



The Brooklyn Union Gas Company
d/b/a National Grid New York
Consolidated Financial Statements
For the years ended March 31, 2019 and 2018

THE BROOKLYN UNION GAS COMPANY

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

INDEPENDENT AUDITORS' REPORT
To the Board of Directors of
The Brooklyn Union Gas Company

We have audited the accompanying consolidated financial statements of The Brooklyn Union Gas Company d/b/a National Grid New York (the "Company"), which comprise the consolidated balance sheets and statements of capitalization as of March 31, 2019 and 2018 and the related consolidated statements of income, cash flows, and changes in shareholders' equity for the two years in the period ended March 31, 2019, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Brooklyn Union Gas Company d/b/a National Grid New York as of March 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte + Touche LLP

July 25, 2019

THE BROOKLYN UNION GAS COMPANY
CONSOLIDATED STATEMENTS OF INCOME
(in thousands of dollars)

	Years Ended March 31,	
	2019	2018
Operating revenues	\$ 1,914,219	\$ 1,684,134
Operating expenses:		
Purchased gas	697,783	606,484
Operations and maintenance	620,311	584,059
Depreciation	103,589	90,553
Other taxes	233,505	218,241
Total operating expenses	1,655,188	1,499,337
Operating income	259,031	184,797
Other deductions:		
Interest on long-term debt	(71,805)	(47,317)
Other interest, including affiliate interest	(23,007)	(7,389)
Loss on sale of assets	-	(43,187)
Other deductions, net	(16,521)	(25,676)
Total other deductions, net	(111,333)	(123,569)
Income before income taxes	147,698	61,228
Income tax expense	40,547	12,768
Net income	\$ 107,151	\$ 48,460

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

BROOKLYN UNION GAS COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands of dollars)

	Years Ended March 31,	
	2019	2018
Operating activities:		
Net income	\$ 107,151	\$ 48,460
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	103,589	90,553
Regulatory amortizations	18,521	29,507
Deferred income tax	74,728	9,274
Bad debt expense	16,911	13,518
Loss on sale of assets	-	43,187
Allowance for equity funds used during construction	(3,792)	(529)
Amortization of debt discount and issuance costs	1,367	1,751
Pension and postretirement benefit expenses, net	27,883	62,130
Pension and postretirement benefit contributions	(60,650)	(40,687)
Environmental remediation payments	(27,921)	(45,471)
Changes in operating assets and liabilities:		
Accounts receivable and other receivable, net, and unbilled revenues	(65,149)	(88,353)
Accounts receivable from/payable to affiliates, net	(526)	-
Inventory	(10,155)	21,355
Regulatory assets and liabilities, net	94,333	60,417
Derivative instruments	3,849	814
Prepaid and accrued taxes	(38,409)	13,414
Accounts payable and other liabilities	49,736	30,196
Other, net	587	13,469
Net cash provided by operating activities	<u>292,053</u>	<u>263,005</u>
Investing activities:		
Capital expenditures	(700,202)	(642,588)
Proceeds from sale of assets	-	162,918
Intercompany money pool	(601,683)	(168,970)
Cost of removal	(78,380)	(62,650)
Other	(33)	(318)
Net cash used in investing activities	<u>(1,380,298)</u>	<u>(711,608)</u>
Financing activities:		
Payments on long-term debt	-	(230,000)
Issuance of long-term debt	1,000,000	650,000
Payment of debt issuance costs	(6,096)	(5,372)
Intercompany money pool	(401,546)	34,813
Capital contributions from parent	500,000	-
Net cash provided by financing activities	<u>1,092,358</u>	<u>449,441</u>
Net increase in cash, cash equivalents and restricted cash	4,113	838
Cash, cash equivalents and restricted cash, beginning of year	6,314	5,476
Cash, cash equivalents and restricted cash, end of year	<u>\$ 10,427</u>	<u>\$ 6,314</u>
Supplemental disclosures:		
Interest paid	\$ (67,404)	\$ (49,434)
Income taxes refunded	46,800	10,053
Significant non-cash items:		
Capital-related accruals included in accounts payable	77,452	60,690
Tax loss allocation	22,664	2,638

THE BROOKLYN UNION GAS COMPANY
CONSOLIDATED BALANCE SHEETS
(in thousands of dollars)

	March 31,	
	2019	2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 10,086	\$ 5,951
Restricted cash	341	363
Accounts receivable	470,118	404,053
Allowance for doubtful accounts	(34,760)	(32,511)
Accounts receivable from affiliates	11,592	7,565
Intercompany money pool	880,947	304,067
Unbilled revenues	96,080	111,658
Inventory	52,688	42,533
Regulatory assets	18,902	22,836
Derivative instruments	1,920	706
Accrued tax benefits and prepaid taxes	96,880	41,866
Other	5,008	4,491
Total current assets	1,609,802	913,578
Property, plant and equipment, net	5,248,773	4,609,648
Other non-current assets:		
Regulatory assets	1,967,584	1,934,282
Goodwill	1,451,141	1,451,141
Postretirement benefits assets	51,488	48,921
Other	21,655	25,111
Total other non-current assets	3,491,868	3,459,455
Total assets	\$ 10,350,443	\$ 8,982,681

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

THE BROOKLYN UNION GAS COMPANY
CONSOLIDATED BALANCE SHEETS
(in thousands of dollars)

	March 31,	
	2019	2018
LIABILITIES AND CAPITALIZATION		
Current liabilities:		
Accounts payable	\$ 216,158	\$ 171,141
Accounts payable to affiliates	95,403	116,705
Taxes accrued	8,316	14,645
Customer deposits	22,390	24,655
Interest accrued	6,951	3,800
Regulatory liabilities	121,672	126,754
Intercompany money pool	-	401,546
Derivative instruments	9,998	4,910
Environmental remediation costs	67,537	60,240
Other	22,117	22,232
Total current liabilities	570,542	946,628
Other non-current liabilities:		
Regulatory liabilities	986,754	963,172
Asset retirement obligations	15,468	14,594
Deferred income tax liabilities, net	602,208	526,284
Postretirement benefits	62,990	106,496
Environmental remediation costs	1,251,492	1,208,118
Other	136,610	117,110
Total other non-current liabilities	3,055,522	2,935,774
Commitments and contingencies (Note 13)		
Capitalization:		
Shareholders' equity	4,090,723	3,460,908
Long-term debt	2,633,656	1,639,371
Total capitalization	6,724,379	5,100,279
Total liabilities and capitalization	\$ 10,350,443	\$ 8,982,681

THE BROOKLYN UNION GAS COMPANY
CONSOLIDATED STATEMENTS OF CAPITALIZATION
(in thousands of dollars)

		March 31,	
		2019	2018
Total shareholders' equity		\$ 4,090,723	\$ 3,460,908
Long-term debt:	<u>Interest Rate</u>	<u>Maturity Date</u>	
<i>Unsecured Notes:</i>			
Senior Note	3.41%	March 10, 2026	500,000
Senior Note	3.87%	March 4, 2029	-
Senior Note	4.50%	March 10, 2046	500,000
Senior Note	4.27%	March 15, 2048	650,000
Senior Note	4.49%	March 4, 2049	-
Total debt			1,650,000
Unamortized debt issuance costs			(10,629)
Long-term debt			1,639,371
Total capitalization			\$ 5,100,279

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

THE BROOKLYN UNION GAS COMPANY
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(in thousands of dollars)

	Common Stock	Cumulative Preferred Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)		Retained Earnings	Total
				Equity Investments	Total Accumulated Other Comprehensive Income (Loss)		
Balance as of March 31, 2017	\$ -	\$ -	\$ 2,996,370	\$ -	\$ -	\$ 413,440	\$ 3,409,810
Net income	-	-	-	-	-	48,460	48,460
Tax loss allocation	-	-	2,638	-	-	-	2,638
Balance as of March 31, 2018			\$ 2,999,008		-	\$ 461,900	\$ 3,460,908
Net income	-	-	-	-	-	107,151	107,151
Capital contributions from parent	-	-	500,000	-	-	-	500,000
Tax loss allocation	-	-	22,664	-	-	-	22,664
Balance as of March 31, 2019	\$ -	\$ -	\$ 3,521,672	\$ -	\$ -	\$ 569,051	\$ 4,090,723

The Company had 100 shares of common stock authorized, issued and outstanding, with a par value of \$0.01 per share and 1 share of preferred stock, authorized, issued and outstanding, with a par value of \$1 per share at March 31, 2019 and 2018.

THE BROOKLYN UNION GAS COMPANY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

The Brooklyn Union Gas Company d/b/a National Grid New York (“the Company”) is a gas distribution company engaged in the transportation and sale of natural gas to approximately 1,262,000 customers in the boroughs of Brooklyn and Staten Island and two-thirds of the borough of Queens, all in New York City.

Prior to April 30, 2018, the Company was a wholly-owned subsidiary of KeySpan Corporation (“KeySpan”), which was a wholly-owned subsidiary of National Grid USA (“NGUSA” or the “Parent”), 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 a direct wholly-owned subsidiary of National Grid North America Inc. (“NGNA”) and an indirect wholly-owned subsidiary of National Grid plc, a public limited company incorporated under the laws of England and Wales. Effective April 30, 2018, KeySpan merged into NGUSA and from that point forward the Company is a wholly-owned subsidiary of NGUSA.

Through its wholly-owned subsidiary, North East Transmission Co., Inc. (“NETCO”), the Company owned approximately 6.5 million common units (representing approximately an 8% interest) of Dominion Midstream Partners, LP (“DM”). DM was formed to grow a portfolio of natural gas terminaling, processing, storage, and transportation assets. On February 13, 2018, the Company obtained board approval to sell its investment in DM. The Company completed the sale of its investment in DM to Deutsche Bank for proceeds of \$162.9 million, which settled February 21, 2018.

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”), including the accounting principles for rate-regulated entities. The consolidated financial statements reflect the ratemaking practices of the applicable regulatory authorities. All intercompany balances and transactions have been eliminated in consolidation.

The Company has evaluated subsequent events and transactions through July 25, 2019, the date of issuance of these consolidated financial statements, and concluded that there were no events or transactions that require adjustment to, or disclosure in, the consolidated financial statements as of and for the year ended March 31, 2019.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

In preparing consolidated financial statements that conform to U.S. GAAP, the Company must make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses, and the disclosure of contingent assets and liabilities included in the consolidated financial statements. Actual results could differ from those estimates.

Regulatory Accounting

The New York Public Service Commission (“NYPSC”) regulates the rates the Company charges its customers. In certain cases, the rate actions of the NYPSC can result in accounting that differs from non-regulated companies. In these cases, the Company defers costs (as regulatory assets) or recognizes obligations (as regulatory liabilities) if it is probable that such amounts will be recovered from, or refunded to, customers through future rates. In accordance with ASC 980, “Regulated Operations,” regulatory assets and liabilities are reflected on the balance sheet consistent with the treatment of the related costs in the ratemaking process.

Revenue Recognition

Revenues are recognized for gas distribution services provided on a monthly billing cycle basis. The Company records unbilled revenues for the estimated amount of services rendered from the time meters were last read to the end of the accounting period (see Note 3, "Revenue" for additional details).

Other Taxes

The Company collects taxes and fees from customers such as sales taxes, other taxes, surcharges, and fees that are levied by state or local governments on the sale or distribution of gas. The Company accounts for taxes that are imposed on customers (such as sales taxes) on a net basis (excluded from revenues), while taxes imposed on the Company, such as excise taxes, are recognized on a gross basis. Excise taxes collected and paid for the years ended March 31, 2019 and 2018 were \$64.1 million and \$58.6 million, respectively.

The state of New York imposes on corporations a franchise tax that is computed as the higher of a tax based on income or a tax based on capital. To the extent the Company's state tax based on capital is in excess of the state tax based on income, the Company reports such excess in other taxes and taxes accrued in the accompanying consolidated financial statements.

Income Taxes

Federal and state income taxes have been computed utilizing the asset and liability approach that requires the recognition of deferred tax assets and liabilities for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. Deferred income taxes also reflect the tax effect of net operating losses, capital losses, and general business credit carryforwards. The Company assesses the available positive and negative evidence to estimate whether sufficient future taxable income of the appropriate tax character will be generated to realize the benefits of existing deferred tax assets. When the evaluation of the evidence indicates that the Company will not be able to realize the benefits of existing deferred tax assets, a valuation allowance is recorded to reduce existing deferred tax assets to the net realizable amount.

The effects of tax positions are recognized in the financial statements when it is more likely than not that the position taken, or expected to be taken, in a tax return will be sustained upon examination by taxing authorities based on the technical merits of the position. 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.

NGNA files consolidated federal tax returns including all of the activities of its subsidiaries. Each subsidiary determines its tax provision based on the separate return method, modified by a benefits-for-loss allocation pursuant to a tax sharing agreement between NGNA and its subsidiaries. The benefit of consolidated tax losses and credits are allocated to the NGNA subsidiaries giving rise to such benefits in determining each subsidiary's tax expense in the year that the loss or credit arises. In a year that a consolidated loss or credit carryforward is utilized, the tax benefit utilized in consolidation is paid proportionately to the subsidiaries that gave rise to the benefit regardless of whether that subsidiary would have utilized the benefit. The tax sharing agreement also requires NGNA to allocate its parent tax losses, excluding deductions from acquisition indebtedness, to each subsidiary in the consolidated federal tax return with taxable income. The allocation of NGNA's parent tax losses to its subsidiaries is accounted for as a capital contribution and is performed in conjunction with the annual intercompany cash settlement process following the filing of the federal tax return.

Cash and Cash Equivalents

Cash equivalents consist of short-term, highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at cost which approximates fair value.

Restricted Cash

Restricted cash consists of collateral paid to the Company's counterparties for outstanding derivative instruments. The following table reconciles cash, cash equivalents, and restricted cash as reported on the balance sheets, to the cash, cash equivalents, and restricted cash as reported on the statements of cash flows:

	Years ended March 31,	
	2019	2018
	<i>(in thousands of dollars)</i>	
Cash and Cash Equivalents as reported on the Balance Sheets	\$ 10,086	\$ 5,951
Restricted Cash as reported on the Balance Sheets	341	363
Cash, Cash Equivalents, and Restricted Cash reported on the Statement of Cash Flows	<u>\$ 10,427</u>	<u>\$ 6,314</u>

Accounts Receivable and Allowance for Doubtful Accounts

The Company recognizes an allowance for doubtful accounts to record accounts receivable at estimated net realizable value. The allowance is determined based on a variety of factors including, for each type of receivable, applying an estimated reserve percentage to each aging category, taking into account historical collection and write-off experience, and management's assessment of collectability from individual customers, as appropriate. The collectability of receivables is continuously assessed and, if circumstances change, the allowance is adjusted accordingly. Receivable balances are written off against the allowance for doubtful accounts when the accounts are disconnected and/or terminated and the balances are deemed to be uncollectible.

Inventory

Inventory is composed of materials and supplies as well as gas in storage. Materials and supplies are stated at weighted average cost, which represents net realizable value, and are expensed or capitalized as used. There were no material write-offs of obsolete inventory for the years ended March 31, 2019 or 2018.

Gas in storage is stated at weighted average cost and the related cost is recognized when delivered to customers. Existing rate orders allow the Company to pass directly through to customers the cost of gas purchased, along with any applicable authorized delivery surcharge adjustments. Gas costs passed through to customers are subject to regulatory approvals and are audited annually by the NYPSC.

The Company had materials and supplies of \$16.7 million and \$11.6 million and gas in storage of \$36.0 million and \$30.9 million at March 31, 2019 and 2018, respectively.

Derivative Instruments

The Company uses derivative instruments to manage commodity price risk. All derivative instruments are recorded on the consolidated balance sheet at fair value. All commodity costs, including the impact of derivative instruments, are passed on to customers through the Company's gas cost adjustment mechanism. Regulatory assets or regulatory liabilities are recorded to defer the recognition of unrealized losses or gains on derivative instruments, respectively. The gains or losses on the settlement of these contracts are recognized as purchased gas on the statements of income and refunded to, or collected from, customers consistent with regulatory requirements.

The Company's accounting policy is to not offset fair value amounts recognized for derivative instruments and related cash collateral receivable or payable with the same counterparty under a master netting agreement, but rather to record and present the fair value of the derivative instrument on a gross basis, with related cash collateral recorded within restricted cash and special deposits on the consolidated balance sheet.

Natural Gas Long-Term Arrangements

The Company enters into long-term gas contracts to procure gas to serve its gas customers. Those contracts include Asset Management Agreements, Baseload, and Peaking gas contracts. The Company evaluates whether such agreements are leases, derivative instruments, or executory contracts; and performs an assessment under the guidance for Variable Interest Entities included in Topic 810, "Consolidations," and applies the appropriate accounting treatment.

Fair Value Measurements

The Company measures derivative instruments and pension and postretirement benefit other than pension plan assets at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following is the fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities that a company has the ability to access as of the reporting date;
- Level 2: inputs other than quoted prices included within Level 1 that are directly observable for the asset or liability or indirectly observable through corroboration with observable market data;
- 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; and
- Not categorized: certain investments are not categorized within the fair value hierarchy. These investments are typically in commingled funds or limited partnerships that are not publicly traded and have ongoing subscription and redemption activity. As a practical expedient, the fair value of these investments is the Net Asset Value ("NAV") per fund share, derived from the underlying securities' quoted prices in active markets.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The Company uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs.

Property, Plant and Equipment

Property, plant and equipment is stated at original cost. The cost of repairs and maintenance is charged to expense and the cost of renewals and betterments that extend the useful life of property, plant and equipment is capitalized. The capitalized cost of additions to property, plant and equipment includes costs such as direct material, labor and benefits, and an allowance for funds used during construction ("AFUDC").

Depreciation is computed over the estimated useful life of the asset using the composite straight-line method. Depreciation studies are conducted periodically to update the composite rates and are approved by the NYPSC. The average composite rates for the years ended March 31, 2019 and 2018 were 2.1% and 2.0%, respectively.

Depreciation expense includes a component for the estimated cost of removal, which is recovered through rates charged to customers. Any difference in cumulative costs recovered and costs incurred is recognized as a regulatory liability. When property, plant and equipment is retired, the original cost, less salvage, is charged to accumulated depreciation, and the related cost of removal is removed from the associated regulatory liability. The Company recognized a regulatory liability for the amount that was in excess of costs incurred of \$83.8 million and \$147.7 million at March 31, 2019 and 2018, respectively.

Allowance for Funds Used During Construction

The Company records AFUDC, which represents the debt and equity costs of financing the construction of new property, plant and equipment. The equity component of AFUDC is reported in the accompanying consolidated statements of income as non-cash income in other deductions, net. The debt component of AFUDC is reported as a non-cash offset to other interest, including affiliate interest. After construction is completed, the Company is permitted to recover these costs through their inclusion in rate base. The Company recorded AFUDC related to equity of \$3.8 million and \$0.5 million, and AFUDC related to debt of \$9.7 million and \$5.2 million, for the years ended March 31, 2019 and 2018, respectively. The average AFUDC rates for the years ended March 31, 2019 and 2018 were 2.7% and 1.7%, respectively.

Impairment of Long-Lived Assets

The Company tests the impairment of long-lived assets when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. The recoverability of an asset is determined by comparing its carrying value to the estimated undiscounted cash flows that the asset is expected to generate. If the comparison indicates that the carrying value is not recoverable, an impairment loss is recognized for the excess of the carrying value over the estimated fair value. For the years ended March 31, 2019 and 2018, there were no impairment losses recognized for long-lived assets.

Goodwill

The Company tests goodwill for impairment annually on January 1, and when events occur or circumstances change that would more likely than not reduce the fair value of the Company below its carrying amount. The Company has early adopted Accounting Standards Update (“ASU”) No. 2017-04, “Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment,” which eliminates step two from the two-step goodwill impairment test required under the current standard. The goodwill impairment test requires a recoverability test performed based on the comparison of the Company’s estimated fair value with its carrying value, including goodwill. If the estimated fair value exceeds the carrying value, then goodwill is not considered impaired. If the carrying value exceeds the estimated fair value, the Company is required to recognize an impairment charge for such excess, limited to the carrying amount of goodwill.

Historically, the fair value of the Company was calculated for the annual goodwill impairment test utilizing both the income and market-based approaches. For the year ended March 31, 2019, the fair value of the Company was calculated utilizing only the income approach. The Company believes that this approach provides the most reliable information about the fair value of the Company’s estimated fair value. Based on the resulting fair value from the annual analyses, the Company determined that no adjustment to the goodwill carrying value was required at March 31, 2019 or 2018.

Asset Retirement Obligations

Asset retirement obligations are recognized for legal obligations associated with the retirement of property, plant and equipment, primarily associated with the Company’s gas distribution facilities. Asset retirement obligations are recorded at fair value in the period in which the obligation is incurred, if the fair value can be reasonably estimated. In the period in which new asset retirement obligations, or changes to the timing or amount of existing retirement obligations are recorded, the associated asset retirement costs are capitalized as part of the carrying amount of the related long-lived asset. In each subsequent period the asset retirement obligation is accreted to its present value. The Company applies regulatory accounting guidance and both the depreciation and accretion costs associated with asset retirement obligation are recorded as increases to regulatory assets on the consolidated balance sheet. These regulatory assets represent timing differences between the recognition of costs in accordance with U.S. GAAP and costs recovered through the ratemaking process.

The following table represents the changes in the Company's asset retirement obligations:

	Years Ended March 31,	
	2019	2018
	<i>(in thousands of dollars)</i>	
Balance as of the beginning of the year	\$ 15,345	\$ 14,777
Accretion expense	925	886
Liabilities settled	(196)	(318)
Balance as of the end of the year	\$ 16,074	\$ 15,345

The Company had a current portion of asset retirement obligations of \$0.6 million and \$0.8 million included in other current liabilities on the balance sheet at March 31, 2019 and March 31, 2018, respectively.

Employee Benefits

The Company participates with other NGUSA subsidiaries in defined benefit pension plans and postretirement benefit other than pension ("PBOP") plans for its employees, administered by NGUSA. The Company recognizes its portion of the pension and PBOP plans' funded status on the consolidated balance sheet as a net liability or asset. The cost of providing these plans is recovered through rates; therefore, the net funded status is offset by a regulatory asset or liability. The pension and PBOP plans' assets are commingled and allocated to measure and record pension and PBOP funded status at the year-end date. Pension and PBOP plan assets are measured at fair value, using the year-end market value of those assets.

New and Recent Accounting Guidance

Accounting Guidance Recently Adopted

Pension and Postretirement Benefits

In March 2017, the Financial Accounting Standards Board ("FASB") issued ASU No. 2017-07, "Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost," which changes certain presentation and disclosure requirements for employers that sponsor defined benefit pension and other postretirement benefit plans. The ASU requires the service cost component of the net benefit cost to be classified within the same line item as other compensation in operating income in an entity's statement of income and the other components of net benefit cost to be classified outside of operating income on a retrospective basis. In addition, as prescribed by the ASU, only the service cost component will be eligible for capitalization when applicable, on a prospective basis.

The Company adopted this new guidance on April 1, 2018. As a result of the retrospective adoption of ASU No.2017-07 for the year ended March 31, 2018, the Company reclassified \$21.2 million related to the other components of net benefit cost, that were previously presented within operations and maintenance on the consolidated statement of income, to retrospectively present in other deductions, net. The application of the new guidance did not have a material impact on the Company's results of cash flows and financial position.

Statements of Cash Flows

In November 2016, the FASB issued ASU No. 2016-18, "Statements of Cash Flows (Topic 230): Restricted Cash," which requires entities to show the changes in the total of cash, cash equivalents, restricted cash, and restricted cash equivalents in the statements of cash flows. The Company has adopted the new guidance in the current fiscal year and applied it retrospectively for each prior period presented. Cash and restricted cash are presented on a combined basis in the Company's statements of cash flows. As a result of implementing new accounting guidance for the statement of cash flows, the reclassification of the change in restricted cash balances, which was previously classified as investing activities, resulted in an increase of \$0.3 million in the total change in Cash, Cash Equivalents and Restricted Cash for the year ended March 31, 2018.

In August 2016, the FASB issued ASU No. 2016-15, "Statements of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments," which provides guidance about the classification of certain cash receipts and payments within the statements of cash flows, including debt prepayment or extinguishment costs, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims and policies, and distributions received from equity method investments. The Company adopted the new guidance in the current fiscal year and applied it retrospectively for each prior period presented. The application of the new guidance did not have a material impact on the Company's presentation of its statements of cash flows.

Revenue Recognition

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." The FASB further amended ASC 606 through various updates issued thereafter. The underlying principle of this ASU is that an entity will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration the entity expects to be entitled to, in exchange for those goods or services. The Company adopted the new guidance on April 1, 2018, using the modified retrospective method applied to contracts that were not completed as of April 1, 2018, and the Company did not recognize an adjustment to retained earnings for the cumulative effect of adopting the standard.

The adoption of ASC 606 did not have a material impact on the presentation of the Company's results of operations, cash flows, or financial position. The Company has added additional disclosures as required under ASC 606 (see Note 3, "Revenue" for additional details).

Financial Instruments – Classification and Measurement

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The new guidance eliminates the available-for-sale and cost method classification for equity securities and requires that all equity investments, other than those accounted for using the equity method of accounting, be measured and recorded at fair value with any changes in fair value recognized through net income. However, for equity investments that do not have a readily determinable fair value an entity may choose to measure equity investments at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for identical or similar investments. If any entity elects to use the measurement alternative for equity investments without readily determinable fair values, those investments must be qualitatively assessed for impairment at each reporting period and if impairment exist the investment is required to be measured at fair value. The guidance does not impact the classification or measurement of investments in debt securities. The guidance also amended certain disclosure requirements related to financial instruments. The application of the new guidance did not have a material impact on the Company's results of operations, cash flows, and financial position.

Accounting Guidance Not Yet Adopted

Leases

In February 2016, the FASB issued ASU 2016-02 "Leases" (Topic 842) related to lease accounting. For the Company, the new standard is effective for the fiscal year ending March 31, 2020, and interim periods within. Under the new standard, a lease is defined as a contract, or part of a contract, that conveys the right to control the use of identified assets for a period of time in exchange for consideration. Under the requirements of the new standard, lessees will need to recognize leases on the balance sheet as a right-of-use asset and a related lease liability, which will be equal to the present value of the estimated future lease payments. The right-of-use asset at inception will be based on the liability, subject to certain adjustments, such as initial direct costs. The new standard requires leases to be classified as either operating or financing which will impact the amount and classification of lease related expenses on the statements of income. Under the new standard, lessor accounting is largely unchanged. The new standard also has additional disclosure requirements.

The new standard provides the Company with transition practical expedients including a package of three expedients that must be taken together and allows the Company to: not reassess whether existing contracts contain leases, carryforward the

existing classification of any leases, and not reassess initial direct costs associated with existing leases. The Company has exercised its option to elect the package of practical expedients. The Company will make the election under the new standard to not reflect a right-of-use asset or related liability for leases with a term of 12 months or less. The Company has also elected the practical expedient to not reevaluate land easements existing at adoption if they were not previously accounted for as leases. The Company will not make the election to combine the lease components and the associated non-lease components of an arrangement and account for as a single lease component and will also not elect the expedient to use hindsight in determining the lease term for existing leases at the time of adoption.

The Company will recognize and measure the cumulative effect of the new standard at the beginning of the earliest period presented using the modified retrospective approach. The Company determined the impact the ASUs will have on its financial statements by reviewing its lease population and identifying lease data needed for the disclosure requirements. The Company will implement a new lease accounting system in fiscal year 2020, to ensure ongoing compliance with the ASU's requirements. The Company recognized approximately \$50.9 million of operating lease liabilities and right-of-use assets on the balance sheets upon transition at April 1, 2019. Implementation of the new guidance will not materially impact our results of operations or cash flows, as we do not expect significant changes to our pattern of expense recognition as a result of the new standard. The Company's leases are further discussed in Note 13, "Commitments and Contingencies".

Financial Instruments

In June 2016, the FASB issued ASU No. 2016-13 "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Statements" requires a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The FASB further amended Topic 326 through additional updates issued thereafter. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. For the Company, the requirements of the new standard will be effective for the fiscal year ending March 31, 2022, and interim periods within, with early adoption permitted from the fiscal year ending March 31, 2020 and interim periods within. The Company is currently assessing the impact of this standard.

Reclassifications

Certain reclassifications have been made to the consolidated financial statements to conform the prior period's balances to the current period's presentation. These reclassifications had no effect on reported income, total assets, or stockholders' equity as previously reported.

3. REVENUE

The following table presents, for the year ending March 31, 2019, revenue from contracts with customers, as well as additional revenue from sources other than contracts with customers, disaggregated by major source:

	<u>Year ended March 31, 2019</u>	
	<i>(in thousands of dollars)</i>	
Revenue from Contracts with Customers:		
Gas Distribution	\$	1,794,623
Off System Sales		<u>126,112</u>
Total Revenue from Contracts with Customers		<u>1,920,735</u>
Revenue from Regulatory Mechanisms		(9,545)
Other Revenue		<u>3,029</u>
Total Operating Revenues	\$	<u><u>1,914,219</u></u>

Gas Distribution: The Company owns and maintains a natural gas distribution network in downstate New York. Distribution revenues are primarily from the sale of gas and related services to retail customers. Distribution sales are regulated by the NYPSC, which is responsible for determining the prices and other terms of services as part of the rate making process. The arrangement where a utility provides a service to a customer in exchange for a price approved by a regulator is referred to as a tariff sales contract. Gas distribution revenues are derived from the regulated sale and distribution of natural gas to residential, commercial, and industrial customers within the Company's service territory under the tariff rates. The tariff rates approved by the regulator are designed to recover the costs incurred by the Company for products and services provided and along with a return on investment.

The performance obligation for distribution sales is to provide natural gas to the customers on demand. The natural gas supplied under the tariff represents a single performance obligation as it is a series of distinct goods or services that are substantially the same. The performance obligation is satisfied over time because the customer simultaneously receives and consumes the natural gas as the Company provides these services. The Company records revenues related to the distribution sales based upon the approved tariff rates and the volume delivered to the customers, which corresponds with the amount the Company has the right to invoice.

The distribution revenue also includes estimated unbilled amounts, which represent the estimated amounts due from retail customers for natural gas provided to customers by the Company, but not yet billed. Unbilled revenues are determined based on estimated unbilled sales volumes for the respective customer classes and then applying the applicable tariff rate to those volumes. Actual amounts billed to customers when the meter readings occur, may be different from the estimated amounts.

Certain customers have the option to obtain natural gas from other suppliers. In those circumstances' revenue is only recognized for providing delivery of the commodity to the customer.

Off System Sales (OSS): Represents direct sales of gas to participants in the wholesale natural gas marketplace, which occur after customers' demands are satisfied.

Revenue from Regulatory Mechanisms: The company records revenues in accordance with accounting principles for rate-regulated operations that are arrangements between the Company and the regulator that are not accounted for as contracts with customers. These include various deferral mechanisms such as capital trackers, energy efficiency programs, and programs that qualify as Alternative Revenue Programs ("ARPs"). ARPs enable the Company to adjust rates in the future, in response to past activities or completed events. The Company's gas distribution rates have a revenue decoupling mechanism ("RDM") which allows for annual adjustments to the Company's delivery rates as a result of the reconciliation between allowed revenue and billed revenue. The Company also has other ARPs related to the achievement of certain objectives, demand side management initiatives, and certain other rate making mechanisms. The Company recognizes ARPs with a corresponding offset to a regulatory asset or liability account when the regulatory specified events or conditions have been met, when the amounts are determinable, and are probable of recovery (or payment) through future rate adjustments.

Other Revenues: Includes other transactions that are not considered contracts with customers.

4. REGULATORY ASSETS AND LIABILITIES

The Company records regulatory assets and liabilities that result from the ratemaking process. The following table presents the regulatory assets and regulatory liabilities recorded on the consolidated balance sheet:

	March 31,	
	2019	2018
	<i>(in thousands of dollars)</i>	
Regulatory assets		
Current:		
Derivative instruments	\$ 8,053	\$ 4,204
Facilities system surcharge	2,984	-
Gas costs adjustment	-	16,079
Gas safety and reliability surcharge	2,115	-
Revenue decoupling mechanism	2,508	51
Temperature control revenues	3,242	-
Temporary state assessment	-	2,502
Total	<u>18,902</u>	<u>22,836</u>
Non-current:		
Environmental response costs	1,477,892	1,460,645
Postretirement benefits	244,813	251,227
Temperature control/interruptible sharing	103,855	123,436
Other	141,024	98,974
Total	<u>1,967,584</u>	<u>1,934,282</u>
Regulatory liabilities		
Current:		
Energy efficiency	25,567	43,452
Gas costs adjustment	26,390	-
Revenue decoupling mechanism	66,586	77,688
Other	3,129	5,614
Total	<u>121,672</u>	<u>126,754</u>
Non-current:		
Carrying charges	67,338	54,120
Cost of removal	83,790	147,663
Postretirement benefits	82,858	68,403
Regulatory tax liability, net	431,349	433,330
Transition balancing accounts	71,163	71,163
Other	250,256	188,493
Total	<u>986,754</u>	<u>963,172</u>
Net regulatory assets	<u>\$ 878,060</u>	<u>\$ 867,192</u>

Carrying charges: The Company records carrying charges on regulatory balances for which cash expenditures have been made and are subject to recovery, or for which cash has been collected and is subject to refund as approved in accordance with the PSC. Carrying charges are not recorded on items for which expenditures have not yet been made.

Cost of removal: Represents cumulative amounts collected, but not yet spent, to dispose of property, plant and equipment. This liability is discharged as removal costs are incurred.

Derivative instruments: The Company evaluates open derivative instruments for regulatory deferral by determining if they are probable of recovery from, or refund to, customers through future rates. Derivative instruments that qualify for recovery are recorded at fair value, with changes in fair value recorded as regulatory assets or regulatory liabilities in the period in which the change occurs.

Energy efficiency: Represents the difference between revenue billed to customers through the Company's energy efficiency charge and the costs of the Company's energy efficiency programs as approved by the NYPSC.

Environmental response costs: Represents deferred costs associated with the Company's shares of the estimated costs to investigate and perform certain remediation activities at former manufactured gas plant ("MGP") sites and related facilities. The Company believes future costs, beyond the expiration of current rate plans, will continue to be recovered through rates. The regulatory liability represents the excess of amounts received in rates over the Company's actual site investigation and remediation ("SIR") costs.

Facilities system surcharge: On May 1, 2018, the Company entered the New York Facilities Agreement ("NYFA") with The Brooklyn Union Gas Company and Consolidated Edison Company of New York, Inc. to design, maintain and operate their respective constructed portion of a system of gas mains and associated facilities for receiving and distributing natural gas. On October 18, 2018, the NYPSC issued an order to allow the Company to recover or refund NYFA costs as compared to the amount reflected in base rates. An initial surcharge was implemented on November 1, 2018, effective for the five-month period ending March 31, 2019.

Gas costs adjustment: The Company is subject to rate adjustment mechanisms for commodity costs, whereby an asset or liability is recognized resulting from differences between actual revenues and the underlying cost being recovered or differences between actual revenues and targeted amounts as approved by the NYPSC. These amounts will be refunded to, or recovered from, customers over the next year.

Gas safety and reliability surcharge: The regulatory asset represents the recovery of costs to incrementally replace leak prone pipes, costs to repair leaks that do not present an immediate risk to public safety, and positive revenue adjustments earned for achieving performance metrics. The surcharge is reconciled on a calendar year basis and included in the delivery rate adjustment recovered from firm sales and firm transportation customers in the following fiscal year.

Postretirement benefits: The regulatory asset balance represents the Company's, unamortized, non-cash accrual of net pension actuarial gains and losses in addition to actual costs associated with Company's pension plans in excess of amounts received in rates that are to be collected in future periods. The regulatory liability represents the Company's, unamortized, non-cash accrual of net PBOP actuarial gains and losses in addition to excess amounts received in rates over actual costs of the Company's PBOP plans that are to be passed back in future periods.

Regulatory tax liability, net: Represents over-recovered federal and state deferred taxes of the Company primarily as a result of regulatory flow through accounting treatment, state income tax rate changes and excess federal deferred taxes as a result of the Tax Cuts and Jobs Act of 2017 ("Tax Act").

Revenue decoupling mechanism ("RDM"): As approved by the NYPSC, the gas RDM allows for an annual adjustment to the Company's delivery rates as a result of the reconciliation between allowed and actual billed revenues. Any difference is recorded as a regulatory asset or regulatory liability.

Temperature control/interruptible ("TC/IT") sharing: Under a previous rate agreement, the Company was subject to an annual price cap on interruptible and temperature control customers and was allowed to defer related amounts, subject to sharing with customers – 90% to customers and 10% to shareholders. This mechanism was discontinued under the current rate agreement. In conjunction with its 2019 rate case filing (see Note 5, "Rate Matters", for additional details) the Company proposed to combine this and other regulatory assets and liabilities into a single net deferral liability to be refunded to customers.

Temperature control revenues: The temperature control service revenue is reconciled to the revenue target approved by the NYPSC on a calendar year basis. Any difference between the actual revenue collected and target revenue is deferred and credited or surcharged to firm sales and firm transportation customers in the following fiscal year through the delivery rate adjustment.

Temporary state assessment: In June 2009, the NYPSC authorized utilities, including the Company, to recover the costs required for payment of the Temporary State Energy & Utility Service Conservation Assessment (“Temporary State Assessment”), including carrying charges. The Temporary State Assessment was subject to reconciliation over a five year period which began July 1, 2009. On June 18, 2014, the NYPSC issued an order authorizing certain utilities, including the Company, to recover the Temporary State Assessment subject to reconciliation, including carrying charges, from July 1, 2014 through June 30, 2017. The Temporary State Assessment factor was discontinued as of June 2017, however the Company was allowed to continue to defer the general assessment expenses through March 31, 2018. The timing for the disposition of any associated deferred balances will be determined by future NYPSC rulings.

Transition balancing accounts (“TBA”): In May 2002, the NYPSC approved the gas restructuring joint proposal (“the proposal”), which required the Company to take measures toward the transition to a competitive retail market for gas service in the Company’s service territories. Allowed costs within the TBA were ordered to be funded by various sources including but not limited to excess earnings, which are earnings due to ratepayers in excess of the threshold returns on equity specified within the Company’s rate plan. All TBA activities from the proposal have concluded, and no further TBA related activity have occurred since 2008. The timing for the disposition of any associated deferred balances will be determined by future NYPSC rulings.

5. RATE MATTERS

Rate Case Filing

On January 29, 2016, the Company and KeySpan Gas East Corporation (the “New York Gas Companies”) filed to adjust their base gas rates, to be effective from January 1, 2017. The filing requested to increase gas delivery base revenues. On September 7, 2016, the New York Gas Companies filed a Joint Proposal establishing a three year rate plan beginning January 1, 2017 and ending December 31, 2019. The NYPSC issued an order approving the Joint Proposal on December 15, 2016 and the new rates went into effect beginning January 1, 2017.

The rate plan provided for a revenue increase of \$272 million in the first year, an additional \$41 million in the second year, and an additional \$48.9 million in the third year, for a cumulative three year increase of \$947 million, for the Company. In an effort to mitigate the potential bill impacts that the revenue increases would have on customers in the first year, the revenue increases are levelized over the three year rate period. As such, for U.S. GAAP reporting, revenues are recognized equal to the amounts actually billed to customers during each period rather than per the provisions of the rate plan. The settlement is based upon a 9% return on equity (“ROE”) and 48% common equity ratio and includes an earnings sharing mechanism in which customers will share earnings when the Company’s ROE is in excess of 9.5%.

Key provisions of the settlement include funding for removal of a specific mileage of leak prone pipe (“LPP”) in each rate year. Additionally, recovery of proactive LPP replacement costs incurred in excess of this mileage are permitted and recovered through the Gas Safety and Reliability Surcharge. This also includes a positive revenue adjustment mechanism for unit cost savings versus those specific in rates.

The Company has capital tracker mechanisms that reconcile the Company’s capital expenditures to the amounts permitted in rates. The Net Utility Plant and Depreciation Expense tracker is a downward only reconciliation that applies to the Companies’ aggregate total average net plant and depreciation expense combined. The reconciliation is summed at the end of rate year Three (December 31, 2019) to determine whether any underspend is owed to customers. Under the City/State Construction Reconciliation, the Company is authorized to defer 90% of the revenue requirement impact difference (excluding operations and maintenance expense) between actual and forecast city/state construction costs for future recovery from or return to customers.

The Company's RDM was also adjusted to include revenue-per-class RDMs for industrial and commercial customers not previously subject to the RDM.

Each rate year, the Company will fully reconcile actual SIR expense (inclusive of Gowanus Canal and Newtown Creek costs) to the Forecast Rate Allowance. Any under or over expenditures will be deferred for future refund to or recovery from customers (with the exception of the Citizens site). The Company will continue to absorb 10% of the remaining investigation costs for the Citizens site.

The Company's environmental SIR expense has also been moved from a surcharge to base rates. Beginning in January 2018, to the extent that the difference between actual SIR expense and the Forecast Rate Allowance exceeds \$25 million on a cumulative basis, the Company will utilize its SIR Recovery Surcharge. The surcharge is designed to provide recovery for the differences between actual SIR expenses and the amounts allowed in rates and will be calculated annually and be limited to an amount no greater than 2% of the Company's prior year aggregate revenues. Differences over this threshold will be deferred for future recovery.

On April 30, 2019, the Company and KeySpan Gas East Corporation filed to increase revenues by \$236.8 million (19.3%) and \$49.4 million (6%), respectively, for the twelve months ending March 31, 2021 ("Rate Year"). The filings propose to invest over \$1.5 billion in the Rate Year to modernize the New York Gas Companies' gas infrastructure by replacing aging pipelines, implementing safety improvements, enhancing storm hardening and resiliency, and reducing methane emissions. The filings also include proposals to enhance gas safety and promote a sustainable and affordable path toward a low-carbon energy future. The New York Gas Companies included three additional years of data to facilitate the possibility of a multi-year rate settlement.

On July 12, 2019, the NYPSC initiated a proceeding requiring KEDNY and KEDLI to demonstrate why a penalty action should not be commenced for more than 1,600 alleged gas safety violations. The alleged violations concern the Commission's investigation of improper operator qualification and related issues following a 2016 anonymous letter alleging a contractor had facilitated employees cheating on operator qualification exams. The NYPSC also alleges violations for both Company employees and other contractors' workers whose qualifications had lapsed. The order directs KEDNY and KEDLI to respond within 45 days. KEDNY and KEDLI are assessing the allegations in the order. At this time, the Company is unable to determine the amount and probability of any potential penalty.

Tax Act

In response to the Tax Act, the NYPSC issued an Order Instituting Proceeding under Case 17-M-0815 - Proceeding on Motion of the Commission on Changes in Law that May Affect Rates. This proceeding was instituted to solicit comments on the Tax Act's implications and places the utilities on notice of the NYPSC's intent to protect ratepayers' interest and to ensure that any cost reductions from the changes in federal income taxes are deferred for future ratepayer benefit. On August 9, 2018, the NYPSC issued an order in its generic proceeding considering the impacts of federal tax reform. NYPSC Staff had advocated that all New York utilities implement a sur-credit by October 1st that would reflect the immediate effects of the Tax Act and also return any deferred benefits to customers. In response, the Company filed a proposal to (i) delay any sur-credit to January 1 to offset scheduled rate increases and (ii) retain any deferred benefits, including accumulated deferred federal income taxes ("ADFIT"), for future rate moderation.

The NYPSC's order effectively approved all aspects of the Company's proposal. The NYPSC agreed that the Company should be allowed to defer both the pass back of calendar year 2018 tax savings and the amortization of excess ADFIT balances, and use the benefits as a rate moderator when base rates are next revised in 2020/2021. Specifically the NYPSC approved the Company's proposal to implement a sur-credit to reflect the lower tax rate effective January 1, 2019 to offset planned rate increases and retain the calendar year 2018 deferred amounts for future rate mitigation and/or to offset investments. Deferring the tax benefits until January 1, 2019 results in a deferred balance of \$40 million.

Operations Staffing Audit

In January 2014, the NYPSC initiated an operational audit to review internal staffing levels and use of contractors for the core utility functions of the investor owned utilities operating in New York, including the Company. On June 26, 2014, the NYPSC selected a third party to conduct the audit. On February 21, 2017, the third party submitted its final report, which contained recommendations for all of National Grid's New York utilities designed to improve the staffing and workforce management processes. The report contained 27 recommendations for National Grid. The Company filed its implementation plan on March 23, 2017. On December 15, 2017, the NYPSC issued an Order approving the Company's implementation plan without modification, with updates to be made every four months to the NYPSC on the status of implementation. The Company submitted its most recent update on April 15, 2019.

New York Management Audit

In 2018, the NYPSC initiated a comprehensive management and operations audit of National Grid's three New York electric and gas utilities. New York law requires periodic management audits of all utilities at least once every five years. National Grid last underwent a New York management audit in 2014/2015, when the NYPSC audited our New York gas business. The audit will be process oriented and forward looking, and presents opportunities to obtain feedback on how to improve service to customers and meet regulatory expectations. Areas of focus will include the traditional audit areas of corporate governance, budgeting and finance, customer, work management, and long-term planning, as well as organization design, information systems, gas safety, and grid modernization. The final audit report is due in September 2019.

Update of Rates and Statement of Operating Conditions for Interstate Transportation Service

The Company is a so-called "Hinshaw Pipeline" in that it uses its distribution system to provide limited interstate transportation service. The Federal Energy Regulatory Commission ("FERC") rules and regulations require Hinshaw Pipelines to obtain a blanket certificate to sell or transport gas in interstate commerce at specific rates and to subsequently make new rate election filings in certain circumstances. The FERC regulations require the Company to make a new rate election if the state approved rate used for the Company's current rate election is changed to reflect the reduced income tax rates adopted in the Tax Act. On January 1, 2019, the New York Public Service Commission put in place rate adjustments for the Company to reflect its reduced tax costs because of the Tax Act. Accordingly, the Company was required to make a new rate election at FERC. On March 4, 2019, the Company filed with FERC tariff records to reflect revised rates in compliance with the above-referenced rules and regulations. On April 25, 2019, FERC approved the tariff filing made by the Company to update its rates and Statement of Operating conditions for the use of its distribution system to provide interstate transportation service.

6. PROPERTY, PLANT AND EQUIPMENT

The following table summarizes property, plant and equipment at cost along with accumulated depreciation and amortization:

	March 31,	
	2019	2018
	<i>(in thousands of dollars)</i>	
Plant and machinery	\$ 5,536,809	\$ 4,966,071
Land and buildings	213,596	201,857
Assets in construction	556,549	446,751
Software and other intangibles	129,617	126,085
Total property, plant and equipment	6,436,571	5,740,764
Accumulated depreciation and amortization	(1,187,798)	(1,131,116)
Property, plant and equipment, net	\$ 5,248,773	\$ 4,609,648

7. DERIVATIVE INSTRUMENTS

The Company utilizes derivative instruments to manage commodity price risk associated with its natural gas purchases. The Company's commodity risk management strategy is to reduce fluctuations in firm gas sales prices to its customers.

The Company's financial exposures are monitored and managed as an integral part of the Company's overall financial risk management policy. The Company engages in risk management activities only in commodities and financial markets where it has an exposure, and only in terms and volumes consistent with its core business.

The volume of outstanding gas derivative instruments at March 31, 2019 and March 31, 2018 was 45.1 million dekatherms and 41.4 million dekatherms, respectively

Derivative Financial Instruments

The following tables reflect the gross and net amounts of the Company's derivative assets and liabilities at March 31, 2019 and 2018:

March 31, 2019					
<i>(in thousands of dollars)</i>					
	Gross amounts of recognized assets (liabilities)	Gross amounts offset in the Balance Sheets	Net amounts of assets (liabilities) presented in the Balance Sheets	Gross amounts not offset in Balance Sheets	Net amount
	A	B	C=A+B	D	E=C-D
ASSETS:					
Current Assets					
Gas contracts	\$ 1,920	\$ -	\$ 1,920	\$ 686	\$ 1,234
Other non-current assets					
Gas contracts	25	-	25	-	25
Total	<u>1,945</u>	<u>-</u>	<u>1,945</u>	<u>686</u>	<u>1,259</u>
LIABILITIES:					
Current Liabilities					
Gas contracts	(9,998)	-	(9,998)	(1,027)	(8,971)
Total	<u>(9,998)</u>	<u>-</u>	<u>(9,998)</u>	<u>(1,027)</u>	<u>(8,971)</u>
Net liabilities	<u>\$ (8,053)</u>	<u>\$ -</u>	<u>\$ (8,053)</u>	<u>\$ (341)</u>	<u>\$ (7,712)</u>

March 31, 2018
(in thousands of dollars)

	Gross amounts of recognized assets (liabilities) A	Gross amounts offset in the Balance Sheets B	Net amounts of assets (liabilities) presented in the Balance Sheets C=A+B	Gross amounts not offset in Balance Sheets D	Net amount E=C-D
ASSETS:					
Current Assets					
Gas contracts	\$ 706	\$ -	\$ 706	\$ -	\$ 706
Total	<u>706</u>	<u>-</u>	<u>706</u>	<u>-</u>	<u>706</u>
LIABILITIES:					
Current Liabilities					
Gas contracts	(4,910)	-	(4,910)	(363)	(4,547)
Total	<u>(4,910)</u>	<u>-</u>	<u>(4,910)</u>	<u>(363)</u>	<u>(4,547)</u>
Net liabilities	<u>\$ (4,204)</u>	<u>\$ -</u>	<u>\$ (4,204)</u>	<u>\$ (363)</u>	<u>\$ (3,841)</u>

The Company enters into enabling agreements that allow for payment netting with its counterparties, which reduces its exposure to counterparty risk by providing for the offset of amounts payable to the counterparty against amounts receivable from the counterparty.

The changes in fair value of the Company's rate recoverable contracts are offset by changes in regulatory assets and liabilities. As a result, the changes in fair value of those contracts had no impact in the accompanying statements of income. All of the Company's derivative instruments are subject to rate recovery as of March 31, 2019 and 2018.

Credit and Collateral

The Company is exposed to credit risk related to transactions entered into for commodity price risk management. Credit risk represents the risk of loss due to counterparty non-performance. Credit risk is managed by assessing each counterparty's credit profile and negotiating appropriate levels of collateral and credit support.

The credit policy for commodity transactions is managed and monitored by the Finance Committee to National Grid plc's Board of Directors ("Finance Committee"), which is responsible for approving risk management policies and objectives for risk assessment, control and valuation, and the monitoring and reporting of risk exposures. NGUSA's Energy Procurement Risk Management Committee ("EPRMC") is responsible for approving transaction strategies, annual supply plans, and counterparty credit approval, as well as all valuation and control procedures. The EPRMC is chaired by the Vice President of U.S. Treasury and reports to both the NGUSA Board of Directors and the Finance Committee.

The EPRMC monitors counterparty credit exposure and appropriate measures are taken to bring such exposures below the limits, including, without limitation, netting agreements, and limitations on the type and tenor of trades. In instances where a counterparty's credit quality has declined, or credit exposure exceeds certain levels, the Company may limit its credit exposure by restricting new transactions with the counterparty, requiring additional collateral or credit support, and negotiating the early termination of certain agreements. Similarly, the Company may be required to post collateral to its counterparties.

The Company's credit exposure for all commodity derivative instruments, applicable payables and receivables, and instruments that are subject to master netting agreements, was a liability of \$7.7 million and \$2.9 million as of March 31, 2019 and 2018, respectively.

The aggregate fair value of the Company's commodity derivative instruments with credit-risk-related contingent features that were in a liability position at March 31, 2019 and 2018 was \$0.1 million and \$1.5 million, respectively. The Company had no collateral posted for these instruments at March 31, 2019 and 2018. At March 31, 2019, if the Company's credit rating were to be downgraded by one, two, or three levels, it would be required to post additional collateral to its counterparties of zero, zero, or \$0.3 million, respectively. At March 31, 2018, if the Company's credit rating had been downgraded by one, two, or three levels, it would have been required to post additional collateral to its counterparties of zero, zero, or \$1.8 million, respectively.

8. FAIR VALUE MEASUREMENTS

The following tables present assets and liabilities measured and recorded at fair value on the consolidated balance sheet on a recurring basis and their level within the fair value hierarchy as of March 31, 2019 and 2018:

	March 31, 2019			
	Level 1	Level 2	Level 3	Total
	<i>(in thousands of dollars)</i>			
Assets:				
Derivative instruments				
Gas contracts	\$ -	\$ 1,570	\$ 375	\$ 1,945
Total	-	1,570	375	1,945
Liabilities:				
Derivative instruments				
Gas contracts	-	9,775	223	9,998
Total	-	9,775	223	9,998
Net (liabilities) assets	\$ -	\$ (8,205)	\$ 152	\$ (8,053)
	March 31, 2018			
	Level 1	Level 2	Level 3	Total
	<i>(in thousands of dollars)</i>			
Assets:				
Derivative instruments				
Gas contracts	\$ -	\$ 658	\$ 48	\$ 706
Total	-	658	48	706
Liabilities:				
Derivative instruments				
Gas contracts	-	4,569	341	4,910
Total	-	4,569	341	4,910
Net liabilities	\$ -	\$ (3,911)	\$ (293)	\$ (4,204)

Derivative instruments: The Company's Level 2 fair value derivative instruments primarily consist of over-the-counter ("OTC") gas swap contracts and gas purchase contracts with pricing inputs obtained from the New York Mercantile Exchange and the Intercontinental Exchange ("ICE"), except in cases where the ICE publishes seasonal averages or where there were no transactions within the last seven days. The Company may utilize discounting based on quoted interest rate curves, including consideration of non-performance risk, and may include a liquidity reserve calculated based on bid/ask spread for the Company's Level 2 derivative instruments. 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 95% or higher.

The Company's Level 3 fair value derivative instruments primarily consist of OTC gas option contracts and gas purchase contracts, which are valued based on internally-developed models. Industry-standard valuation techniques, such as the Black-Scholes pricing model, Monte Carlo simulation, and Financial Engineering Associates libraries are used for valuing such instruments. For valuations that include both observable and unobservable inputs, if the unobservable input is determined to be significant to the overall inputs, the entire valuation is categorized in Level 3. This includes derivative instruments valued using indicative price quotations whose contract tenure extends into unobservable periods. In instances where observable data is unavailable, consideration is given to the assumptions that market participants would use in valuing the asset or liability. This includes assumptions about market risks such as liquidity, volatility, and contract duration. Such instruments are categorized in Level 3 as the model inputs generally are not observable. The Company considers non-performance risk and liquidity risk in the valuation of derivative instruments categorized in Level 2 and Level 3.

The significant unobservable inputs used in the fair value measurement of the Company's gas derivative instruments are implied volatility and gas forward curves. A relative change in commodity price at various locations underlying the open positions can result in significantly different fair value estimates.

9. EMPLOYEE BENEFITS

The Company participates with other NGUSA subsidiaries in qualified and non-qualified non-contributory defined benefit plans (the "Pension Plans") and PBOP plans (together with the Pension Plan (the "Plans")), covering substantially all employees.

Plan assets are maintained for all of NGUSA and its subsidiaries in commingled trusts. In respect of cost determination, plan assets are allocated to the Company based on its proportionate share of projected benefit obligation. The Plans' costs are first directly charged to the Company based on the Company's employees that participate in the Plans. Costs associated with affiliated service companies' employees are then allocated as part of the labor burden for work performed on the Company's behalf. The Company applies deferral accounting for pension and PBOP expenses associated with its regulated gas operations. Any differences between actual pension costs and amounts used to establish rates are deferred and collected from, or refunded to, customers in subsequent periods. Pension and PBOP service costs are included within operations and maintenance expense and non-service costs are included within other (deductions) income, net in the accompanying statements of income. Portions of the net periodic benefit costs disclosed below have been capitalized as a component of property, plant and equipment.

Pension Plans

The Qualified Pension Plans are defined benefit plans which provides union employees, as well as non-union employees hired before January 1, 2011, with a retirement benefit. Supplemental non-qualified, non-contributory executive retirement programs provide additional defined pension benefits for certain executives. During the years ended March 31, 2019 and 2018, the Company made contributions of approximately \$58.7 million and \$23.5 million, respectively, to the Qualified Pension Plans. The Company expects to contribute approximately \$36.2million to the Qualified Pension Plans during the year ending March 31, 2020.

Benefit payments to Pension Plan participants for the years ended March 31, 2019 and 2018 were approximately \$36.2 million and \$16.3 million, respectively.

PBOP Plans

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

ended March 31, 2019 and 2018, the Company made contributions of approximately zero and \$15.5 million, respectively, to the PBOP Plans. The Company does not expect to contribute to the PBOP Plans during the year ending March 31, 2020.

Benefit payments to PBOP plan participants for the years ended March 31, 2019 and 2018 were \$10.9 million and \$21.6 million, respectively.

Defined Contribution Plan

NGUSA has a defined contribution pension plan that covers substantially all employees. For the years ended March 31, 2019 and 2018, the Company recognized an expense in the accompanying statements of income of \$2.7 million and \$2.4 million, respectively, for matching contributions.

Net Periodic Benefit Costs

The Company's net periodic benefit pension cost for the years ended March 31, 2019 and 2018 were \$28.1 million and \$35.5 million, respectively.

The Company's net periodic benefit PBOP cost for the years ended March 31, 2019 and 2018 were \$3.3 million and \$6.1 million, respectively.

Amounts Recognized in Regulatory Assets/Liabilities

The following tables summarize the Company's changes in actuarial gains/losses and prior service costs recognized in regulatory assets/liabilities for the years ended March 31, 2019 and 2018:

	Pension Plans	
	Years Ended March 31,	
	2019	2018
	<i>(in thousands of dollars)</i>	
Net actuarial loss	\$ 17,944	\$ 12,883
Amortization of net actuarial loss	(30,761)	(34,579)
Amortization of prior service cost, net	(19)	(19)
Total	<u>\$ (12,836)</u>	<u>\$ (21,715)</u>
Included in regulatory assets	<u>\$ (12,836)</u>	<u>\$ (21,715)</u>
Total	<u>\$ (12,836)</u>	<u>\$ (21,715)</u>

	PBOP Plans	
	Years Ended March 31,	
	2019	2018
	<i>(in thousands of dollars)</i>	
Net actuarial loss (gain)	\$ 560	\$ (16,469)
Amortization of net actuarial loss	(4,497)	(5,977)
Amortization of prior service cost, net	(21)	(20)
Total	<u>\$ (3,958)</u>	<u>\$ (22,446)</u>
Included in regulatory liabilities	<u>\$ (3,958)</u>	<u>\$ (22,466)</u>
Total	<u>\$ (3,958)</u>	<u>\$ (22,466)</u>

Amounts Recognized in Regulatory Assets/Liabilities – not yet recognized as components of net actuarial loss

The following tables summarize the Company's amounts in regulatory assets/liabilities on the balance sheet that have not yet been recognized as components of net actuarial loss at March 31, 2019 and 2018:

	Pension Plans	
	At March 31,	
	2019	2018
	<i>(in thousands of dollars)</i>	
Net actuarial loss	\$ 100,101	\$ 112,918
Prior service cost	70	89
Total	<u>\$ 100,171</u>	<u>\$ 113,007</u>
Included in regulatory assets	<u>\$ 100,171</u>	<u>\$ 113,007</u>
Total	<u>\$ 100,171</u>	<u>\$ 113,007</u>

	PBOP Plans	
	At March 31,	
	2019	2018
	<i>(in thousands of dollars)</i>	
Net actuarial gain	\$ (5,007)	\$ (1,070)
Prior service benefit	(62)	(41)
Total	<u>\$ (5,069)</u>	<u>\$ (1,111)</u>
Included in regulatory liabilities	<u>\$ (5,069)</u>	<u>\$ (1,111)</u>
Total	<u>\$ (5,069)</u>	<u>\$ (1,111)</u>

The amount of net actuarial loss to be amortized from regulatory assets or liabilities during the year ending March 31, 2020 for the Pension Plans and PBOP Plans is \$19.9 million and \$2.0 million, respectively.

Amounts Recognized on the Balance Sheet

The following table summarizes the portion of the funded status above that is recognized on the Company's balance sheet at March 31, 2019 and 2018:

	Pension Plans		PBOP Plans	
	March 31,		March 31,	
	2019	2018	2019	2018
	<i>(in thousands of dollars)</i>			
Projected benefit obligation	\$ (803,183)	\$ (798,801)	\$ (273,837)	\$ (277,058)
Allocated fair value of plan assets	740,193	692,305	325,325	325,979
Total	<u>\$ (62,990)</u>	<u>\$ (106,496)</u>	<u>\$ 51,488</u>	<u>\$ 48,921</u>
Other non-current assets	\$ -	\$ -	\$ 51,488	\$ 48,921
Other non-current liabilities	(62,990)	(106,496)	-	-
Total	<u>\$ (62,990)</u>	<u>\$ (106,496)</u>	<u>\$ 51,488</u>	<u>\$ 48,921</u>

Expected Benefit Payments

Based on current assumptions, the following benefit payments are expected subsequent to March 31, 2019 in respect of the Company:

<i>(in thousands of dollars)</i>	Pension		PBOP	
	Plans		Plans	
Years Ended March 31,				
2020	\$	38,407	\$	10,269
2021		39,678		10,800
2022		41,158		11,300
2023		42,338		11,859
2024		43,581		12,332
2025-2029		231,363		66,238
Total	\$	<u>436,525</u>	\$	<u>122,798</u>

Assumptions Used for Employee Benefits Accounting

	Pension Plans	
	Years Ended March 31,	
	2019	2018
Benefit Obligations:		
Discount rate	4.10%	4.10%
Rate of compensation increase	3.50%	3.50%
Expected return on plan assets	6.50%	6.25%
Net Periodic Benefit Costs:		
Discount rate	4.10%	4.30%
Rate of compensation increase	3.50%	3.50%
Expected return on plan assets	6.25%	6.50%
	PBOP Plans	
	Years Ended March 31,	
	2019	2018
Benefit Obligations:		
Discount rate	4.10%	4.10%
Rate of compensation increase	n/a	n/a
Expected return on plan assets	6.50%-7.25%	6.25%-6.75%
Net Periodic Benefit Costs:		
Discount rate	4.10%	4.30%
Rate of compensation increase	n/a	n/a
Expected return on plan assets	6.25%-6.75%	6.50%-6.75%

The Company selects its discount rate assumption based upon rates of return on highly rated corporate bond yields in the marketplace as of each measurement date. Specifically, the Company uses the Hewitt AA Above Median Curve along with the expected future cash flows from the Company retirement plans to determine the weighted average discount rate assumption.

The expected 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 assumptions. A small premium is added for active management of both equity and fixed income securities. The rates of return for each asset class are then weighted in accordance with the actual asset allocation, resulting in a long-term return on asset rate for each plan.

Assumed Health Cost Trend Rate

	March 31,	
	2019	2018
Health care cost trend rate assumed for next year		
Pre 65	7.25%	7.50%
Post 65	5.75%	5.75%
Prescription	9.75%	10.25%
Rate to which the cost trend is assumed to decline (ultimate)	4.50%	4.50%
Year that rate reaches ultimate trend		
Pre 65	2028	2028
Post 65	2026	2026
Prescription	2027	2027

Plan Assets

NGUSA, as the Plans' sponsor, manages the 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 study which analyzes the Plans' liabilities and 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 market segments. Small investments are also approved for private equity, real estate, and infrastructure with the objective of enhancing long-term returns while improving portfolio diversification. For the PBOP Plans, 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 allocation study. Investment risk and return are reviewed by NGUSA's Investment Committee on a quarterly basis.

The Pension Plan is a trustee non-contributory defined benefit plan covering all eligible represented employees of the Company and eligible non-represented employees of the participating National Grid companies. The PBOP Plans are both a contributory and non-contributory, trustee, employee life insurance, and medical benefit plan sponsored by NGUSA. Life insurance and medical benefits are provided for eligible retirees, dependents, and surviving spouses of NGUSA.

The target asset allocations for the benefit plans as of March 31, 2019 and 2018 are as follows:

	Pension Plans		Union PBOP Plans		Non-Union PBOP Plans	
	March 31,		March 31,		March 31,	
	2019	2018	2019	2018	2019	2018
U.S. equities	20%	20%	34%	34%	45%	45%
Global equities (including U.S.)	7%	7%	12%	12%	0%	0%
Global tactical asset allocation	10%	10%	17%	17%	0%	0%
Non-U.S. equities	10%	10%	17%	17%	25%	25%
Fixed income securities	40%	40%	20%	20%	30%	30%
Private equity	5%	5%	0%	0%	0%	0%
Real estate	5%	5%	0%	0%	0%	0%
Infrastructure	3%	3%	0%	0%	0%	0%
	100%	100%	100%	100%	100%	100%

Fair Value Measurements

The following tables provide the fair value measurement amounts for the pension and PBOP assets at the Plan level:

	March 31, 2019				Total
	Level 1	Level 2	Level 3	Not categorized	
	<i>(in thousands of dollars)</i>				
Pension Assets:					
Cash and cash equivalents	\$ -	\$ 4,505	\$ -	\$ 71,620	\$ 76,125
Accounts receivable	142,262	-	-	-	142,262
Accounts payable	(251,231)	-	-	-	(251,231)
Equity	376,893	-	-	1,298,495	1,675,388
Fixed income securities	-	1,230,062	-	671,615	1,901,677
Preferred securities	-	11,302	-	-	11,302
Private equity	-	-	-	299,528	299,528
Real estate	-	-	-	219,668	219,668
Other	124,129	367	-	324,661	449,157
Total	<u>\$ 392,053</u>	<u>\$ 1,246,236</u>	<u>\$ -</u>	<u>\$ 2,885,587</u>	<u>\$ 4,523,876</u>
PBOP Assets:					
Cash and cash equivalents	\$ 18,938	\$ -	\$ -	\$ -	\$ 18,938
Accounts receivable	3,922	-	-	-	3,922
Accounts payable	(1)	-	-	-	(1)
Equity	170,220	-	-	532,528	702,748
Fixed income securities	3,246	227,196	-	-	230,442
Private equity	-	-	-	700	700
Other	89,751	-	-	236,443	326,194
Total	<u>\$ 286,076</u>	<u>\$ 227,196</u>	<u>\$ -</u>	<u>\$ 769,671</u>	<u>\$ 1,282,943</u>

	March 31, 2018				
	Level 1	Level 2	Level 3	Not categorized	Total
	<i>(in thousands of dollars)</i>				
Pension Assets:					
Cash and cash equivalents	\$ 1,331	\$ 20,844	\$ -	\$ 72,420	\$ 94,595
Accounts receivable	196,817	-	-	-	196,817
Accounts payable	(298,572)	-	-	-	(298,572)
Equity	582,386	-	-	1,238,311	1,820,697
Fixed income securities	149	1,093,506	-	637,665	1,731,320
Preferred securities	-	11,725	-	-	11,725
Private equity	-	-	-	260,209	260,209
Real estate	-	-	-	208,488	208,488
Other	2,370	-	-	303,504	305,874
Total	<u>\$ 484,481</u>	<u>\$ 1,126,075</u>	<u>\$ -</u>	<u>\$ 2,720,597</u>	<u>\$ 4,331,153</u>
PBOP Assets:					
Cash and cash equivalents	\$ 15,390	\$ 6	\$ -	\$ 22	\$ 15,418
Accounts receivable	1,733	-	-	-	1,733
Accounts payable	(136)	-	-	-	(136)
Equity	241,131	-	-	536,938	778,069
Fixed income securities	6,428	236,732	-	192	243,352
Preferred securities	-	4	-	-	4
Private equity	-	-	-	4,310	4,310
Real Estate	-	-	-	63	63
Other	35,738	-	-	229,677	265,415
Total	<u>\$ 300,284</u>	<u>\$ 236,742</u>	<u>\$ -</u>	<u>\$ 771,202</u>	<u>\$ 1,308,228</u>

The methods used to fair value pension and PBOP assets are described below:

Cash and cash equivalents: Cash and cash equivalents that can be priced daily are classified as Level 1. Active reserve funds, reserve deposits, commercial paper, repurchase agreements, and commingled cash equivalents are classified as Level 2. Cash and cash equivalents invested in commingled money market investment funds which have Net Asset Value (“NAV”) pricing per fund share are excluded from the fair value hierarchy.

Accounts receivable and accounts payable: Accounts receivable and accounts payable are classified as Level 1. Such amounts are short-term and settle within a few days of the measurement date.

Equity and preferred securities: Common stocks, preferred stocks, and real estate investment trusts are valued using the official close of the primary market on which the individual securities are traded. Equity securities are primarily comprised of securities issued by public companies in domestic and foreign markets plus investments in commingled funds, which are valued on a daily basis. If the Company can exchange shares of the publicly traded securities and the fair values are primarily sourced from the closing prices on stock exchanges where there is active trading, the securities are classified as Level 1 investments. If there is less active trading, then the publicly traded securities would typically be priced using observable data, such as bid and ask prices, and these measurements are classified as Level 2 investments. Mutual funds with publicly quoted prices and active trading are classified as Level 1 investments. For investments in commingled funds that are not publicly traded and have ongoing subscription and redemption activity, the fair value of the investment is the NAV as a practical expedient per fund share, derived from the underlying securities’ quoted prices in active markets. These investments are excluded from the fair value hierarchy.

Fixed income securities: Fixed income securities (which include corporate debt securities, municipal fixed income securities, U.S. Government and Government agency securities including government mortgage backed securities, index linked government bonds, and state and local bonds), convertible securities, and investments in securities lending collateral (which include repurchase agreements, asset backed securities, floating rate notes and time deposits) are valued with an institutional bid valuation. A bid valuation is an estimated price 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 when primary vendors do not supply prices. Fixed income investments are primarily comprised of fixed income securities and fixed income commingled funds. The prices for direct investments in fixed income securities are generated on a daily basis. Prices generated from less active trading with wider bid ask prices are classified as Level 2 investments. Mutual funds with publicly quoted prices and active trading are classified as Level 1 investments. For commingled funds that are not publicly traded and have ongoing subscription and redemption activity, the fair value of the investment is the NAV a practical expedient per fund share. These investments are excluded from the fair value hierarchy.

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 (NAV, as a practical expedient, per fund share) based on proprietary models, or based on the NAV. Investments in private equity and real estate funds are primarily invested in privately held real estate investment properties, trusts, and partnerships as well as equity and debt issued by public or private companies. The Company's interest in a fund or partnership is estimated based on the NAV. The Company's interest in these funds cannot be readily redeemed due to the inherent lack of liquidity and the primarily long-term nature of the underlying assets. Distribution is made through the liquidation of the underlying assets. The Company views these investments as part of a long-term investment strategy. These investments are valued by each investment manager based on the underlying assets. The funds utilize valuation techniques consistent with the market, income, and cost approaches to measure the fair value of certain real estate investments. The majority of the underlying assets are valued using significant unobservable inputs and often require significant management judgment or estimation based on the best available information. Market data includes observations of the trading multiples of public companies considered comparable to the private companies being valued. Investments in limited partnerships with redemption restrictions and that use NAV are excluded from the fair value hierarchy.

While management believes its valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the NAV as a practical expedient could result in a different fair value measurement at the reporting date.

10. CAPITALIZATION

The aggregate maturities of long-term debt for the years subsequent to March 31, 2019 are as follows:

<i>(in thousands of dollars)</i>	
<u>Years Ending March 31,</u>	
2020	\$ -
2021	-
2022	-
2023	-
2024	-
Thereafter	<u>2,650,000</u>
Total	<u>\$ 2,650,000</u>

The Company's debt agreements and banking facilities contain covenants, including those relating to the periodic and timely provision of financial information by the issuing entity. Failure to comply with these covenants, or to obtain waivers of those requirements, could in some cases trigger a right, at the lender's discretion, to require repayment of some of the Company's debt and may restrict the Company's ability to draw upon its facilities or access the capital markets. During the years ended March 31, 2019 and 2018, the Company was in compliance with all such covenants.

Debt Authorizations

On February 8, 2019 the NYPSC authorized the Company to issue up to \$1.4 billion of long-term debt in one or more transactions through March 31, 2022. Under the authorization, on February 27, 2019, the Company issued \$550 million of unsecured senior long-term debt at a fixed rate of 3.87% with a maturity date of March 4, 2029 and \$450 million of unsecured senior long-term debt at a fixed rate of 4.49% with a maturity date of March 4, 2049.

Under previous authorization, in March 2018, the Company issued \$650 million of unsecured debt at 4.27% with a maturity date of March 15, 2048.

Dividend Restrictions

Pursuant to the NYPSC's orders, the ability of the Company to pay dividends to NGUSA is conditioned upon maintenance of a utility capital structure with debt not exceeding 56% of total utility capitalization. At March 31, 2019 and 2018, the Company was in compliance with the utility capital structure required by the NYPSC. In accordance with the NYPSC order approving the acquisition of KeySpan, the Company is permitted to declare dividends in an amount not to exceed retained earnings accumulated since the date of acquisition plus unappropriated retained earnings, unappropriated undistributed earnings and accumulated other comprehensive income existing immediately prior to the date of acquisition.

Preferred Stock

In connection with the acquisition of KeySpan by NGUSA, the Company became subject to a requirement to issue a class of preferred stock, having one share (the "Golden Share"), subordinate to any existing preferred stock. The holder of the Golden Share 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 the Golden Share. The NYPSC subsequently authorized the issuance of the Golden Share to a trustee, GSS Holdings, Inc. ("GSS"), who will hold the Golden Share subject to a Services and Indemnity Agreement requiring GSS to vote the Golden Share in the best interests of New York State ("NYS"). On July 8, 2011, the Company issued the Golden Share with a par value of \$1.

Capital Contribution From Parent

On March 28, 2019, the Company received a capital contribution of \$500 million from NGUSA. This contribution was made in order to achieve the agreed upon capital structure of 48% equity and 52% debt as set forth in the Joint Proposal (as discussed in Note 5, "Rate Matters" under "Rate Case Filing").

11. INCOME TAXES

Components of Income Tax Expense

	Years Ended March 31,	
	2019	2018
	<i>(in thousands of dollars)</i>	
Current tax expense (benefit):		
Federal	\$ (9,535)	\$ 67
State	(24,646)	3,427
Total current tax expense (benefit)	<u>(34,181)</u>	<u>3,494</u>
Deferred tax expense (benefit):		
Federal	42,043	9,211
State	32,856	974
Total deferred tax expense (benefit)	<u>74,899</u>	<u>10,185</u>
Amortized investment tax credits ⁽¹⁾	<u>(171)</u>	<u>(911)</u>
Total deferred tax expense (benefit)	<u>74,728</u>	<u>9,274</u>
Total income tax expense	<u>\$ 40,547</u>	<u>\$ 12,768</u>

(1) Investment tax credits ("ITC") are accounted for using the deferral and gross up method of accounting and amortized over the depreciable life of the property giving rise to the credits.

Statutory Rate Reconciliation

The Company's effective tax rates for the years ended March 31, 2019 and 2018 are 27.5% and 20.9%, respectively. The following table presents a reconciliation of income tax expense at the federal statutory tax rate of 21.0% and 31.55%, respectively, to the actual tax expense:

	Years Ended March 31,	
	2019	2018
	<i>(in thousands of dollars)</i>	
Computed tax	\$ 31,016	\$ 19,318
Change in computed taxes resulting from:		
Audit and related reserve movements	3,843	-
Federal rate change		(5,731)
State income tax, net of federal benefit	6,486	3,013
Other items, net	<u>(798)</u>	<u>(3,832)</u>
Total changes	<u>9,531</u>	<u>(6,550)</u>
Total income tax expenses	<u>\$ 40,547</u>	<u>\$ 12,768</u>

The Company is included in the NGNA and subsidiaries consolidated federal income tax return and New York unitary state income tax return. The Company has joint and several liability for any potential assessments against the consolidated group.

On December 22, 2017, the Tax Act was signed into law. The Tax Act includes significant changes to various federal tax provisions applicable to the Company, including provisions specific to regulated public utilities. The most significant changes include the reduction in the corporate federal income tax rate from 35.0% to 21.0% effective January 1, 2018, the elimination of bonus depreciation for certain property acquired or placed in service after September 27, 2017 and extension of the normalization requirements for ratemaking treatment of excess deferred taxes.

On August 3, 2018, the Internal Revenue Service ("IRS") and the U.S. Department of Treasury released proposed regulations associated with the bonus depreciation rules enacted as part of the Tax Act. The proposed regulations would enable utilities to claim additional bonus depreciation on property acquired and placed in service between September 28, 2017 and March 31, 2018. The Company adopted the guidance in the proposed regulations and claimed the additional six months of bonus depreciation on its fiscal year 2018 Federal income tax return.

In accordance with ASC 740, "Income Taxes," the effect of changes in tax law are required to be recognized in the period of enactment, which for the Company was the period ended March 31, 2018. Since the Company's fiscal year end is March 31, the statutory rate applicable for the Company's fiscal year ended March 31, 2018, was a blended tax rate of 31.55%. For the fiscal year ended March 31, 2019 and future period, the federal income tax rate is 21.0%. In addition, ASC 740 requires deferred income tax assets and liabilities to be measured at the enacted tax rate expected to apply when temporary differences are to be realized or settled. As a result, the Company remeasured its federal deferred income tax assets and liabilities using the newly enacted tax rate of 21.0%.

On December 22, 2017, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") 118, which provides guidance on accounting for the effects of the Tax Act. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date to complete the accounting under ASC 740, "Income Taxes". To the extent that a company's accounting for certain income tax effects of the Tax Act is incomplete, a company can determine a reasonable estimate for those effects and record a provisional estimate in the financial statements. As of March 31, 2019, any and all provisional amounts previously recorded in accordance with SAB 118 have been adjusted to reflect their final amounts.

As of March 31, 2018, the remeasurement amounted to a decrease in net deferred income tax liability of \$326.5 million of which \$5.7 million was recorded to deferred income tax benefit and \$320.8 million recorded as a regulatory liability for the refund of excess accumulated deferred income taxes to the ratepayers ("excess ADIT"). During the current period, the Company adjusted the remeasurement of the net deferred income tax liability by \$0.2 million, which was recorded as a decrease to a regulatory liability for excess ADIT. As of March 31, 2019, the regulatory liability for excess ADIT on a pre-tax basis prior to amortization amounted to \$442.8 million (\$321.0 million post-tax.)

Deferred Tax Components

	March 31,	
	2019	2018
	<i>(in thousands of dollars)</i>	
Deferred tax assets:		
Environmental remediation costs	\$ 387,267	\$ 372,136
Future federal benefit on state taxes	33,715	26,834
Net operating losses	99,169	47,446
Regulatory tax liabilities	126,643	127,138
Regulatory liabilities - other	166,598	109,163
Other items	45,543	79,746
Total deferred tax assets	<u>858,935</u>	<u>762,463</u>
Deferred tax liabilities:		
Property related differences	874,076	740,258
Regulatory assets - environmental response costs	428,704	424,119
Regulatory assets - other	146,938	113,097
Other items	11,425	11,102
Total deferred tax liabilities	<u>1,461,143</u>	<u>1,288,576</u>
Net deferred income tax liabilities	602,208	526,113
Deferred investment tax credits	-	171
Deferred income tax liabilities, net	<u>\$ 602,208</u>	<u>\$ 526,284</u>

Net Operating Losses

The amounts and expiration dates of the Company's net operating losses carryforward as of March 31, 2019 are as follows:

	Carryforward Amount	Expiration Period
	<i>(in thousands of dollars)</i>	
Federal	\$ 555,041	2033-2038
NYS	207,537	2035-2037

As a result of the accounting for uncertain tax positions, the amount of deferred tax assets reflected in the financial statements is less than the amount of the tax effect of the federal net operating loss carryforwards reflected on the income tax returns.

The Company recognizes interest related to unrecognized tax benefits in other interest, including affiliate interest and related penalties, if applicable, in other deductions, net in the accompanying consolidated statements of income. As of March 31, 2019, and 2018, the Company has accrued for interest related to unrecognized tax benefits of \$12.4 million and \$9.2 million, respectively. During the years ended March 31, 2019 and 2018, the Company recorded interest expense of \$3.2 million and \$3.1 million, respectively. No tax penalties were recognized during the years ended March 31, 2019 and 2018.

It is reasonably possible that other events will occur during the next twelve months that would cause the total amount of unrecognized tax benefits to increase or decrease. However, the Company does not believe any such increases or decreases would be material to its results of operations, financial position, or cash flows.

During the year ended March 31, 2019, the Company reached a settlement with the Internal Revenue Service for the tax years ended August 24, 2007, March 31, 2008 and March 31, 2009. The outcome of the settlement did not have a material impact to the Company's results of operations, financial position, or cash flows. The IRS continues its examination of the next cycle which includes the income tax returns for the years ended March 31, 2010 through March 31, 2012. The examination is expected to conclude in the next fiscal year and result in a settlement agreement with the IRS. The Company does not anticipate the settlement to have a material impact on the Company's financial position. As a result of the settlement with the IRS a refund of \$12.4 million is expected to be received within the next 12 months. The income tax returns for the years ended March 31, 2013 through March 31, 2019 remain subject to examination by the IRS.

The state of New York began the examination of the Company's New York State income tax returns for the years ended March 31, 2009 through March 31, 2012. The income tax returns for the years ended March 31, 2013 through March 31, 2019 remain subject to examination by the state of New York.

The following table indicates the earliest tax year subject to examination for each major jurisdiction:

Jurisdiction	Tax Year
Federal	March 31, 2010
New York	March 31, 2009

12. ENVIRONMENTAL MATTERS

The normal ongoing operations and historic activities of the Company are subject to various federal, state, and local environmental laws and regulations. Under federal and state Superfund laws, potential liability for the historic contamination of property may be imposed on responsible parties jointly and severally, without regard to fault, even if the activities were lawful when they occurred.

The Company has identified numerous MGP sites and related facilities, which were owned or operated by the Company or its predecessors. These former sites, some of which are no longer owned by the Company, have been identified to the NYPSC and the New York State Department of Environmental Conservation (“DEC”) for inclusion on appropriate site inventories. Administrative Orders on Consent or Voluntary Cleanup Agreements have been executed with the DEC to address the investigation and remediation activities associated with certain sites. Expenditures incurred for the years ended March 31, 2019 and 2018 were \$27.9 million and \$45.5 million, respectively.

The Company estimated the remaining costs of environmental remediation activities were \$1.3 billion at March 31, 2019 and 2018. These costs are expected to be incurred over approximately 44 years, and these undiscounted amounts have been recorded as estimated liabilities on the balance sheet. However, remediation costs for each site may be materially higher than estimated, depending on changing technologies and regulatory standards, selected end use for each site, and actual environmental conditions encountered. The Company has recovered amounts from certain insurers and potentially responsible parties, and, where appropriate, the Company may seek additional recovery from other insurers and from other potentially responsible parties, but it is uncertain whether, and to what extent, such efforts will be successful.

By rate orders, the NYPSC has provided for the recovery of SIR costs. Accordingly, as of March 31, 2019 and 2018, the Company has recorded net environmental regulatory assets of \$1.5 billion and \$1.4 billion, respectively.

The Company believes that its ongoing operations, and its approach to addressing conditions at historic sites, are in substantial compliance with all applicable environmental laws. Where the Company has regulatory recovery, it believes that the obligations imposed on it because of the environmental laws will not have a material impact on its results of operations or financial position.

13. COMMITMENTS AND CONTINGENCIES

Operating Lease Obligations

The Company has various operating leases relating to office space. Total rental expense for operating leases, net of amounts allocated to other affiliated entities, included in operations and maintenance expense in the accompanying statements of income was \$5.7 million and \$5.0 million, for the years ended March 31, 2019 and 2018, respectively.

The future minimum lease payments for the years subsequent to March 31, 2019 are as follows:

<i>(in thousands of dollars)</i>	
<u>Years Ending March 31,</u>	
2020	\$ 11,086
2021	11,124
2022	10,989
2023	10,943
2024	10,939
Thereafter	<u>10,028</u>
Total	<u>\$ 65,109</u>

Purchase Commitments

The Company has entered into various contracts for gas delivery, storage, and supply services. Certain of these contracts require payment of annual demand charges, which are recoverable from customers. The Company is liable for these payments regardless of the level of service required from third parties.

The Company's commitments under these long-term contracts for the years subsequent to March 31, 2019 are summarized in the table below:

<i>(in thousands of dollars)</i>	
<u>Years Ending March 31,</u>	
	Gas
	<u>Purchases</u>
2020	\$ 224,984
2021	214,696
2022	194,947
2023	136,272
2024	101,048
Thereafter	<u>633,813</u>
Total	<u>\$ 1,505,760</u>

Legal Matters

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

Other Contingencies

At March 31, 2019 and 2018, the Company had accrued workers compensation, auto, and general insurance claims which have been incurred but not yet reported ("IBNR") of \$15.0 million and \$10.6 million, respectively. IBNR reserves have been established for claims and/or events that have transpired, but have not yet been reported to the Company for payment.

14. RELATED PARTY TRANSACTIONS

Accounts Receivable from and Accounts Payable to Affiliates

NGUSA and its affiliates provide various services to the Company, including executive and administrative, customer services, financial (including accounting, auditing, risk management, tax, and treasury/finance), human resources, information technology, legal, and strategic planning, that are charged between the companies and charged to each company.

The Company records short-term receivables from, and payables to, certain of its affiliates in the ordinary course of business. The amounts receivable from, and payable to, its affiliates do not bear interest and are settled through the intercompany money pool. A summary of outstanding accounts receivable from affiliates and accounts payable to affiliates is as follows:

	Accounts Receivable from Affiliates		Accounts Payable to Affiliates	
	March 31,		March 31,	
	2019	2018	2019	2018
	<i>(in thousands of dollars)</i>			
KeySpan Corporation	\$ -	\$ 2,392	\$ -	\$ 70,249
KeySpan Gas East Corporation	1,610	-	1,147	9,356
National Grid Electric Services	-	418	159	1,519
National Grid Engineering Services, LLC	64	1,785	194	148
NGUSA	886	968	62,714	2,793
NGUSA Service Company	8,560	1,820	30,659	32,427
Other	472	182	530	213
Total	<u>\$ 11,592</u>	<u>\$ 7,565</u>	<u>\$ 95,403</u>	<u>\$ 116,705</u>

Intercompany Money Pool

The settlement of the Company's various transactions with NGUSA and certain affiliates generally occurs via the intercompany money pool in which it participates. The Company is a participant in the Regulated Money Pool, except for NETCO, which participates in the Unregulated Money Pool, and can both borrow and invest funds. Borrowings from the Regulated Money and Unregulated Money Pools bear interest in accordance with the terms of the Regulated and Unregulated Money Pool Agreements. As the Company fully participates in the Regulated and Unregulated Money Pools rather than settling intercompany charges with cash, all changes in the intercompany money pool balance are reflected as investing or financing activities in the accompanying consolidated statements of cash flows. For the purpose of presentation in the statements of cash flows, it is assumed all amounts settled through the intercompany money pool are constructive cash receipts and payments, and therefore are presented as such.

The Regulated and Unregulated Money Pools are funded by operating funds from participants in the applicable pool. NGUSA has the ability to borrow up to \$3 billion from National Grid plc for working capital needs including funding of the Money Pools, if necessary. The Company had short-term intercompany money pool investment of \$617.2 million and short-term intercompany money pool borrowing of \$401.5 million at March 31, 2019 and 2018, respectively. NETCO had short-term intercompany money pool investments of \$263.7 million and \$304.1 million at March 31, 2019 and 2018, respectively. The average interest rates for the intercompany money pool were 2.4% and 1.6% for the years ended March 31, 2019 and 2018, respectively.

Service Company Charges

The affiliated service companies of NGUSA provide certain services to the Company at their cost. The service company costs are generally allocated to associated companies through a tiered approach. First and foremost, costs are directly charged to the benefited company whenever practicable. Secondly, in cases where direct charging cannot be readily determined, costs are allocated using cost/causation principles linked to the relationship of that type of service, such as number of employees, number of customers/meters, capital expenditures, value of property owned, and total transmission and distribution expenditures. Lastly, all other costs are allocated based on a general allocator determined using a 3-point formula based on net margin, net property, plant and equipment, and operations and maintenance expense.

Charges from the service companies of NGUSA to the Company, are mostly related to traditional administrative support functions, of which for the years ended March 31, 2019 and 2018 were \$404.3 million and \$376.3 million, respectively.