivable	(18,703)	58,639
Materials and supplies and gas in storage	6,020	44,907
Accounts payable and accrued expenses	(36,093)	(28,205)
Prepaid taxes and accruals	3,742	14,119
Other	15,269	(8,839)
Net cash provided by operating activities	<u>230,404</u>	<u>253,893</u>
Investing Activities		
Capital expenditures	(132,650)	(122,443)
Derivative margin calls	(100)	7,871
Other, including removal costs	(15,050)	(13,021)
Net cash used in investing activities	<u>(147,800)</u>	<u>(127,593)</u>
Financing Activities		
Proceeds from long term debt issuance	500,000	-
Repayment on long-term debt	(125,904)	(400,000)
Dividends paid to Parent	(320,000)	-
Change in intercompany money pool	(56,386)	254,528
Accounts payable, affiliates, net	(80,314)	19,172
Net cash used in financing activities	<u>(82,604)</u>	<u>(126,300)</u>
Net increase in cash and cash equivalents	-	-
Cash and cash equivalents beginning of year	25	25
Cash and cash equivalents end of year	<u>\$ 25</u>	<u>\$ 25</u>
Supplemental information		
Interest paid	\$ 7,615	\$ 37,263
Income taxes paid (refund)	\$ 29,855	\$ (33,227)
Capital-related accruals in accounts payable	\$ 1,383	\$ 417

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

KEY SPAN GAS EAST CORPORATION
STATEMENTS OF RETAINED EARNINGS

<i>(in thousands of dollars)</i>	Years Ended March 31,	
	2011	2010
Balance beginning of year	\$ 278,976	\$ 191,853
Net income	97,502	87,123
Dividends paid to Parent	(320,000)	-
Balance end of year	\$ 56,478	\$ 278,976

STATEMENTS OF COMPREHENSIVE INCOME

<i>(in thousands of dollars)</i>	Years Ended March 31,	
	2011	2010
Net income	\$ 97,502	\$ 87,123
Other comprehensive income, net of tax		
Reclassification of losses included in net income	-	324
Other comprehensive income, net of tax	-	324
Comprehensive Income	\$ 97,502	\$ 87,447
Related tax expense		
Reclassification of losses included in net income	-	174
Total tax expense	\$ -	\$ 174

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

KEY SPAN GAS EAST CORPORATION
STATEMENTS OF CAPITALIZATION

<i>(in thousands of dollars, except per share and number of shares data)</i>	March 31		March 31,	
	2011	2010	2011	2010
	<u>Shares issued and outstanding</u>			
Shareholders' equity				
Common stock, \$0.01 per share	100	100	\$ -	\$ -
Additional paid-in capital			2,014,878	2,014,878
Retained earnings			56,478	278,976
Total shareholder's equity	100	100	<u>2,071,356</u>	<u>2,293,854</u>
Long-term debt				
<i>Notes:</i>	<u>Interest rate</u>	<u>Maturity date</u>		
Senior unsecured note	5.819%	April 1, 2041	500,000	-
Senior unsecured note	5.6%	November 29, 2016	100,000	100,000
Total long-term debt			<u>600,000</u>	<u>100,000</u>
Advance from KeySpan Corporation			-	125,904
Total capitalization			<u>\$ 2,671,356</u>	<u>\$ 2,519,758</u>

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

NOTES TO THE FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

A. Nature of Operations

KeySpan Gas East Corporation d/b/a National Grid (the “Company”, “we”, “us”, and “our”) provides gas distribution sales services to approximately 493,000 customers and transports natural gas to approximately 59,000 customers in Nassau and Suffolk Counties in Long Island, New York and the Rockaway Peninsula in Queens, New York.

The Company is a wholly-owned subsidiary of KeySpan Corporation (“KeySpan” or “Parent”). KeySpan is a wholly-owned subsidiary of National Grid USA (“NGUSA”), a public utility holding company with regulated subsidiaries engaged in the generation of electricity and the transmission, distribution and sale of both natural gas and electricity. NGUSA is an indirectly-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 accounting principles generally accepted in the United States of America (“GAAP”), including the accounting principles for rate-regulated entities, and are in accordance with the accounting requirements and ratemaking practices of the applicable regulatory authorities.

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

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

C. Accounting for the Effects of Rate Regulation

The New York State Public Service Commission (“NYPSC”) provides the final determination of the rates we charge our customers. In certain cases, the actions of the NYPSC would result in an accounting treatment different from that used by non-regulated companies to determine the rates we charge our customers. In this case, the Company is required to defer the recognition of costs (a regulatory asset) or the recognition of obligations (a regulatory liability) if it is probable that, through the rate-making process, there will be a corresponding increase or decrease in future rates.

In the event the Company determines that its net regulatory assets are not probable of recovery, the Company would be required to record an after-tax, non-cash charge against income for any remaining regulatory assets and liabilities. The impact could be material to the Company’s reported financial condition and results of operations.

D. Revenue Recognition

Customers are generally billed on a monthly basis. Revenues include unbilled amounts related to the estimated gas usage that occurred from the most recent meter reading to the end of each month.

The cost of gas used is recovered when billed to firm customers through the operation of a cost of gas adjustment factor (“CGAF”) included in the utility tariff. The CGAF provision requires an annual reconciliation of recoverable gas costs and CGAF revenues. Any difference is deferred pending subsequent recovery from or refund to firm customers.

KeySpan Gas East Corporation’s tariff contains a weather normalization adjustment that provides for recovery from, or refund to, firm customers of material shortfalls or excesses of firm delivery revenues (revenues less applicable gas costs and revenue taxes) during a heating season due to variations from normal weather.

The gas distribution business is influenced by seasonal weather conditions. Annual revenues are principally realized during the heating season (November through April) as a result of the large proportion of heating sales in these months. Accordingly, results of operations are most favorable in the first calendar quarter of the Company's fiscal year, followed by the fourth calendar quarter. Operating losses are generally incurred in the second and third calendar quarters.

During the year ended March 31, 2011, 50.31% of the Company's revenue from its gas distribution services was derived from residential customers and 17.07% from commercial and industrial customers, while 32.62% was derived from its gas transportation and other services. During the year ended March 31, 2010, 52.27% of the Company's revenue from gas distribution services was derived from residential customers and 21.29% from commercial and industrial customers, while 26.44% from was derived from its gas transportation and other services. .

E. Property, Plant and Equipment

Property, plant, and equipment are stated at original cost. The cost of additions to property, plant, and equipment and replacements of retired units of property are capitalized. Costs include direct material, labor, overhead and allowance for funds used during construction (AFUDC), which represents capitalized interest and an equity return, if applicable. Replacement of minor items of property, plant, and equipment and the cost of current repairs and maintenance are charged to expense. Whenever property, plant, and equipment plant is retired, its original cost, together with cost of removal, less salvage, is charged to accumulated depreciation. In accordance with regulatory accounting guidance, the Company recovers cost of removal through rates charged to customers as a portion of depreciation expense.

F. Goodwill

Goodwill represents the excess of purchase price of a business combination over the fair value of tangible and intangible assets acquired, net of the fair value of liabilities assumed and the fair value of any non-controlling interest in the acquisition. The Company tests goodwill for impairment on an annual basis and on an interim basis when certain events or circumstances exist.

The goodwill impairment analysis is comprised of two steps. In the first step, the Company compares the fair value of each reporting unit to its carrying value. The Company considers both an income-based approach using projected discounted cash flows and a market-based approach using valuation multiples of comparable companies to determine fair value. The Company's estimate of fair value of each reporting unit is based on a number of subjective factors, including: (i) the appropriate weighting of valuation approaches (income-based approach and market-based approach), (ii) estimates of the future revenue and cash flows, (iii) discount rate for estimated cash flows, (iv) selection of peer group companies for the market-based approach, (v) assumed terminal value including the growth rate, and (vi) control premium.

If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not considered impaired and no further analysis is required to be performed. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value, then a second step is performed to determine the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then an impairment charge equal to the difference is recorded.

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 5.91% and a terminal year growth rate of 2.4% based upon expected long-term average growth rates. Within its calculation of forecasted returns, the Company made certain assumptions with respect to the amount of pension and environmental costs to be recovered in future periods. Should the Company not continue to receive the same level of recovery 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. Our forecasts assume long-term recovery and rate of returns that are in line with historical levels within the utility industry. The resulting fair value of the annual analysis determined that no adjustment of the goodwill carrying value was required.

G. Cash and Cash Equivalents

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

H. Incomes 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 income taxes reflect the tax effect of net operating losses, capital losses and general business credit carryforwards and the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial statement and income tax purposes, as determined under enacted tax laws and rates. The financial effect of changes in tax laws or rates is accounted for in the period of enactment. Deferred investment tax credits are amortized over the useful life of the underlying property. Additionally, the Company follows the current accounting guidance relating to uncertainty in income taxes which applies to all income tax positions reflected 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. Gas distribution revenues include the collection of excise taxes, while operating taxes include the related expense. Excise taxes collected and paid for the years ended March 31, 2011 and March 31, 2010 were \$12.5 million and \$9.9 million, respectively.

I. Other Comprehensive Income (Loss)

The Company has other comprehensive income (loss) which includes derivative financial instrument gains or losses realized through March 31, 2010.

J. Employee Benefits

The Company employees are members of a consolidated defined benefit pension and postretirement benefits other than pensions plan ("PBOP") sponsored by KeySpan. The Company receives an allocation from KeySpan and National Grid for the Company's portion of pension and postretirement benefit costs which results in an intercompany payable. Consistent with past practice and as required by current guidance, KeySpan values its pension and other postretirement assets using the year-end market value of those assets. Benefit obligations are also measured at year-end.

K. 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 risks in the event of non-performance by counter-parties to derivative contracts, as well as non-performance by the counter-parties of the transactions against which they are hedged.

Firm Gas Sales Derivative Instruments

We utilize derivative financial instruments to reduce the cash flow variability associated with the purchase price for a portion of future natural gas purchases. Our strategy is to minimize fluctuations in firm gas sales prices to our regulated firm gas sales customers. Because these derivative instruments are being employed to reduce the variability of the purchase price of natural gas to be sold to regulated firm gas sales customers, the accounting for these derivative instruments is subject to the current accounting guidance on the accounting for the effects of rate regulation. Therefore, changes in the market value of these derivatives have been recorded as a regulatory asset or regulatory liability on the Balance Sheets. Gains or losses on the settlement of these contracts are initially deferred and then refunded to or collected from our firm gas sales customers during the appropriate winter heating season consistent with regulatory requirements.

Physically-Settled Commodity Derivative Instruments

Certain of our contracts for the physical purchase of natural gas are derivatives as defined by current accounting literature. As such, these contracts are recorded on the Balance Sheets at fair market value. However, because such contracts were executed for the purchases of natural gas that is sold to regulated firm gas sales customers, and pursuant to the requirements for accounting for the effects of rate regulation, changes in the fair market value of these contracts are recorded as a regulatory asset or regulatory liability on the Balance Sheets.

Other Financially-Settled Commodity Derivative Instruments

Occasionally, we also employ a limited number of derivative financial instruments that are accounted for pursuant to the requirements of the Financial Accounting Standards Board (FASB) guidance on the accounting for derivative instruments and hedging activities. With respect to those commodity derivative instruments that are designated and accounted for as cash flow hedges, the effective portion of periodic changes in the fair market value of cash flow hedges would be recorded as accumulated other comprehensive income/(loss) on the Balance Sheets, while the ineffective portion of such changes in fair value would be recognized in earnings. At March 31, 2011 we have no such derivative instruments. Unrealized gains and losses (on such cash flow hedges) that are recorded as accumulated other comprehensive income (loss) would be subsequently reclassified into earnings concurrent with when hedged transactions impact earnings. With respect to those commodity derivative instruments that are not designated as hedging instruments, such derivatives are accounted for on the Balance Sheets at fair value, with all changes in fair value reported in earnings.

L. Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following is the fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels as follows:

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 forward curves and pricing models for the asset or liability due to little or no market activity for the asset or liability with low correlation to observable market inputs.

M. Gas in storage and materials

Gas in storage is recorded initially at average weighted cost and is expensed when delivered to customers as gas purchased for resale. Materials and supplies are recorded when purchased and expensed as used or capitalized into specific capital additions as utilized. The Company's policy is to write off obsolete materials and supplies.

Per current accounting guidance, the Company is required to re-value storage and materials at the lower of cost or market. However, per rate orders in effect as issued by the NYPSC, the Company is permitted to pass through the cost of gas purchased for resale directly to the rate payers along with any applicable authorized delivery surcharge adjustments. Therefore, the value of gas in storage never falls below the cost to the Company. Gas costs passed through to the rate payers are subject to periodic regulatory approval and are regularly reported to the NYPSC.

N. Change In Accounting Estimate

The Company calculates its bad debt reserve on its customer accounts receivable (including purchased receivables) based on the bad debt write-offs compared to actual billed sales and transportation revenues (with a six month lag). All receivables over 360 days past due are 80% reserved. Certain identified "at risk" customers are 100% reserved. As of March 31, 2011, there were no "at risk" customers identified. Economic conditions and other factors are considered in addition to the historic write-off rate. The Company reduced the write-off rate for the year ended March, 31 2011, for improved economic conditions which were evidenced by improved collection patterns for overdue receivables. The aggregate effect of these changes in methodology for calculating the bad debt reserve resulted in a pre-tax benefit of \$4.7 million.

O. Recent Accounting Pronouncements

Prospective Accounting Pronouncements

In the preceding twelve months, the FASB and other authoritative bodies have issued numerous updates to GAAP. The Company has evaluated these guidelines and has deemed them as not material for presentation based on its nature of operations. A discussion of the more significant and relevant updates is as follows:

In June 2011, the FASB issued accounting guidance that eliminated the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. This update seeks to improve financial statement users' ability to understand the causes of an entity's change in financial position and results of operations. The Company is now required to consecutively present the statement of income and statement of comprehensive income and also present reclassification adjustments from other comprehensive income to net income on the face of the financial statements. This update does not change the items that are reported in other comprehensive income or any reclassification of items to net income. Additionally, the update does not change an entity's option to present components of other comprehensive income net of or before related tax effects. This guidance is effective for public companies for fiscal years, and interim periods within that year, beginning after December 15, 2011, and it is to be applied retrospectively. Early adoption is permitted. The Company does not expect adoption of this guidance to have an impact on the Company's financial position, results of operations or cash flows.

In April 2011, the FASB issued accounting guidance that substantially amended existing guidance with respect to the fair value measurement topic ("the Topic"). The guidance seeks to amend the Topic in order to achieve common fair value measurement and disclosure requirements in GAAP and International Financial Reporting Standards. Consequently, the guidance changes the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements as well as changing specific applications of the Topic. Some of the amendments clarify the FASB's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements including, but not limited to, fair value measurement of a portfolio of financial instruments, fair value measurement of premiums and discounts and additional disclosures about fair value measurements. This guidance is effective for financial statements issued for interim and annual periods beginning after December 15, 2011. The early adoption of this guidance is not permitted and can only be applied prospectively. The Company is currently determining the potential impact of the guidance on its financial position, results of operations and cash flows.

In March 2011, the FASB issued updated guidance over the agreements between two entities to transfer financial assets. Prior to this update, an entity could recognize this transfer when it was deemed that the transferee had effective control over the transferred asset, specifically whether the entity has the ability to repurchase substantially the same asset based on the transferor's collateral. This accounting update evaluates the effectiveness of the entity's control by focusing on the transferor's contractual rights and obligations as opposed to the entity's ability to perform on those rights and obligations. This update also eliminates the requirement to demonstrate that the transferor possesses adequate collateral to fund substantially all the cost of purchasing replacement financial assets. This guidance is treated prospectively and effective for annual or interim reporting periods beginning on or after December 15, 2011. The Company does not expect adoption of this guidance to have an impact on the Company's financial position, results of operations or cash flows.

In December 2010, the FASB issued an accounting update to address inconsistencies in the application of accounting guidance related to reporting pro forma revenue and earnings of business combinations. This update is effective for entities who entered into an acquisition and whose acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. This disclosure requires revenue and earnings of the combined entity to be disclosed as though the combination had occurred at the beginning of the prior reporting period. The supplemental disclosure related to this activity now is required to provide a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination. The Company does not expect the adoption of this guidance to have an impact on the Company's financial position, results of operations or cash flows.

In December 2010, the FASB issued an accounting update that modified the goodwill impairment procedures necessary for entities with zero or negative carrying value. The FASB created this guidance to require entities to complete Step 2 of the

impairment test, which requires the entity to assess whether or not it was likely that impairment existed throughout the period. To do this, an entity should consider whether there were adverse qualitative factors throughout the period that would contribute to impairment. This update is effective for fiscal years and interim periods beginning after December 15, 2011. The Company does not expect the adoption of this guidance to have an impact on the Company's financial position, results of operations or cash flows.

Recently Adopted Accounting Pronouncements

In March 2010, the FASB issued updated guidance that provides for scope exceptions applicable to financial instrument contracts with embedded credit derivative features. This FASB guidance is effective for financial statements issued for interim periods beginning after June 15, 2010. On an ongoing basis, the Company evaluates new and existing transactions and agreements to determine whether they are derivatives, or have provisions that meet the characteristics of embedded derivatives. Those transactions designated for any of the elective accounting treatments for derivatives must meet specific, restrictive criteria, both at the time of designation and on an ongoing basis. None of the financial instrument contracts or credit agreements the Company has entered were identified and designated as meeting the criteria for derivative or embedded derivative treatment. The adoption of this guidance did not have an impact on the Company's financial position, results of operations or cash flows.

In February 2010, the FASB issued an amendment to certain recognition and disclosure requirements for events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. The amendment applies to both issued financial statements and financial statements revised as a result of either a correction of an error or retrospective application of GAAP. The new provisions require non-public entities to disclose both the date that the financial statements were issued, or available to be issued, and the date the revised financial statements were issued or available to be issued. The amendment is effective for interim or annual periods ending after June 15, 2010. The adoption of this guidance did not have an impact on the Company's financial position, results of operations or cash flows.

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 statements issued for interim and annual periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this guidance did not have an impact on the Company's financial position, results of operations or cash flows.

In June 2009, the FASB issued an amendment to the accounting and disclosure requirements for transfers and servicing of financial assets and extinguishment of liabilities. The objective of the amendment is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; and effects of a transfer on its financial position, financial performance and cash flows; and transferor's continuing involvement, if any, in transferred financial assets. The new provisions must be applied as of the beginning of each reporting entity's first annual reporting period beginning after November 15, 2009 and are to be applied to transfers occurring on or after the date of adoption. The adoption of this guidance did not have an impact on the Company's financial position, results of operations or cash flows.

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. The adoption of this guidance did not have an impact on the Company's financial position, results of operations or cash flows.

In May 2009, the FASB issued accounting guidance establishing the general standards of accounting for the 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. The FASB guidance is effective for financial statements issued for interim and annual periods ending after June 15, 2009. The Company adopted this standard for the reporting period beginning April 1, 2010 and noted no impact on the Company's financial position, results of operations or cash flows due to the adoption of this standard.

P. Reclassifications

Certain reclassifications have been made to conform prior periods' data to the current presentation. The prior year audited financial statement included the postretirement benefit reserve as a component of Accounts Payable to Affiliates under current liabilities which is now being reclassified as a separate line item under deferred credits in the accompanying balance sheets.

In addition, the Company determined that certain derivative contracts or discrete, separable components of derivative contracts do not qualify for hedge or derivative accounting and should therefore, be excluded from the balance sheet. The Company adjusted the prior period by decreasing the net derivative liabilities and net regulatory assets by \$81.4 million in the accompanying balance sheet.

These reclassifications had no effect on the Company's results of operations and cash flows.

Note 2. Rates and Regulatory

The following table presents the Company's regulatory assets and regulatory liabilities at March 31, 2011 and 2010:

<i>(in thousands of dollars)</i>	March 31,	
	2011	2010
<i>Regulatory assets - current</i>		
Environmental costs	\$ 2,737	\$ 2,444
Postretirement benefits	26,173	23,412
Derivative contracts	14,909	22,201
Other regulatory assets-current	7,775	12,601
Total current regulatory assets	<u>51,594</u>	<u>60,658</u>
<i>Regulatory assets - non-current</i>		
Regulatory tax asset	7,407	6,673
Property taxes	26,299	21,437
Environmental costs	483,437	418,974
Postretirement benefits	133,517	159,700
Derivative contracts	23,392	14,957
Other regulatory assets-non-current	24,044	17,876
Total non-current regulatory assets	<u>698,096</u>	<u>639,617</u>
Total regulatory assets	<u>749,690</u>	<u>700,275</u>
<i>Regulatory liabilities-current</i>		
Property taxes	(12,400)	(12,400)
Miscellaneous liabilities	(4,000)	(4,000)
Derivative contracts	(12,670)	(18,918)
Total current regulatory liabilities	<u>(29,070)</u>	<u>(35,318)</u>
<i>Regulatory liabilities-non-current</i>		
Environmental costs	(59,509)	(56,471)
Postretirement benefits	(35,688)	(31,708)
Property taxes	(35,943)	(46,012)
Delivery rate adjustment	(44,886)	(17,300)
Miscellaneous liabilities	(68,099)	(54,858)
Derivative contracts	(37,173)	(47,008)
Removal costs recovered	(44,901)	(55,575)
Total non-current regulatory liabilities	<u>(326,199)</u>	<u>(308,932)</u>
Total regulatory liabilities	<u>(355,269)</u>	<u>(344,250)</u>
Net regulatory assets	<u>\$ 394,421</u>	<u>\$ 356,025</u>

The regulatory items above are not included in the utility rate base. We record carrying charges, as appropriate, on the regulatory items for which cash expenditures have been made and are subject to recovery or for which cash has been collected and is subject to refund. In the year ended March 31, 2010, we recorded a net out of period adjustment for interest income for carrying charges of \$3.7 million before tax. Carrying charges are not recorded on items for which expenditures have not yet been made. We anticipate recovering these costs in our gas rates concurrently with future cash expenditures. If recovery is not concurrent with the cash expenditures, we will record the appropriate level of carrying charges. Deferred gas costs of approximately \$7.03 million and \$12.7 million as of March 31, 2011 and March 31, 2010 are reflected against accounts receivable on the Balance Sheets.

Rate Matters

In June 2009, the Company made a compliance filing with the New York State Public Service Commission ("NYPSC") regarding the implementation of the Temporary State Energy & Utility Conservation Assessment. The NYPSC authorized

recovery of the revenues required for payment of the Temporary State Assessment subject to reconciliation over five years, July 1, 2009 through June 30, 2014. In a second compliance filing on June 15, 2010, the Company increased its Temporary State Assessment surcharge to \$26.6 million for the period from July 1, 2010 through June 30, 2011. At March 31, 2011, \$6.1 million was deferred pending recovery; \$6.0 million was recorded at March 31, 2010. On June 15, 2011, the Company submitted a compliance filing in which it proposed to maintain the surcharge for the July 1, 2011 through June 30, 2012 recovery period.

The Company is currently subject to a five year rate plan through December 2012. Base delivery rates were increased by \$60 million in January 2008 based on an allowed return on equity of 9.8%. From 2009 through 2012, the delivery rate surcharge is increased by \$10 million annually. However, the incremental revenue from the increase in the delivery rate surcharge will be deferred and used to offset future increases in rates for costs such as environmental investigation and remediation or other cost deferrals. Cumulative annual earnings above 10.5% will be shared with customers. The Company recorded a reserve of \$6.1 million of earnings in excess of the allowed return pertaining to the rate plan for the fiscal year ending March 31, 2011. The Company is not eligible to submit a new rate plan until January 2012 at the earliest, for rates to take effect January 2013.

In January 2010, the Company filed the status of its regulatory deferrals so that the NYPSC can determine whether in 2011 the Company should adjust the level of revenue it receives under the existing rate plan to minimize outstanding deferrals. The Company proposed an increase to 2009 revenues of 2.48% through an existing surcharge, to take effect January 1, 2011, subject to NYPSC approval. The Company is proposing to recover \$33.3 million of regulatory assets, which is comprised of an annual amortization of deferral balances on the balance sheet at December 31, 2009 of \$27.2 million, and a half year annual amortization of the 2010 forecasted deferral balances of \$6.2 million. The discovery phase of the proceeding remains ongoing at the NYPSC and a completion date can not be predicted at this time.

Other Regulatory Matters

In February 2011, NYPSC selected Overland Consulting Inc., a management consulting firm, to perform a management audit of National Grid's affiliate cost allocation, policies and procedures. The audit of these service company charges seeks to determine if any service company transactions have resulted in unreasonable costs to New York customers for the provision of delivery service. If potentially material levels of misallocated or inappropriate service company costs are discovered, at the direction of the NYPSC, the investigation will be expanded to prior years to determine if a material amount of misallocated or inappropriate costs under these service company contracts have been charged to the New York utilities. A report of this review to the NYPSC is anticipated in November 2011. At the present time we are not aware of any material misallocation of costs among our affiliates and we do not expect the audit to result in any material adjustment to our financial statements.

In February 2011, the NYPSC instituted a statewide investigation to review its policies regarding the funding mechanisms supporting site investigation and remediation ("SIR") expenditures and directing the state's utilities to assist the Commission in developing a comprehensive record of: (1) the current and future scope of utility site investigation SIR programs; (2) the current cost controls in place by utilities and opportunities to improve such cost controls; (3) the appropriate allocation of costs among customers and potentially shareholders; and (4) methods for recovering costs appropriately borne by ratepayers in a way that minimizes the impact. The NYPSC has requested that the Administrative Law Judge provide a presentation of recommendations before the end of 2011.

In August 2010, the Company filed an initial Verified Petition for Authority to Issue Securities with the NYPSC seeking multi-year authority to issue, prior to March 31, 2014, up to \$1.1 billion in new long-term debt securities, which was revised to \$1.0 billion in February 2011. In March 2011, the NYPSC granted this authority and during the same month the Company issued \$500 million in long term debt.

On December 22, 2009, the NYPSC adopted the terms of a Joint Proposal between NYPSC Staff and the Company that provided for a revenue decoupling mechanism to take effect as of January 1, 2010. The revenue decoupling mechanism applies only to the Company's firm residential heating sales and transportation customers, and permits the Company to reconcile actual revenue per customer to target revenue per customer for the affected customer classes on an annual basis. The revenue decoupling mechanism is designed to eliminate the disincentive for the Company to implement energy efficiency programs. At March 31, 2011, the deferred amount was a payable of \$1.9 million which is fully refundable to the affected customer class. At March 31, 2010, the deferred amount was a receivable of \$0.7 million.

In November 2008, FERC commenced an audit of NGUSA, including its service companies and other affiliates in the National Grid holding company system. The audit evaluates our compliance with: 1) cross-subsidization restrictions on affiliate transactions; 2) accounting, recordkeeping and reporting requirements; 3) preservation of records requirements for holding companies and service companies; and 4) Uniform System of Accounts for centralized service companies. The final audit report from the FERC was received in February 2011 which identified several compliance findings primarily related to allocation of costs between various subsidiaries of NGUSA. In April 2011, the Company replied to the FERC and outlined its corrective action plan which we are currently in the process of implementing.

Note 3. Employee Benefits

Summary

The Company participates with certain other KeySpan subsidiaries in a non-contributory defined benefit pension plan and a postretirement benefits other than pensions plan (the “Plans”).

The pension plan is a defined benefit plan which provides union employees with a retirement benefit and non-union employees hired before January 1, 2011 with a retirement benefit.

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

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

Pension Plans

The Company participates in the pension plans with certain other KeySpan subsidiaries. Pension plan assets are commingled and cannot be allocated to an individual company. Pension costs are allocated to the Company. The pension plans had a net underfunded obligation of \$643.9 million at March 31, 2011 and \$740.2 million at March 31, 2010.

Certain current year changes in the funded status of the pension plans are allocated to the Company through an intercompany payable account. The Company is subject to certain deferral accounting requirements mandated by the NYPSC for pension expense and other postretirement health care costs. Any variation between actual costs and amounts used to establish rates are deferred and collected from or refunded to customers in subsequent periods. Any deferral is recorded as either a regulatory asset or regulatory liability on the Balance Sheets. Gross actuarial pension expense allocated to the Company was approximately \$9.6 million and \$11.1 million for the years ended March 31, 2011 and March 31, 2010, respectively.

Other Postretirement Benefits

The Company participates in the PBOP plans with certain other KeySpan subsidiaries. PBOP plan assets are commingled and cannot be allocated to an individual company. PBOP costs are allocated to the Company. The PBOP plans had a net underfunded obligation of \$1.1 billion at each of the years ended March 31, 2011 and March 31, 2010.

Certain current year changes in the funded status of the KeySpan plan are allocated to the Company through an intercompany payable account. The Company is subject to certain deferral accounting requirements mandated by the NYPSC for PBOP expense. Any variation between actual costs and amounts used to establish rates are deferred and collected from or refunded to customers in subsequent periods. Any deferral is recorded as either a regulatory asset or regulatory liability on the Balance Sheets. Gross actuarial PBOP expense allocated to the Company was \$11.6 million and \$8.3 million for the years ended March 31, 2011 and March 31, 2010, respectively.

Health Care Reform Act

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 that resulted in the repeal, with effect from 2012, of the deduction for

federal income tax purposes of the portion of the cost of an employer's retiree prescription drug coverage for which the employer received a benefit under the Medicare Prescription Drug Improvement and Modernization Act of 2003. The consequential reduction in the deferred tax asset balance resulted in a net charge to the 2010 Statements of Income of approximately \$5.0 million.

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

Workforce Reduction Program

In connection with National Grid plc's acquisition of KeySpan, National Grid plc and KeySpan offered 673 non-union employees a voluntary early retirement offer ("VERO") in an effort to reduce the workforce. Eligible employees must have been working in a targeted area as of April 13, 2007 and be at least 52 years of age with seven or more years of service as of September 30, 2007. For eligible employees who have elected to accept the VERO offer, National Grid plc and KeySpan had the right to retain that employee for up to three years before VERO payments are made. An employee who accepted the VERO offer but elected to terminate employment with National Grid plc or KeySpan prior to the three year period, without consent of National Grid plc or KeySpan, forfeited all rights to VERO payments. The VERO is completed and the Company has accrued approximately \$12.8 million which has been deferred for recovery from gas sales customers as part of the synergy savings and cost to achieve calculations.

Note 4. Debt

5.6% Senior Unsecured Notes

In November 29, 2006, KeySpan Gas East Corporation issued \$100 million of Senior Unsecured Notes at 5.6% due November 29, 2016. Interest is payable on a semi-annual basis each May and November.

5.819% Senior Unsecured Notes

In March, 2011, KeySpan Gas East Corporation issued \$500 million of Senior Unsecured Notes at 5.819% due April 1, 2041. Interest is payable on a semi-annual basis each April and October.

Debt to KeySpan

On March 31, 2011, the Company repaid \$125.9 million of inter-company debt to KeySpan Corporation that was charging an interest rate of 7.25%.

Debt Maturity Schedule

The Company is in compliance with the various covenants of its debt agreements. The Company's Balance Sheet reflects the long term debt at carrying value. The following table reflects the maturity schedule for our debt repayment requirement at March 31, 2011:

<i>(in thousands of dollars)</i>		
2012	\$	-
2013		-
2014		-
2015		-
2016		-
Thereafter		600,000
	\$	600,000

Note 5. Property, Plant and Equipment

At March 31, 2011 and March 31, 2010, property, plant and equipment at cost and accumulated depreciation are as follows:

<i>(in thousands of dollars)</i>	March 31,	
	2011	2010
Plant and machinery	\$ 1,304,632	\$ 1,232,356
Land and buildings	1,366,636	1,310,329
Assets in construction	32,089	33,476
Software and other intangibles	24,149	23,438
Total	2,727,506	2,599,599
Accumulated depreciation	(542,595)	(496,416)
Property, plant and equipment, net	\$ 2,184,911	\$ 2,103,183

Depreciation

Depreciation was provided on a straight-line basis in amounts equivalent to composite rates on average depreciable property of 2.03% at March 31, 2011 and 2.25% at March 31, 2010. The cost of property retired, and the cost of removal less salvage, is charged to accumulated depreciation. The Company recovers certain asset retirement costs through rates charged to customers as a portion of depreciation expense. At March 31, 2011 and March 31, 2010, the Company had costs recovered in excess of costs incurred totaling \$44.9 million and \$55.6 million, respectively. These amounts are reflected as a regulatory liability on the Balance Sheets.

AFUDC

The Company capitalizes AFUDC as part of construction costs. AFUDC represents an allowance for the cost of funds used to finance construction and includes a debt component and an equity component. AFUDC is capitalized in "Property, plant and equipment" with offsetting credits to "Other interest, including affiliate interest" for the debt component and to "Other income" for the equity component. This method is in accordance with an established rate-making practice under which a utility is permitted to earn a return on, and the recovery of, prudently incurred capital costs through its ultimate inclusion in rate base and in the provision for depreciation. The composite AFUDC rates were 8.53% at March 31, 2011 and 9.09% at March 31, 2010. Capitalized interest for the year ended March 31, 2011 and March 31, 2010 was approximately \$0.9 million and \$0.8 million, respectively, and is reflected as a reduction to interest expense.

Note 6. Income Taxes

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

<i>(in thousands of dollars)</i>	Years Ended March 31,	
	2011	2010
<i>Components of federal and state income taxes:</i>		
Current tax (benefit) expense:		
Federal	\$ (30,339)	\$ (32,648)
State	3,699	(18,295)
Total current tax (benefit) expense	(26,640)	(50,943)
Deferred tax expense:		
Federal	92,566	97,835
State	22,204	29,174
Total deferred tax expense	114,770	127,009
Investment Tax Credits ⁽¹⁾		
Total income tax expense	\$ 88,130	\$ 76,066

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

Income tax expense for the years ended March 31, 2011 and March 31, 2010 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 ended March 31, 2011 and March 31, 2010 is presented in the following table:

<i>(in thousands of dollars)</i>	Years Ended March 31,	
	2011	2010
Computed tax	\$ 64,972	\$ 57,116
<i>Increase (reduction) attributable to certain tax adjustments:</i>		
State income taxes, net of federal income tax benefit	16,838	7,071
Audit and related reserve adjustments	6,606	5,215
Medicare charge attributable to Patient Protection & Affordable Care Act	-	4,156
Provision to return adjustments	(9)	2,943
Allowance for equity funds used during construction	(376)	(475)
Other items, net	99	40
Total	23,158	18,950
Federal and state income taxes	\$ 88,130	\$76,066

Significant components of the Company's net deferred tax assets and liabilities at March 31, 2011 and 2010 are presented in the following table:

<i>(in thousands of dollars)</i>	2011	2010
Pensions, OPEB and other employee benefits	\$ 114,019	\$ 111,560
Reserve - environmental	70,386	66,997
Regulatory liabilities - other	66,917	48,100
Future federal benefit on state taxes	28,645	20,819
Regulatory Assets - Property taxes	12,690	19,820
Allowance for uncollectible accounts	10,030	11,450
Other items, net	13,193	9,619
Total deferred tax assets ⁽¹⁾	315,880	288,365
Property related differences	(515,173)	(412,768)
Regulatory assets - Environmental	(195,575)	(167,310)
Regulatory assets - Pension and OPEB	(57,745)	(61,295)
Regulatory assets - Other	(26,005)	(17,088)
Property taxes	(24,758)	(27,408)
Total deferred tax liabilities	(819,256)	(685,869)
Net accumulated deferred income tax liability	(503,376)	(397,504)
Current portion of net deferred tax asset (liability)	(16,297)	(20,816)
Non-current portion of net deferred income tax liability	(487,079)	(376,688)
Net accumulated deferred income tax liability	(503,376)	(397,504)

⁽¹⁾ There were no valuation allowances for deferred tax assets at March 31, 2011 or 2010.

Subsequent to the Keyspan acquisition by NGUSA on August 24, 2007, KeySpan and its subsidiaries became members of the National Grid Holdings Inc. ("NGHI") and subsidiaries consolidated federal income tax return. The Company is a member of this consolidated group. The Company has joint and several liability for any potential assessments against the consolidated group.

As of March 31, 2011 and March 31, 2010, the Company's current federal income tax balances payable to its Parent are \$20.9 million, and \$71.3 million, respectively.

The Company adopted the provisions of the current accounting guidance which clarifies the accounting and disclosure of uncertain tax positions in the financial statements. The 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.

As of March 31, 2011 and March 31, 2010, the Company's unrecognized tax benefits totaled \$118.3 million and \$133.4 million, respectively, of which \$28.3 million and \$18.6 million, respectively, would impact the effective tax rate, if recognized.

The following table reconciles the changes to the Company's unrecognized tax benefits for the years ended March 31, 2011 and March 31, 2010:

Reconciliation of Unrecognized Tax Benefits			
<i>(in thousands of dollars)</i>			
	2011		2010
Beginning Balance	\$	133,403	\$ 48,972
Gross increases (decreases) related to prior period		13,277	
Gross increases (decreases) related to current period		15,175	84,431
Settlements with tax authorities		(43,521)	
Ending Balance	\$	118,334	\$ 133,403

As of March 31, 2011 and March 31, 2010, the Company has accrued for interest related to unrecognized tax benefits of \$6.0 million and \$25.6 million, respectively. During the years ended March 31, 2011 and March 31, 2010, the Company recorded interest benefits of \$1.7 million and interest expense of \$7.1 million, respectively. The Company recognizes accrued interest related to unrecognized tax benefits in interest expense or interest income and related penalties, if applicable, in operating expenses. No penalties were recognized during the years ended March 31, 2011 and March 31, 2010.

In November 2010, Keyspan and its subsidiaries reached a settlement agreement with the Internal Revenue Service ("IRS") on outstanding tax matters for calendar tax years 2000 through 2006. The Company was a member of the KeySpan Companies' consolidated US federal income tax return for these years and was obligated to pay \$39.7 million to KeySpan for its share of the settlement pursuant to the tax sharing agreement. In connection with the settlement, the Company incurred a \$6.6 million charge to tax expense for differences between the amounts settled upon with the IRS compared to the tax positions previously accrued. Resolution of tax matters for these years with state and local tax authorities is outstanding. The tax returns for the short year ended August 24, 2007, as well as the fiscal years ended March 31, 2008 through March 31, 2011 remain subject to examination by the IRS.

The State of New York is in the process of examining the Company's NYS income tax returns for calendar years ended December 31, 2000 through December 31, 2002, short year ended August 24, 2007, and fiscal year ended March 31, 2008. The tax returns for the fiscal years ended March 31, 2009 through March 31, 2011 remains subject to examination by the State of New York. The company has filed NY ITC claims for tax years ended December 31, 2000 through December 31, 2006. These claims have been denied by the State of New York and are currently under appeal.

Note 7. Derivative Contracts

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 purchased option contract to qualify as normal purchase and normal sales. Certain contracts for the physical purchase of natural gas do not qualify for this exception. Because these contracts are for the purchase of natural gas sold to regulated firm gas sales customers, the accounting for these contracts follows the accounting guidance for rate-regulated enterprises. Additionally, KeySpan Gas East Corporation has gas transportation service agreements with large generating facilities that contain embedded derivatives. These contracts and related embedded derivatives also follow the accounting guidance for rate-regulated enterprises. The fair value of these derivatives at March 31, 2011 and March 31, 2010 was a gain of \$15.7 million and \$45.8 million, respectively.

Financial Derivatives

The Company uses derivative financial instruments to reduce the cash flow variability associated with the purchase price for a portion of future natural gas purchases. Our strategy is to minimize fluctuations in firm gas sales prices to regulated firm gas sales customers in our service territory. The accounting for these derivative instruments follows the accounting guidance for rate-regulated enterprises. Therefore, the fair value of these derivatives is recorded as current or deferred assets and liabilities, with offsetting positions recorded as regulatory assets or regulatory liabilities on the Balance Sheets. As these

derivative contracts are eligible for rate regulated accounting treatment, changes in fair value have no Income Statement impact. Gains or losses upon settlement of these contracts are initially deferred and then refunded to or collected from our firm gas sales customers consistent with regulatory requirements. The fair value of these derivative instruments was a liability of \$4.1 million and \$17.0 million as of March 31, 2011 and March 31, 2010, respectively.

The following are commodity volumes associated with those derivative contracts as of March 31, 2011:

<i>(in thousands)</i>		
Physicals	Gas (dths)	24,209
Financials	Gas swaps (dths)	11,367
	Gas options (dths)	3,760
Total	Gas (dths)	39,336

The following table presents the Company's derivative contract assets and (liabilities) on the Balance Sheets:

Fair Values of Derivative Instruments - Balance Sheets					
<i>(in thousands of dollars)</i>	Asset Derivatives			Liability Derivatives	
	March 31, 2011	March 31, 2010		March 31, 2011	March 31, 2010
<i>Regulated contracts</i>					
<u>Gas Contracts:</u>					
Gas swap contract			Gas swap contract		
- current asset	\$ 174	\$ 9	- current liability	\$ (4,137)	\$ (16,991)
Gas options contract			Gas options contract		
- current asset	100	-	- current liability	(62)	-
Gas purchase contract			Gas purchase contract		
- current asset	12,396	18,908	- current liability	(10,710)	(5,210)
<i>Current asset</i>	<i>12,670</i>	<i>18,917</i>	<i>Current liability</i>	<i>(14,909)</i>	<i>(22,201)</i>
Gas swap contract			Gas swap contract		
- deferred asset	48	-	- deferred liability	(247)	-
Gas options contract			Gas options contract		
- deferred asset	7	-	- deferred liability	(15)	-
Gas purchase contract			Gas purchase contract		
- deferred asset	37,118	47,008	- deferred liability	(23,130)	(14,957)
<i>Deferred asset</i>	<i>37,173</i>	<i>47,008</i>	<i>Deferred liability</i>	<i>(23,392)</i>	<i>(14,957)</i>
Total Derivatives	\$ 49,843	\$ 65,925		\$ (38,301)	\$ (37,158)

The following table presents the regulatory (assets) and liabilities whose change in fair value exactly corresponds to the related derivative contracts in the preceding table. The Company had no derivative contracts eligible for non-rate-regulated accounting treatment as of March 31, 2011 and March 31, 2010. As such, the changes in fair value of derivative contracts and their related regulatory (assets) and liabilities had no Income Statement impact.

Fair Values of Derivative Instruments			
	Year to date		
<i>(in thousands of dollars)</i>	movement	March 31, 2011	March 31, 2010
Regulated contracts			
Gas Contracts:			
Gas swap contract - regulatory asset	\$ 12,607	\$ (4,384)	\$ (16,991)
Gas option contract - regulatory asset	(77)	(77)	-
Gas purchase contract - regulatory asset	(13,673)	(33,840)	(20,167)
Gas swap contract - regulatory liability	213	222	9
Gas option contract - regulatory liability	107	107	-
Gas purchase contract - regulatory liability	(16,403)	49,514	65,917
Total	\$ (17,226)	\$ 11,542	\$ 28,768

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, 2011, the Company had no collateral associated with outstanding derivative contracts.

The aggregate fair value of all of the Company's derivative instruments with credit-risk-related contingent features that are in a liability position on March 31, 2011 for which the Company does not post any collateral in the normal course of business is \$4.2 million. If the Company's credit rating were to be downgraded by one notch, it would not be required to post any additional collateral. If the Company's credit rating were to be downgraded by three notches, it would be required to post \$4.4 million additional collateral to its counterparties.

Note 8. Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company does not have any assets and liabilities recorded at fair value using level 1 inputs. The following is the fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into levels two and three:

The Company's Level 2 fair value derivative instruments primarily consist of over-the-counter ("OTC") gas swaps and forward physical gas deals where market data for pricing inputs is observable. Level 2 pricing inputs are obtained from the New York Mercantile Exchange ("NYMEX") and Intercontinental Exchange ("ICE"), except cases when ICE publishes seasonal averages or there were no transactions within last seven days. During periods prior to March 31, 2011, Level 2 pricing inputs were 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 ICE based on transactions within last seven days. 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. Level 3 is also applied in cases when forward curve is internally developed, extrapolated or derived from market observable curve with correlation coefficients less than 0.95, or optionality is present, or non-economical assumptions are made. The internally developed forward curves have a high level of correlation with Platts M2M curves.

The following table presents assets and liabilities measured and recorded at fair value on the Company's Balance Sheet on a recurring basis and their level within the fair value hierarchy as of March 31, 2011:

Recurring Fair Value Measurements

<i>(in thousands of dollars)</i>	Level 1	Level 2	Level 3	Total
Assets	\$ -	\$ 222	\$ 49,621	\$ 49,843
Liabilities	-	(4,384)	(33,917)	(38,301)
Total derivative net liabilities	\$ -	\$ (4,162)	\$ 15,704	\$ 11,542

Year to Date Level 3 Movement Table

The following table presents the fair value reconciliation of Level 3 assets and liabilities during the year ended March 31, 2011:

<i>(in thousands of dollars)</i>	Amount
Beginning balance at March 31, 2010	\$ 45,774
Transfers into Level 3	-
Total gains or losses included in regulatory assets and liabilities	(29,803)
Purchases	(267)
Sales	
Ending balance at March 31, 2011	<u>\$ 15,704</u>
The amount of total gains or losses for the period included in earnings (or changes in net assets) attributed to the change in unrealized gains or losses relating to assets still held at March 31, 2010	<u>\$ -</u>

The fair value of 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 Sheets reflect the long term debt at carrying value. The fair value of this debt at March 31, 2011 and March 31, 2010 was \$611.6 million and \$108.5 million, respectively.

Note 9. Commitments and Contingencies

Legal Matters

The Company is subject to various legal proceedings arising out of the ordinary course of its business. Except as described below, the Company does not consider any of such proceedings to be material to its business or likely to result in a material adverse effect on its results of operations, financial condition, or cash flows.

Since July 12, 2006, several lawsuits have been filed that allege damages resulting from contamination associated with the historic operations of a former manufactured gas plant located in Bay Shore. The Company has been conducting site investigations and remediation at Bay Shore pursuant to an Administrative Order on Consent (“ACO”) with the New York State Department of Environmental Conservation (“DEC”). The Company intends to contest each of these remaining proceedings vigorously.

Environmental Matters - Manufactured Gas Plant Sites

The Company uses the “Expected Value” method for measuring its environmental liabilities. The Expected Value method applies a weighting to potential future expenditures based on the probability of these costs being incurred. A liability is recognized for all potential costs based on this probability. Costs considered to be 100% probable of being incurred are recognized in full, with costs below a 100% probability recognized in proportion to their probability. The Company discounted its environmental reserves at the time of the KeySpan acquisition by National Grid plc using an appropriate fair value methodology.

We have identified numerous MGP sites and related facilities that were owned or operated by us or our predecessors. These former sites, some of which are no longer owned by us, have been identified to the NYPSC and the DEC for inclusion on appropriate site inventories. ACO or Voluntary Cleanup Agreements (“VCA”) have been executed with the DEC to address the investigation and remediation activities associated with certain sites.

The Company presently estimates the remaining cost of our environmental remediation activities will be \$162.0 million at March 31, 2011, which amount has been accrued by us as a reasonable estimate of cost for known sites. However, remediation costs for each site may be materially higher than noted, depending upon changing technologies and regulatory standards, selected end use for each site, and actual environmental conditions encountered. Expenditures incurred to date by us with respect to the Company’s MGP-related activities total \$296.2 million and \$248.3 million as of March 31, 2011 and 2010, respectively.

With respect to remediation costs, the Company’s rate plan provides for the recovery and deferral of investigation and remediation cost. A net regulatory asset of \$426.7 million and \$364.9 million for MGP sites is reflected as of March 31, 2011 and 2010, respectively.

Asset Retirement Obligations

The Company has various asset retirement obligations associated with its gas distribution facilities. These obligations have remained substantially unchanged from March 31, 2010, except for normal accretion adjustments and costs incurred. Generally, our 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 our 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. These obligations total \$11.8 million and \$12.2 million at March 31, 2011 and 2010, respectively.

The following asset retirement obligations were recorded on the Balance Sheets at their estimated present values:

		March 31,	
<i>(in thousands of dollars)</i>		2011	2010
Tanks removal and cleaning	\$	27	\$ 25
Main-cutting, purging and capping		11,793	12,195
Total asset retirement obligations	\$	11,820	\$ 12,220

Fixed Charges Under Firm Contracts

The Company has entered into various contracts for gas delivery, storage and supply services. KeySpan Gas East Corporation is liable for these payments regardless of the level of service it requires from third parties. Such charges are currently recovered from utility customers as gas costs.

<i>(in thousands of dollars)</i>	Gross Payments
2012	\$ 281,543
2013	273,711
2014	249,645
2015	236,620
2016	209,711
Total	\$ 1,251,230

Note 10. Related Party Transactions

Money Pool

The Company is engaged in various transactions with KeySpan, NGUSA and certain affiliates. For the most part, the various affiliates of KeySpan do not maintain separate cash balances. Financing for the Company's working capital and gas inventory needs are obtained through participation in the KeySpan's utility money pool for regulated entities. The Company is limited in its participation in the moneypool and is authorized to borrow funds as needed.

The money pool is funded by operating funds from money pool participants. In addition, KeySpan and NGUSA collectively have the ability to borrow up to \$3 billion from National Grid plc for working capital needs including funding of the money pool, if necessary. We had an outstanding short-term moneypool borrowings of \$228.1 million and \$284.5 million at March 31, 2011 and March 31, 2010, respectively. Interest rates associated with the money pool are designed to approximate the cost of third-party short-term borrowings.

The average interest rate for the money pool was 1.20% and 0.91% for the years ended March 31, 2011 and 2010, respectively.

Advances to/from Affiliates

NGUSA and its affiliates also provide us with various services, including executive and administrative, customer services, financial (including accounting, auditing, risk management, tax, treasury/finance), human resources, information technology, legal, and strategic planning. The costs of these services are charged to the Company via intercompany billings and generally settled through the money pool on a monthly basis. The Company had a \$146.3 million and \$159.1 million liability for these services at March 31, 2011 and 2010, respectively.

In addition, the Company had an intercompany tax payable of \$21.0 million. Therefore, at March 31, 2011, KeySpan Gas East Corporation had a money pool payable of \$228.1 million for a total net intercompany payable position of \$395.4 million.

Service Company Charges

The affiliated service companies of NGUSA provide certain services to the Company at their cost. The service company costs are generally allocated to associated companies through a tiered approach. First and foremost, costs are directly charged to the benefitted company whenever practicable. Secondly, in cases where direct charging cannot be readily determined, costs are typically allocated using cost/causation principles linked to the relationship of that type of service, such as meters, square footage, number of employees, etc. Lastly, other costs are allocated based on a general allocator. These costs include operating and capital expenditures of \$155.7 million and \$22.1 million for the year ended March 31, 2011 and

\$177.5 million and \$25.2 million for the year ended March 31, 2010, respectively.

Holding Company Charges

NGUSA received charges from National Grid Commercial Holdings Limited (an affiliated company in the UK) for certain corporate and administrative services provided by the corporate functions of National Grid plc to its US subsidiaries. These charges, which are recorded on the financial statements of NGUSA, have not been reflected on these financial statements. Were these amounts allocated to this subsidiary, the estimated effect on net income would be approximately \$3.3 million and \$2.2 million before taxes, and \$2.1 million and \$1.4 million after taxes, for the years ended March 31, 2011 and 2010, respectively.

Organizational Restructuring

On January 31, 2011, National Grid plc announced substantial changes to the organization, including new global, US and UK operating models, and changes to the leadership team. The announced structure seeks to create a leaner, more-efficient business backed by streamlined operations that will help meet, more efficiently, the needs of regulators, customers and shareholders. The implementation of the new U.S. business structure commences on April 4, 2011 and targets annualized savings of \$200 million by March 2012 primarily through the reduction of up to 1,200 positions. As of March 31, 2011, NGUSA had recorded a \$66.8 million reserve for one-time employment termination benefits related to severance, payroll taxes, healthcare continuation, outplacement services as well as consulting fees related to the restructuring program. These charges have been recorded by NGUSA and none have been allocated to the Company as at March 31, 2011. Subsequently in June 2011, we offered a voluntary severance plan to certain individuals which is expected to cost up to an additional \$20 million across all entities affiliated with NGUSA.

Note 11. Dividends

Pursuant to the NYPSC's orders, the ability of the Company to pay dividends to KeySpan is conditioned upon maintenance of a utility capital structure with debt not exceeding 58 % of total utility capitalization. At the end of the rate year (December 31, 2010), the Company was in compliance with the utility capital structure required by the NYPSC.

On January 28, 2011, a director of the Company, in lieu of a special meeting of its Board of Directors, executed a written consent to declare dividends in the amount of \$320.0 million on the Company's outstanding common stock. The dividends were declared payable on January 31, 2011 to KeySpan Corporation, the sole stockholder of record at the close of January 31, 2011.

Note 12. Subsequent Events

In accordance with current authoritative accounting guidance, the Company has evaluated for disclosure subsequent events that have occurred up through June 24, 2011, the date of issuance of these financial statements. As of June 24, 2011, there were no subsequent events which required recognition or disclosure.