nationalgrid

Brooklyn Union Gas Company
d/b/a National Grid New York

Consolidated Financial Statements

For the years ended March 31, 2017, 2016, and 2015

BROOKLYN UNION GAS COMPANY

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Report of Independent Auditors

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, which comprise the consolidated balance sheets and statements of capitalization as of March 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, cash flows, and changes in shareholders' equity for each of the three years in the period ended March 31, 2017.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the 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 the 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 our 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, we consider 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 as of March 31, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2017 in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

August 18, 2017

BROOKLYN UNION GAS COMPANY
CONSOLIDATED STATEMENTS OF INCOME

(in thousands of dollars)

	Years Ended March 31,		
	2017	2016	2015
Operating revenues	**$ 1,465,860**	$ 1,317,700	$ 1,519,052
Operating expenses:			
Purchased gas	**482,604**	373,853	598,698
Operations and maintenance	**527,448**	506,224	438,784
Depreciation	**96,525**	95,861	91,544
Other taxes	**207,374**	199,615	190,192
Total operating expenses	**1,313,951**	1,175,553	1,319,218
Operating income	**151,909**	142,147	199,834
Other income and (deductions):			
Interest on long-term debt	**(60,168)**	(51,218)	(48,918)
Other interest, including affiliate interest	**(1,134)**	(4,084)	1,020
Income from equity investments	**-**	8,072	16,995
Gain on sale of assets	**-**	70,253	-
Unrealized gains on investment in Dominion Midstream Partners, LP	**13,973**	50,470	-
Other income (deductions), net	**14,146**	4,274	(4,313)
Total other (deductions) income, net	**(33,183)**	77,767	(35,216)
Income before income taxes	**118,726**	219,914	164,618
Income tax expense	**42,439**	89,200	66,574
Net income	**$ 76,287**	$ 130,714	$ 98,044

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

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

	Years Ended March 31,		
	2017	2016	2015
Net income	**$ 76,287**	$ 130,714	$ 98,044
Other comprehensive income (loss), net of taxes:			
Unrealized gains (losses) on securities from equity investments	**106**	91	(85)
Total other comprehensive income (loss)	**106**	91	(85)
Comprehensive income	**$ 76,393**	$ 130,805	$ 97,959
Related tax (expense) benefit:			
Unrealized losses (gains) on securities from equity investments	**$ 169**	$ (62)	$ 59
Total tax benefit (expense)	**$ 169**	$ (62)	$ 59

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,		
	2017	2016	2015
Operating activities:			
Net income	**$ 76,287**	$ 130,714	$ 98,044
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	**96,525**	95,861	91,544
Regulatory amortizations	**58,654**	53,903	38,867
Provision for deferred income taxes	**42,430**	73,642	52,677
Bad debt expense	**13,511**	21,779	8,526
Loss from equity investments, net of dividends received	**-**	1,660	4,345
Gain on sale of assets	**-**	(70,253)	-
Unrealized gains on investment in Dominion Midstream Partners, LP	**(13,973)**	(50,470)	-
Amortization of debt discount and issuance costs	**1,872**	1,855	2,249
Net postretirement benefits (contributions) expense	**(1,955)**	15,049	16,339
Environmental remediation payments	**(53,844)**	(45,932)	(42,577)
Changes in operating assets and liabilities:			
Accounts receivable, net, and unbilled revenues	**(92,518)**	97,722	106,451
Inventory	**18,408**	(21,104)	(5,819)
Regulatory assets and liabilities, net	**27,426**	(36,214)	(549)
Derivative instruments	**3,193**	(8,787)	7,019
Prepaid and accrued taxes	**(43,577)**	5,240	(11,835)
Accounts payable and other liabilities	**49,048**	12,753	(5,562)
Other, net	**(26,310)**	(5,847)	4,497
Net cash provided by operating activities	**155,177**	271,571	364,216
Investing activities:			
Capital expenditures	**(469,493)**	(441,352)	(348,694)
Affiliated money pool investing and receivables/payables, net	**340,015**	(356,843)	(38,059)
Cost of removal	**(40,659)**	(24,752)	(20,676)
Insurance proceeds applied to capital expenditures	**-**	-	1,418
Other	**(146)**	(394)	3,379
Net cash used in investing activities	**(170,283)**	(823,341)	(402,632)
Financing activities:			
Payments on long-term debt	**(810,500)**	-	-
Proceeds from long-term debt	**-**	994,269	-
Affiliated money pool borrowing and receivables/payables, net	**468,552**	(447,912)	(2,115)
Equity infusion from Parent	**350,000**	-	-
Parent loss tax allocation	**8,296**	5,818	17,461
Net cash provided by financing activities	**16,348**	552,175	15,346
Net increase (decrease) in cash and cash equivalents	**1,242**	405	(23,070)
Cash and cash equivalents, beginning of year	**4,234**	3,829	26,899
Cash and cash equivalents, end of year	**$ 5,476**	$ 4,234	$ 3,829
Supplemental disclosures:			
Interest paid	**$ (70,011)**	(49,156)	(48,631)
Income taxes refunded (paid)	**7,056**	(3,790)	2,505
Significant non-cash items:			
Capital-related accruals included in accounts payable	**25,878**	44,494	27,910

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

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

	March 31,	
	2017	2016
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 5,476**	$ 4,234
Accounts receivable	**343,166**	305,287
Allowance for doubtful accounts	**(31,830)**	(37,252)
Accounts receivable from affiliates	**1,847**	1,768
Intercompany money pool	**134,957**	581,265
Unbilled revenues	**97,029**	61,323
Inventory	**63,888**	82,296
Regulatory assets	**21,716**	18,644
Derivative instruments	**3,967**	3,518
Prepaid taxes	**43,858**	34,591
Other	**7,614**	7,390
Total current assets	**691,688**	1,063,064
Property, plant and equipment, net	**3,989,669**	3,601,891
Other non-current assets:		
Regulatory assets	**1,915,783**	1,272,522
Goodwill	**1,451,141**	1,451,141
Financial investments	**206,155**	192,076
Other	**34,993**	16,988
Total other non-current assets	**3,608,072**	2,932,727
Total assets	**$ 8,289,429**	$ 7,597,682

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

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

	March 31,	
	2017	2016
LIABILITIES AND CAPITALIZATION		
Current liabilities:		
Accounts payable	**$ 129,966**	$ 138,249
Accounts payable to affiliates	**175,752**	115,242
Current portion of long-term debt	**-**	810,500
Taxes accrued	**5,861**	16,181
Customer deposits	**25,032**	26,798
Interest accrued	**2,513**	13,309
Regulatory liabilities	**115,114**	64,289
Intercompany money pool	**301,828**	-
Derivative instruments	**4,446**	3,715
Other	**21,369**	17,233
Total current liabilities	**781,881**	1,205,516
Other non-current liabilities:		
Regulatory liabilities	**426,116**	409,632
Asset retirement obligations	**14,777**	14,145
Deferred income tax liabilities, net	**957,682**	899,908
Postretirement benefits	**100,913**	222,320
Environmental remediation costs	**1,276,398**	567,370
Derivative instruments	**2,911**	-
Other	**96,923**	85,367
Total other non-current liabilities	**2,875,720**	2,198,742
Commitments and contingencies (Note 12)		
Capitalization:		
Shareholders' equity	**3,409,810**	2,975,121
Long-term debt	**1,222,018**	1,218,303
Total capitalization	**4,631,828**	4,193,424
Total liabilities and capitalization	**$ 8,289,429**	$ 7,597,682

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

BROOKLYN UNION GAS COMPANY
CONSOLIDATED STATEMENTS OF CAPITALIZATION

(in thousands of dollars)

			March 31,	
			2017	2016
Total shareholders' equity			**$ 3,409,810**	$ 2,975,121
Long-term debt:	Interest Rate	Maturity Date		
Unsecured Notes:				
Senior Note	5.60%	November 29, 2016	**-**	400,000
Senior Note	3.41%	March 10, 2026	**500,000**	500,000
Senior Note	4.50%	March 10, 2046	**500,000**	500,000
Gas Facilities Revenue Bonds:				
1993A and 1993B[1]	6.37%	April 1, 2020	**-**	75,000
1997	Variable	December 1, 2020	**125,000**	125,000
1996[1]	5.50%	January 1, 2021	**-**	153,500
2005A[1]	4.70%	February 1, 2024	**-**	82,000
2005B	Variable	June 1, 2025	**55,000**	55,000
1991A and 1991B[1]	6.95%	July 1, 2026	**-**	100,000
1991D	Variable	July 1, 2026	**50,000**	50,000
Total debt			**1,230,000**	2,040,500
Unamortized debt issuance costs			**(7,982)**	(11,697)
Current portion of long-term debt			**-**	810,500
Long-term debt			**1,222,018**	1,218,303
Total capitalization			**$ 4,631,828**	$ 4,193,424

[1] During March 2016, the Company issued Notice of Optional Redemption letters to the bond holders of the fixed interest rate gas facilities revenue bonds. The Company fully repaid these bonds during April 2016 and hence classified these bonds within current portion of long-term debt at March 31, 2016.

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

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

				Accumulated Other Comprehensive (Loss) Income			
	Common Stock	Cumulative Preferred Stock	Additional Paid-in Capital	Equity Investments	Total Accumulated Other Comprehensive (Loss) Income	Retained Earnings	Total
Balance as of March 31, 2014	**$ -**	**$ -**	**$ 2,614,795**	**$ (112)**	**$ (112)**	**$ 108,395**	**$ 2,723,078**
Net income	-	-	-	-	-	98,044	98,044
Other comprehensive loss:							
Unrealized losses on securities from equity investments, net of $59 tax benefit	-	-	-	(85)	(85)	-	(85)
Total comprehensive income							97,959
Parent loss tax allocation	-	-	17,461	-	-	-	17,461
Balance as of March 31, 2015	**$ -**	**$ -**	**$ 2,632,256**	**$ (197)**	**$ (197)**	**$ 206,439**	**$ 2,838,498**
Net income	-	-	-		-	130,714	130,714
Other comprehensive income:							
Unrealized gains on securities from equity investments, net of $62 tax expense	-	-	-	91	91	-	91
Total comprehensive income							130,805
Parent loss tax allocation	-	-	5,818	-	-	-	5,818
Balance as of March 31, 2016	**$ -**	**$ -**	**$ 2,638,074**	**$ (106)**	**$ (106)**	**$ 337,153**	**$ 2,975,121**
Net income	-	-	-		-	76,287	76,287
Other comprehensive income:							
Unrealized gains on securities from equity investments, net of $169 tax benefit	-	-	-	106	106	-	106
Total comprehensive income							76,393
Equity infusion from Parent	-	-	350,000	-	-	-	350,000
Parent loss tax allocation	-	-	8,296	-	-	-	8,296
Balance as of March 31, 2017	**$ -**	**$ -**	**$ 2,996,370**	**$ -**	**$ -**	**$ 413,440**	**$ 3,409,810**

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, 2017 and 2016.

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

BROOKLYN UNION GAS COMPANY
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Brooklyn Union Gas Company d/b/a National Grid New York (the "Company") distributes natural gas to approximately 1,017,000 retail customers and transports natural gas to approximately 236,000 customers in the boroughs of Brooklyn and Staten Island and two-thirds of the borough of Queens, all in New York City.

The Company is a wholly-owned subsidiary of KeySpan Corporation ("KeySpan" or the "Parent"), which is a wholly-owned subsidiary of National Grid USA ("NGUSA"), a public utility holding company with regulated subsidiaries engaged in the generation of electricity and the transmission, distribution, and sale of both natural gas and electricity. NGUSA is 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.

Through its wholly-owned subsidiary, North East Transmission Co., Inc. ("NETCO"), the Company owned a 19.4% interest in Iroquois Gas Transmission System L.P. ("Iroquois"), which owns a 375-mile pipeline that transports Canadian gas supply daily to markets in the northeastern United States. Through another wholly-owned subsidiary, the total interest in Iroquois under KeySpan's common control was 20.4%. Because this interest provided KeySpan and its subsidiaries the ability to exercise significant influence over the operating and financial policies of Iroquois, the Company accounted for its interest under the equity method of accounting. The Company's share of the earnings or losses of the affiliate was included as income from equity investments in the accompanying consolidated statements of income through September 29, 2015.

On September 29, 2015, NETCO contributed its 19.4% interest in Iroquois to Dominion Midstream Partners, LP ("DM") in exchange for approximately 6.5 million common units (representing approximately an 8% interest) of DM. DM was formed to grow a portfolio of natural gas terminaling, processing, storage, and transportation assets. The transaction resulted in a gain on sale of assets of $70.3 million in the year ended March 31, 2016. The Company has elected the fair value option with respect to its investment in DM and as such, any changes in the fair value of these common units are recorded as unrealized gains on investment in Dominion Midstream Partners, LP in the accompanying consolidated statements of income. The Company's investment in DM is included within financial investments on the consolidated balance sheet.

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 August 18, 2017, 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, 2017.

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. Regulatory assets and liabilities are reflected on the consolidated 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.

With respect to base distribution rates, the NYPSC has approved a Revenue Decoupling Mechanism ("RDM"). Prior to January 1, 2017, the RDM applied only to the Company's firm residential heating sales and transportation customers. Under the new rate plan (as discussed in Note 4, "Rate Matters" under "Rate Case Filing") the RDM was expanded to include commercial and industrial customers. The RDM requires the Company to adjust its base rates annually to reflect the over or under recovery of the Company's allowed revenues per customer from the prior year (May-April).

The Company's tariff includes a cost of gas adjustment factor which requires an annual reconciliation of recoverable gas costs and revenues. Any difference is deferred pending recovery from, or refund to, customers.

The gas distribution business is influenced by seasonal weather conditions, and, therefore, the Company's tariff contains a weather normalization adjustment that provides for recovery from, or refund to, firm customers of material shortfalls or excesses of firm delivery revenues (revenues less applicable gas costs and revenue taxes) during a heating season due to variations from normal weather.

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, 2017, 2016 and 2015 were $48.8 million, $43.3 million, and $35.9 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. The Company was in an excess position this year.

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 consolidated 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 effects of tax positions are recognized in the consolidated 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 current and deferred taxes based on the separate return method, modified by benefits-for-loss allocation pursuant to a tax sharing agreement between NGNA and its subsidiaries. To the extent that the consolidated return group settles cash differently than the amount reported as realized under the benefit-for-loss allocation, the difference is accounted for as either a capital contribution or as a distribution and is reflected within the accompanying consolidated statements of changes in stockholders’ equity as parent loss tax allocation.

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.

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 comprised of materials and supplies as well as gas in storage. Materials and supplies are stated at the lower of weighted average cost or market and are expensed or capitalized as used. The Company’s policy is to write-off obsolete inventory; there were no material write-offs of obsolete inventory for the years ended March 31, 2017, 2016, or 2015.

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 reported periodically to the NYPSC.

The Company had materials and supplies of $14.3 million and $19.2 million and gas in storage of $49.6 million and $63.1 million at March 31, 2017 and 2016, respectively.

Derivative Instruments

The Company uses derivative instruments (including option, purchase, and swap contracts) to manage commodity price risk. All derivative instruments are recorded on the consolidated balance sheet at their fair value. All commodity costs, including the impact of derivative instruments, are passed on to customers through the Company’s gas cost adjustment mechanism. Therefore, gains or losses on the settlement of these contracts are initially deferred and then 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, and 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. There was no related cash collateral as of March 31, 2017 or 2016.

Natural Gas Long-Term Arrangements

The Company enters into long-term gas contracts to procure commodity to serve its gas customers. Those contracts include Asset Management Agreements, Baseload, and Peaking gas contracts. The Company evaluates whether such agreements are derivative instruments or executory contracts and applies the appropriate accounting treatment.

Fair Value Measurements

The Company measures derivative instruments and financial assets for which it has elected the fair value option 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; and
- 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.

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, 2017, 2016, and 2015 were 2.2%, 2.3%, and 2.5%, respectively.

Depreciation expense includes a component for estimated future 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 had cumulative costs recovered in excess of costs incurred of $177.9 million and $194.1 million at March 31, 2017 and 2016, 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. AFUDC equity is reported in the consolidated statements of income as non-cash income in other income (deductions), net, and AFUDC debt 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 and corresponding depreciation expense. The Company recorded AFUDC related to equity of $8.9 million, $1.3 million, and zero and AFUDC related to debt of $5.0 million, $1.9 million, and $0.2 million for the years ended March 31, 2017, 2016, and 2015, respectively. The average AFUDC rates for the years ended March 31, 2017, 2016, and 2015 were 4.3%, 1.3%, and 0.3%, respectively.

Impairment of Long-Lived Assets

The Company tests the impairment of long-lived assets annually or 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 future 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, 2017, 2016, and 2015, 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. Goodwill is tested for impairment using a two-step approach. The first step compares the estimated fair value of the Company with its carrying value, including goodwill. If the estimated fair value exceeds the carrying value, then goodwill is considered not impaired. If the carrying value exceeds the estimated fair value, then a second step is performed to determine the implied fair value of goodwill. If the carrying value of goodwill exceeds its implied fair value, then an impairment charge equal to the difference is recorded.

The fair value of the Company was calculated in the annual goodwill impairment test for the year ended March 31, 2017 utilizing the income approach. The Company believes that due to the recent rate order received from the Company's regulator, this approach provides the most reliable information. Based on the resulting fair value from the annual analyses, the Company determined that no adjustment of the goodwill carrying value was required at March 31, 2017 or 2016.

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 rate-making process.

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

	Years Ended March 31,	
	2017	2016
	(in thousands of dollars)	
Balance as of the beginning of the year	**$ 14,145**	$ 13,567
Accretion expense	**797**	681
Liabilities settled	**(165)**	(103)
Balance as of the end of the year	**$ 14,777**	$ 14,145

Employee Benefits

The Company participates with other KeySpan subsidiaries in defined benefit pension plans and postretirement benefit other than pension ("PBOP") plans for its employees, administered by the Parent. 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 cannot be allocated to an individual company. The Company measures and records its 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 Adopted in Fiscal Year 2017

Presentation of Financial Statements – Balance Sheet Classification of Debt Issuance Costs

In April 2015, the FASB issued ASU 2015-03, "Simplifying the Presentation of Debt Issuance Costs." The new guidance requires that debt issuance costs related to term loans, be presented in the balance sheets as a direct deduction from the carrying value of debt. The guidance was adopted and retrospectively applied as described in Note 9, "Capitalization."

Presentation of Financial Statements – Going Concern, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern

In August 2014, the FASB issued amendments on reporting about an entity's ability to continue as a going concern in ASU 2014-15, "Presentation of Financial Statements – Going Concern (Subtopic 205 - 40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern." The amendments provide guidance about management's responsibility to evaluate whether there is substantial doubt surrounding an entity's ability to continue as a going concern. If management concludes that substantial doubt exists, the amendments require additional disclosures relating to management's evaluation and conclusion. Management is not aware of any indicators giving rise to substantial doubt about the Company's ability to continue to operate and to meet its obligations as they fall due.

Accounting Guidance Not Yet Adopted

Pension and Postretirement Benefits

In March 2017, the FASB issued ASU 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 in the same line item as other compensation in operating income and the other components of net benefit cost to be presented outside of operating income on a retrospective basis. In addition, only the service cost component will be eligible for capitalization when applicable, on a prospective basis. For the Company, the requirements of the new standard will be effective for the fiscal year ended March 31, 2020, with early adoption permitted. The Company is currently evaluating the impact of the new guidance on the presentation, results of its operations, cash flows, and financial position.

Goodwill

In January 2017, the FASB issued ASU 2017-04, "Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment," which eliminates Step 2 from the goodwill impairment test. For the Company, the requirements of the new standard will be effective for the fiscal year ended March 31, 2023, with early adoption permitted. The Company currently anticipates adopting the ASU in the year ended March 31, 2018.

Statement of Cash Flows

In November 2016, the FASB issued ASU No. 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force)," which requires entities to show the changes in the total of cash, cash equivalents, restricted cash, and restricted cash equivalents in the statement of cash flows. For the Company, the requirements of the new standard will be effective for the fiscal year ended March 31, 2020, and interim periods thereafter, with early adoption permitted.

In August 2016, the FASB issued ASU No. 2016-15, "Classification of Certain Cash Receipts and Cash Payments (Topic 230)," which provides guidance about the classification of certain cash receipts and payments within the statement 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. For the Company, the requirements of the new standard will be effective for the fiscal year ended March 31, 2020, and interim periods thereafter, with early adoption permitted.

The Company is currently evaluating the impact of the new guidance on the presentation of its consolidated statements of cash flows.

Income Taxes

In October 2016, the FASB issued ASU No. 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory," which eliminates the exception for all intra-entity sales of assets other than inventory. As a result, a reporting entity would recognize the tax expense from the sale of the asset in the seller's tax jurisdiction when the transfer occurs, even though the pre-tax effects of that transaction are eliminated in consolidation. For the Company, the requirements of the new standard will be effective for the fiscal year ended March 31, 2020, and interim periods thereafter, with early adoption permitted. The Company is currently evaluating the impact of the new guidance on the results of its operations, cash flows, and financial position.

Financial Instruments – Credit Losses

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendment replaces the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. For the Company, the requirements of the new standard will be effective for the fiscal year ended March 31, 2022, and interim periods thereafter, with early adoption permitted. The Company is currently evaluating the impact of the new guidance on the results of its operations, cash flows, and financial position.

Revenue Recognition

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606), which changes the criteria for recognizing revenue from a contract with a customer. In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers – Deferral of the Effective Date", which effectively defers by one year the effective date of ASU 2014-09. The underlying principle of "Revenue from Contracts with Customers" 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.

Additionally, there were subsequent amendments to ASU 2014-09. In March 2016, the FASB issued ASU 2016-08, which clarifies the implementation guidance on principal versus agent considerations. In April 2016, the FASB issued ASU No. 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing," which provides guidance in the new revenue standard on identifying performance obligations and accounting for licenses of intellectual property. In May 2016, the FASB issued ASU 2016-12, providing additional clarity on various aspects of Topic

606. Lastly, in December 2016, the FASB issued ASU No. 2016-20, "Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers." The amendments in this Update cover a variety of corrections and improvements to the Codification related to the new revenue recognition standard.

The new revenue recognition guidance and related amendments must be adopted using either a full retrospective approach or a modified retrospective approach. For the Company, the new guidance is effective for the fiscal year ended March 31, 2019, and interim periods within the reporting period, with early adoption permitted.

The Company continues to assess the impacts this guidance may have on its results of operations, cash flows and financial position. In performing this assessment the Company is utilizing an implementation team comprising both internal and external resources. The key areas of focus include but not limited to: reviewing the potential new disclosures regarding the nature, amount, timing and uncertainty of revenue and related cash flows; developing an implementation approach and process for complying with these new disclosures; and evaluating existing contracts and revenue streams for potential changes in the amounts and timing of recognizing revenues under the new guidance. While there continues to be ongoing activities in all these areas, the Company has preliminarily concluded that it expects to apply the new guidance using the modified retrospective method.

Leases

In February 2016, the FASB issued a new lease accounting standard, ASU 2016-02, "Leases (Topic 842)." The key objective of the new standard is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Lessees will need to recognize a right-of-use asset and a lease liability for virtually all of their leases (other than leases that meet the definition of a short-term lease). For income statement purposes, a dual model has been retained, with leases to be designated as operating leases or finance leases. Expenses will be recognized on a straight-line basis for operating leases, and a front-loaded basis for finance leases. For the Company, the new standard is effective for the fiscal year ended March 31, 2021, and interim periods thereafter, with early adoption permitted. The new standard must be adopted using a modified retrospective transition, and provides for certain practical expedients. The Company is currently evaluating the impact of the new guidance on the results of its operations, cash flows, and financial position. The Company's leases are discussed in Note 12, "Commitments and Contingencies" under "Operating Lease Obligations."

Financial Instruments – Classification and Measurement

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities." The new guidance principally affects the accounting for equity investments and financial liabilities where the fair value option has been elected, as well as the disclosure requirements for financial instruments. For the Company, the new guidance is effective for the fiscal year ended March 31, 2020, and interim periods thereafter, with early adoption permitted. The Company is currently evaluating the impact of the new guidance on the results of its operations, cash flows, and financial position.

Measurement of Inventory

In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory." The new guidance requires that inventory be measured at the lower of cost or net realizable value (other than inventory measured using "last-in, first out" and the "retail inventory method"). For the Company, the new guidance, which must be applied prospectively, is effective for the fiscal year ended March 31, 2018, and interim periods thereafter, with early adoption permitted. The application of this guidance is not expected to have a material impact on the results of operations, cash flows, or financial position of the Company since the Company's gas in storage is fully recoverable from customers and material and supplies inventory is stated at the lower of cost or market.

Consolidation

In February 2015, the FASB issued ASU 2015-02, "Consolidation (Topic 810): Amendments to the Consolidation Analysis." The new guidance eliminates entity specific consolidation guidance for limited partnerships. It also revises other aspects of the consolidation analysis, including how kick-out rights, fee arrangements and related parties are assessed. The new guidance, which requires either modified retrospective or full retrospective basis application, is effective for the fiscal year ended March 31, 2018, and interim periods thereafter, with early adoption permitted. The application of this guidance is not expected to have a material impact on the results of operations, cash flows, or financial position of the Company.

Financial Statement Revision

During 2017, management determined that certain transactions were not properly recorded in the Company's previously issued financial statements. The Company has corrected the errors by revising the prior period financial statements presented herein, the impacts of which are described below. The Company concluded that the errors were not material to any prior periods.

During the Company's review of its regulatory account balances for fiscal year 2017, management determined it had not correctly recognized a regulatory liability for carrying charges related to under-funded pension and PBOP balances. A cumulative adjustment of $5.3 million (net of income taxes) was recorded, of which $4.4 million was recorded as a decrease to opening retained earnings as of April 1, 2014. Additionally, decreases of $0.5 million and $0.4 million were recorded to net income for the years ended March 31, 2016 and 2015, respectively.

In addition, the Company has corrected various account balances that were improperly recorded. A cumulative adjustment of $0.7 (net of income taxes) was recorded, of which $0.4 million was recorded as a decrease to opening retained earnings as of April 1, 2014. Additionally, $0.2 million and $0.1 million were recorded as decreases to net income for the years ended March 31, 2016 and 2015, respectively. These items reflect a correction to carrying charges recorded on certain regulatory assets and liabilities, a correction to depreciation expense to correct for inaccurate recording of certain retired fixed assets and a correction of interest expense.

In addition to the adjustments made to the statement of income, certain reclassifications have been made to the prior year financial statements to conform prior year's data to the current year's presentation. These reclassifications had no effect on the Company's financial position, results of operations or cash flows. The primary reclassification is a result of the retrospective adoption of ASU 2015-03. Refer to Note 9, "Capitalization."

The cumulative adjustments did not result in any changes to other items in the Statement of Comprehensive Income (other than net income) for the years ended March 31, 2016 and 2015.

	As Previously Reported	Presentation Reclassifications	Adjustments	As Revised
		(in thousands of dollars)		
Statement of Income	**March 2016**			**March 2016**
Total operating revenues	$ 1,316,626	$ -	$ 1,074	$ 1,317,700
Total operating expenses	1,174,326	-	1,227	1,175,553
Operating income	142,300	-	(153)	142,147
Other interest, including affiliate interest	(2,958)	(689)	(437)	(4,084)
Other (deductions) income, net	4,235	689	(650)	4,274
Income before income taxes	221,154	-	(1,240)	219,914
Income tax expense	89,701	-	(501)	89,200
Net income	131,453	-	(739)	130,714
Statement of Income	**March 2015**			**March 2015**
Total operating revenues	$ 1,518,540	$ -	$ 512	$ 1,519,052
Total operating expenses	1,318,653	-	565	1,319,218
Operating income	199,887	-	(53)	199,834
Other interest, including affiliate interest	1,732	-	(712)	1,020
Other (deductions) income, net	(4,362)	-	49	(4,313)
Income before income taxes	165,334	-	(716)	164,618
Income tax expense	66,863	-	(289)	66,574
Net income	98,471	-	(427)	98,044
Statement of Cash Flows	**March 2016**			**March 2016**
Net cash provided by operating activities	$ 271,242	$ -	$ 329	$ 271,571
Net cash used in investing activities	(823,183)	-	(158)	(823,341)
Net cash provided by financing activities	552,346	-	(171)	552,175
Statement of Cash Flows	**March 2015**			**March 2015**
Net cash provided by operating activities	$ 364,285	$ -	$ (69)	$ 364,216
Net cash used in investing activities	(402,583)	-	(49)	(402,632)
Net cash provided by financing activities	15,228	-	118	15,346

	As Previously Reported	Presentation Reclassifications	Adjustments	As Revised
		(in thousands of dollars)		
Balance Sheet	**March 2016**			**March 2016**
Total current assets	$ 1,062,839	$ -	$ 225	$ 1,063,064
Property, plant, and equipment, net	3,603,782	-	(1,891)	3,601,891
Total other non-current assets	2,942,348	(11,296)	1,675	2,932,727
Total assets	7,608,969	(11,296)	9	7,597,682
Total other non-current liabilities	2,198,094	(5,330)	5,978	2,198,742
Long-term debt	1,224,269	(5,966)	-	1,218,303
Total liabilities and capitalization	7,608,969	(11,296)	9	7,597,682
Retained Earnings				
March 31, 2016	$ 343,122	$ -	$ (5,969)	$ 337,153
March 31, 2015	211,669	-	(5,230)	206,439
March 31, 2014	113,198	-	(4,803)	108,395
Shareholders' equity				
March 31, 2016	$ 2,981,090	$ -	$ (5,969)	$ 2,975,121
March 31, 2015	2,843,728	-	(5,230)	2,838,498
March 31, 2014	2,727,881	-	(4,803)	2,723,078

3. 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,	
	2017	2016
	(in thousands of dollars)	
Regulatory assets		
Current:		
Derivative instruments	**$ 3,390**	$ 198
Gas costs adjustment	**18,052**	18,290
Other	**274**	156
Total	**21,716**	18,644
Non-current:		
Environmental response costs	**1,477,604**	770,589
Postretirement benefits	**247,605**	367,057
Temperature control/interruptible sharing	**103,681**	82,676
Other	**86,893**	52,200
Total	**1,915,783**	1,272,522
Regulatory liabilities		
Current:		
Energy efficiency	**37,973**	38,936
Revenue decoupling mechanism	**75,846**	19,561
Other	**1,295**	5,792
Total	**115,114**	64,289
Non-current:		
Carrying charges	**40,760**	19,755
Cost of removal	**177,883**	194,051
Delivery rate adjustment	**44,974**	44,974
Excess earnings	**88,082**	88,082
Other	**74,417**	62,770
Total	**426,116**	409,632
Net regulatory assets	**$ 1,396,269**	$ 817,245

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. 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.

Delivery rate adjustment: The NYPSC authorized a surcharge for recovery of regulatory assets ("Delivery Rate Surcharge") of $5 million beginning January 1, 2008, which increased incrementally by $5 million in rate years two through five;

aggregating to a maximum amount of approximately $75 million over the term of a previous rate agreement, which capped at $45 million. The timing for disposition of any associated deferred balances will be determined by future PSC rulings.

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. Refer to Note 11, "Environmental Matters" for a discussion on the increase from March 31, 2016 to March 31, 2017.

Excess earnings: At the end of each rate year (calendar year), the Company is required to provide the NYPSC with a computation of its return on common equity capital ("ROE"). Under the new rate plan commencing calendar year 2017, if the ROE in the rate year exceeds 9.5% the Company is required to defer a portion of the revenue equivalent associated with any over earnings for the benefit of customers. Previously, the threshold for earnings sharing was 9.4% and the sharing mechanism was calculated based upon a cumulative average ROE over rate years 2013 and 2014 with 80% of any excess earnings applied as a credit against the site investigation and remediation ("SIR") deferral balance. The Company had no excess earnings for the years ended March 31, 2017, 2016, or 2015.

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.

Postretirement benefits: Represents the excess costs of the Company's pension and PBOP plans over amounts received in rates that are to be recovered in future periods and the non-cash accrual of net actuarial gains and losses. Also included within this amount are certain pension deferral amounts recorded prior to the acquisition of KeySpan by NGUSA, which are being recovered in rates over a ten year period ending August 2017.

Rate adjustment mechanisms: The Company is subject to a number of rate adjustment mechanisms 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.

Revenue decoupling mechanism: As approved by the NYPSC, the Company has a RDM as described in Note 2, "Summary of Significant Accounting Policies" under "Revenue Recognition." The RDM allows for annual adjustment to the Company's delivery rates as a result of the reconciliation between allowed revenue per customer and actual revenue per customer. Any difference between the allowed revenue per customer and the actual revenue per customer is recorded as a regulatory asset or regulatory liability.

Temperature control/interruptible ("TC/IT") sharing: Under the existing rate agreement, effective from January 1, 2017, the revenue requirement reflects certain levels of imputed TC/IT margins. Differences between the actual margins and imputed margins are fully credited or surcharged to the ratepayers. Under the previous rate agreement, differences between the actual margins and imputed margins were shared 90% by ratepayers and 10% by shareholders. This regulatory asset represents the ratepayer share of the differences.

4. 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. In an effort to mitigate the potential bill impacts that the revenue increases would have on customers in the first year, the revenue increases will be levelized over the three year rate period. As such, for US 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 and 48% common equity ratio and includes an earning sharing mechanism in which customers will share earnings 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 for repairs 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 various 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 is also adjusted to include revenue-per-class RDMs for industrial and commercial customers not previously subject to the RDM.

The Company's 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.

Operations Audit

In August 2013, the NYPSC initiated an operational audit using a third party to review the accuracy of the customer service, electric reliability, and gas safety data reported by the investor owned utilities operating in New York, including the Company. On December 19, 2013, the NYPSC selected a third party to conduct the audit, which commenced in February 2014. On April 20, 2016, the NYPSC released the third party audit report publicly and adopted the majority of recommendations in the report. The audit report found that the Company, in general, is meeting its obligations to supply self-reported data. The report contains recommendations to improve internal controls and allow for greater consistency in reporting among the New York utilities. The recommendations do not affect current rate case performance targets or mechanisms and may be considered for potential implementation in future rate plans. The Company filed its plan to implement the audit recommendations with the NYPSC on May 19, 2016. On March 10, 2017, the NYPSC issued an Order approving the Company's implementation plan without modification, with quarterly updates to be made to the NYPSC on the status of implementation. The Company filed its first implementation plan update on July 10, 2017.

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 26 recommendations for National Grid. The Company filed its implementation plan on March 23, 2017 and anticipates an order regarding the plan later this year.

5. PROPERTY, PLANT AND EQUIPMENT

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

	March 31,	
	2017	2016
	(in thousands of dollars)	
Plant and machinery	**$ 4,368,971**	$ 4,047,563
Land and buildings	**193,777**	188,580
Assets in construction	**424,225**	345,534
Software and other intangibles	**125,098**	124,399
Total property, plant and equipment	**5,112,071**	4,706,076
Accumulated depreciation and amortization	**(1,122,402)**	(1,104,185)
Property, plant and equipment, net	**$ 3,989,669**	$ 3,601,891

6. 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.

Volumes

Volumes of outstanding commodity derivative instruments measured in dekatherms ("dths") are as follows:

	March 31,	
	2017	2016
	(in thousands)	
Gas option contracts	**3,550**	7,450
Gas purchase contracts	**10,004**	13,979
Gas swap contracts	**23,889**	23,786
Total	**37,443**	45,215

Amounts Recognized on the Consolidated Balance Sheet

	Asset Derivatives			Liability Derivatives	
	March 31,			March 31,	
	2017	2016		**2017**	2016
	(in thousands of dollars)			*(in thousands of dollars)*	
Current assets:			Current liabilities:		
Rate recoverable contracts:			Rate recoverable contracts:		
Gas option contracts	**$ 43**	$ 194	Gas option contracts	**$ 115**	$ 222
Gas purchase contracts	**2,171**	224	Gas purchase contracts	**2,959**	1,216
Gas swap contracts	**1,753**	3,100	Gas swap contracts	**1,372**	2,277
	3,967	3,518		**4,446**	3,715
Other non-current assets:			Other non-current liabilities:		
Rate recoverable contracts:			Rate recoverable contracts:		
Gas purchase contracts	**-**	-	Gas purchase contracts	**2,911**	-
	-	-		**2,911**	-
Total	**$ 3,967**	$ 3,518	Total	**$ 7,357**	$ 3,715

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 consolidated statements of income. All of the Company's derivative instruments are subject to rate recovery as of March 31, 2017 and 2016.

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. The Company enters into enabling agreements that allow for payment netting with its counterparties, which reduce its exposure to counterparty risk by providing for the offset of amounts payable to the counterparty against amounts receivable from the counterparty. 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 an asset of $3.4 million and an asset of $2.2 million as of March 31, 2017 and 2016, 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, 2017 and 2016 was $0.5 million and $0.7 million, respectively. The Company had no collateral posted for these instruments at March 31, 2017 or 2016. If the Company's credit rating were to be downgraded by one or two levels, it would not be required to post any additional collateral. If the Company's credit rating were to be downgraded by three levels, it would be required to post $0.8 million additional collateral to its counterparties at March 31, 2017 and 2016.

Offsetting Information for Derivative Instruments Subject to Master Netting Arrangements

March 31, 2017

Gross Amounts Not Offset in the Consolidated Balance Sheets

(in thousands of dollars)

	Gross amounts of recognized assets	Gross amounts offset in the Consolidated Balance Sheets	Net amounts of assets presented in the Consolidated Balance Sheets	Financial instruments	Cash collateral received	Net amount
ASSETS:	*A*	*B*	*C=A+B*	*Da*	*Db*	*E=C-D*
Derivative instruments						
Gas option contracts	$ 43	$ -	$ 43	$ -	$ -	$ 43
Gas purchase contracts	2,171	-	2,171	-	-	2,171
Gas swap contracts	1,753	-	1,753	-	-	1,753
Total	$ 3,967	$ -	$ 3,967	$ -	$ -	$ 3,967

	Gross amounts of recognized liabilities	Gross amounts offset in the Consolidated Balance Sheets	Net amounts of liabilities presented in the Consolidated Balance Sheets	Financial instruments	Cash collateral paid	Net amount
LIABILITIES:	*A*	*B*	*C=A+B*	*Da*	*Db*	*E=C-D*
Derivative instruments						
Gas option contracts	$ 115	$ -	$ 115	$ -	$ -	$ 115
Gas purchase contracts	5,870	-	5,870	-	-	5,870
Gas swap contracts	1,372	-	1,372	-	-	1,372
Total	$ 7,357	$ -	$ 7,357	$ -	$ -	$ 7,357

March 31, 2016

Gross Amounts Not Offset in the Consolidated Balance Sheets

(in thousands of dollars)

ASSETS:	Gross amounts of recognized assets *A*	Gross amounts offset in the Consolidated Balance Sheets *B*	Net amounts of assets presented in the Consolidated Balance Sheets *C=A+B*	Financial instruments *Da*	Cash collateral received *Db*	Net amount *E=C-D*
Derivative instruments						
Gas option contracts	$ 194	$ -	$ 194	$ -	$ -	$ 194
Gas purchase contracts	224	-	224	-	-	224
Gas swap contracts	3,100	-	3,100	-	-	3,100
Total	$ 3,518	$ -	$ 3,518	$ -	$ -	$ 3,518

LIABILITIES:	Gross amounts of recognized liabilities *A*	Gross amounts offset in the Consolidated Balance Sheets *B*	Net amounts of liabilities presented in the Consolidated Balance Sheets *C=A+B*	Financial instruments *Da*	Cash collateral paid *Db*	Net amount *E=C-D*
Derivative instruments						
Gas option contracts	$ 222	$ -	$ 222	$ -	$ -	$ 222
Gas purchase contracts	1,216	-	1,216	-	-	1,216
Gas swap contracts	2,277	-	2,277	-	-	2,277
Total	$ 3,715	$ -	$ 3,715	$ -	$ -	$ 3,715

7. 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, 2017 and 2016:

	March 31, 2017			
	Level 1	Level 2	Level 3	Total
		(in thousands of dollars)		
Assets:				
Derivative instruments				
Gas option contracts	$ -	$ -	$ 43	$ 43
Gas purchase contracts	-	35	2,136	2,171
Gas swap contracts	-	1,753	-	1,753
Investment in Dominion Midstream Partners, LP	206,105	-	-	206,105
Total	206,105	1,788	2,179	210,072
Liabilities:				
Derivative instruments				
Gas option contracts	-	-	115	115
Gas purchase contracts	-	5,870	-	5,870
Gas swap contracts	-	1,372	-	1,372
Total	-	7,242	115	7,357
Net assets (liabilities)	$ 206,105	$ (5,454)	$ 2,064	$ 202,715

	March 31, 2016			
	Level 1	Level 2	Level 3	Total
		(in thousands of dollars)		
Assets:				
Derivative instruments				
Gas option contracts	$ -	$ -	$ 194	$ 194
Gas purchase contracts	-	6	218	224
Gas swap contracts	-	3,100	-	3,100
Investment in Dominion Midstream Partners, LP	-	192,026	-	192,026
Total	-	195,132	412	195,544
Liabilities:				
Derivative instruments				
Gas option contracts	-	-	222	222
Gas purchase contracts	-	82	1,134	1,216
Gas swap contracts	-	2,277	-	2,277
Total	-	2,359	1,356	3,715
Net assets (liabilities)	$ -	$ 192,773	$ (944)	$ 191,829

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. A derivative is designated Level 3 when it is valued based on a forward curve that is internally developed, extrapolated or derived from market observable curves with correlation coefficients less than 95%, where optionality is present, or if non-economic assumptions are made. The internally developed forward curves have a high level of correlation with published curves and are reviewed by the middle office.

Investment in DM: As of March 31, 2016 the Company's investment in DM was valued based on Level 1 quoted market prices for DM common units, combined with a discount to the quoted market price, which was calculated using Level 2 inputs, to reflect restrictions on the transfer of the units and resulting lack of marketability. As of March 31, 2017 the restrictions on the transfer of the units are no longer in place and as such the Company's investment in DM was valued solely based on Level 1 quoted market prices for DM common units. Transfers are recognized at the end of each period, and as such the investment was transferred from Level 2 to Level 1 in the amount of $154.2 million.

Changes in Level 3 Derivative Instruments

	Years Ended March 31,	
	2017	2016
	(in thousands of dollars)	
Balance as of the beginning of the year	**$ (944)**	$ (4,207)
Total gains included in regulatory assets and liabilities	**4,994**	1,645
Settlements	**(1,986)**	1,618
Balance as of the end of the year	**$ 2,064**	$ (944)

A transfer into Level 3 represents existing assets or liabilities that were previously categorized at a higher level for which the inputs became unobservable during the year. A transfer out of Level 3 represents assets and liabilities that were previously classified as Level 3 for which the inputs became observable based on the criteria discussed previously for classification in Level 2. These transfers, which are recognized at the end of each period, result from changes in the observability of forward curves from the beginning to the end of each reporting period. There were no transfers between Level 1 and Level 2, and no transfers into or out of Level 3, during the years ended March 31, 2017, 2016, or 2015.

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 forward curves used for financial reporting are developed and verified by the middle office. The Company considers non-performance risk and liquidity risk in the valuation of derivative instruments categorized in Level 2 and Level 3.

Quantitative Information About Level 3 Fair Value Measurements

The following tables provide information about the Company's Level 3 valuations:

Commodity	Level 3 Position	Fair Value as of March 31, 2017 Assets	 (Liabilities)	 Total	Valuation Technique(s)	Significant Unobservable Input	Range
		(in thousands of dollars)					
Gas	Purchase contracts	$ 2,113	$ -	$ 2,113	Discounted Cash Flow	Forward Curve (A)	$1.67/dth
Gas/Power	Cross commodity contracts	23	-	23	Discounted Cash Flow	Forward Curve	$31.52 - $238.00/dth
Gas	Option contracts	43	(115)	(72)	Discounted Cash Flow	Implied Volatility	33% - 39%
	Total	$ 2,179	$ (115)	$ 2,064			

(A) Includes deals with valuation assumptions on gas supply.

Commodity	Level 3 Position	Fair Value as of March 31, 2016 Assets	 (Liabilities)	 Total	Valuation Technique(s)	Significant Unobservable Input	Range
		(in thousands of dollars)					
Gas	Purchase contracts	$ -	$ (1,134)	$ (1,134)	Discounted Cash Flow	Forward Curve (A)	$1.89/dth
Gas/Power	Cross commodity contracts	218	-	218	Discounted Cash Flow	Forward Curve	$14.16 - $251.20/dth
Gas	Option contracts	194	(222)	(28)	Discounted Cash Flow	Implied Volatility	34% - 38%
	Total	$ 412	$ (1,356)	$ (944)			

(A) Includes deals with valuation assumptions on gas supply.

The significant unobservable inputs listed above would have a direct impact on the fair values of the Level 3 instruments if they were adjusted. The significant unobservable inputs used in the fair value measurement of the Company's gas purchase and gas option derivative instruments are forward commodity prices, implied volatility, and valuation assumptions pertaining to peaking gas deals based on forward gas curves. A relative change in commodity price at various locations underlying the open positions can result in significantly different fair value estimates.

Other Fair Value Measurements

The Company's consolidated balance sheets reflect long-term debt at amortized cost. The fair value of the Company's long-term debt was based on quoted market prices when available, or estimated using quoted market prices for similar debt. The fair value of this debt at March 31, 2017 and 2016 was $1.3 and $2.1 billion, respectively.

All other financial instruments on the consolidated balance sheet such as accounts receivable, accounts payable, and the intercompany money pool are stated at cost, which approximates fair value.

8. EMPLOYEE BENEFITS

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

The Pension Plans provide union employees, as well as all 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. 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, 2017, 2016, and 2015, the Company made contributions of approximately $53.5 million, $24.6 million, and $22.8 million, respectively, to the Plans.

The Plans' assets are commingled and cannot be allocated to an individual company. 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. In addition, certain changes in the funded status of the Plans are also allocated based on the employees associated with the Company through an intercompany payable account and are presented as postretirement benefits on the consolidated balance sheet. Pension and PBOP expenses are included within operations and maintenance expense in the accompanying consolidated statements of income.

KeySpan's unfunded obligations at March 31, 2017 and 2016 are as follows:

	March 31,	
	2017	2016
	(in thousands of dollars)	
Pension	**$ 660,140**	$ 979,081
PBOP	**442,175**	946,860
	$ 1,102,315	$ 1,925,941

The Company's net pension and PBOP expenses directly charged and allocated from affiliated service companies, net of capital, for the years ended March 31, 2017, 2016, and 2015 are as follows:

	Years Ended March 31,		
	2017	2016	2015
		(in thousands of dollars)	
Pension	**$ 21,738**	$ 15,625	$ 15,656
PBOP	**18,268**	19,186	19,186
	$ 40,006	$ 34,811	$ 34,842

Defined Contribution Plan

NGUSA has a defined contribution pension plan that covers substantially all employees. For the years ended March 31, 2017, 2016, and 2015, the Company recognized an expense in the accompanying consolidated statements of income of $1.9 million, $1.6 million, and $1.1 million, respectively, for matching contributions.

Other Benefits

At March 31, 2017 and 2016, the Company had accrued workers compensation, auto, and general insurance claims which have been incurred but not yet reported ("IBNR") of $9.9 million and $11.9 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.

9. CAPITALIZATION

As a result of retrospective adoption of ASU 2015-03, relating to the balance sheet presentation of debt issuance costs, the Company adjusted its long-term debt and other non-current assets by $11.7 million as of March 31, 2016. Debt issuance costs were $8.0 million at March 31, 2017.

The aggregate maturities of long-term debt for the years subsequent to March 31, 2017 are as follows:

(in thousands of dollars) Years Ending March 31,	
2018	$ -
2019	-
2020	-
2021	125,000
2022	-
Thereafter	1,105,000
Total	$ 1,230,000

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 and financial covenants such as restrictions on the level of indebtedness. 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, 2017 and 2016, the Company was in compliance with all such covenants.

Unsecured Notes

In March 2016, the Company issued $500 million of unsecured senior long-term debt at 3.41% with a maturity date of March 10, 2026 and $500 million of unsecured senior long-term debt at 4.50% with a maturity date of March 10, 2046.

Gas Facilities Revenue Bonds

The Company has outstanding tax-exempt Gas Facilities Revenue Bonds ("GFRB") issued through the New York State Energy Research and Development Authority. At March 31, 2017, $230 million of variable-rate, auction rate GFRB were outstanding. At March 31, 2016, $640.5 million of GFRB were outstanding of which $230 million were variable-rate, auction rate bonds. The GFRB currently in auction rate mode are backed by bond insurance. These bonds cannot be put back to the Company and, in the case of a failed auction, the resulting interest rate on the bonds would revert to the maximum auction rate which depends on the current appropriate, short-term benchmark rates and the senior unsecured rating of the

Company's bonds. The effect of the failed auctions on interest on long-term debt was not material for the years ended March 31, 2017, 2016, or 2015.

Dividend Restrictions

Pursuant to the NYPSC's orders, the ability of the Company to pay dividends to KeySpan is conditioned upon maintenance of a utility capital structure with debt not exceeding 56% of total utility capitalization. At March 31, 2017 and 2016, the Company was in compliance with the utility capital structure required by the NYPSC.

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.

Equity Infusion From Parent

On March 27, 2017, the Company received a capital contribution of $350 million from the Parent. 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 4, "Rate Matters" under "Rate Case Filing").

10. INCOME TAXES

Components of Income Tax Expense

	Years Ended March 31,		
	2017	2016	2015
		(in thousands of dollars)	
Current tax expense (benefit):			
Federal	**$ 9,651**	$ 9,741	$ 9,486
State	**(9,642)**	5,817	4,411
Total current tax expense (benefit)	**9**	15,558	13,897
Deferred tax expense (benefit):			
Federal	**26,808**	60,612	43,534
State	**16,533**	13,941	10,054
Total deferred tax expense (benefit)	**43,341**	74,553	53,588
Amortized investment tax credits [1]	**(911)**	(911)	(911)
Total deferred tax expense (benefit)	**42,430**	73,642	52,677
Total income tax expense	**$ 42,439**	$ 89,200	$ 66,574

[1] Investment tax credits ("ITC") are being deferred 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, 2017, 2016, and 2015 are 35.8%, 40.6%, and 40.4%, respectively. The following table presents a reconciliation of income tax expense at the federal statutory tax rate of 35% to the actual tax expense:

	Years Ended March 31,		
	2017	2016	2015
		(in thousands of dollars)	
Computed tax	**$ 41,554**	$ 76,970	$ 57,615
Change in computed taxes resulting from:			
Allowance for equity funds used during construction	**(2,873)**	(68)	564
Investment tax credits	**(911)**	(911)	(911)
State income tax, net of federal benefit	**4,479**	12,843	9,402
Other items, net	**190**	366	(96)
Total	**885**	12,230	8,959
Total income tax expenses	**$ 42,439**	$ 89,200	$ 66,574

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.

In December 2015, the Protecting Americans from Tax Hikes Act of 2015 was signed into law, extending bonus depreciation for qualifying property acquired and placed in service before January 1, 2020 (bonus depreciation rates will be 50% in 2015 to 2017, 40% in 2018, and 30% in 2019), with an additional year for certain longer lived assets. The Company will continue to claim bonus depreciation for qualifying property acquired and placed in service in accordance with this change in tax law.

On December 1, 2016 the Commissioner of the New York State Department of Taxation and Finance adopted a rule to increase the Metropolitan Transportation Authority surcharge from 28% to 28.3% effective for tax years beginning on or after January 1, 2017 and before January 1, 2018. The rate will remain the same in succeeding years unless otherwise adjusted. During the year ended March 31, 2017, there was no material change in the Company's deferred tax liability for this increase in rate.

Deferred Tax Components

	March 31, 2017	March 31, 2016
	(in thousands of dollars)	
Deferred tax assets:		
Environmental remediation costs	**$ 437,257**	$ 245,785
Future federal benefit on state taxes	**55,251**	46,157
Net operating losses	**97,600**	63,204
Postretirement benefits and other employee benefits	**83,006**	134,572
Regulatory liabilities - other	**179,226**	136,271
Other items	**40,600**	44,920
Total deferred tax assets [1]	**892,940**	670,909
Deferred tax liabilities:		
Investments in partnerships	**91,052**	93,443
Property related differences	**995,899**	885,212
Regulatory assets - environmental response costs	**524,577**	334,330
Regulatory assets - postretirement benefits	**100,887**	147,722
Regulatory assets - other	**121,280**	92,297
Other items	**15,845**	15,821
Total deferred tax liabilities	**1,849,540**	1,568,825
Net deferred income tax liabilities	**956,600**	897,916
Deferred investment tax credits	**1,082**	1,992
Deferred income tax liabilities, net	**$ 957,682**	$ 899,908

[1] The Company established a valuation allowance for deferred tax assets related to expiring charitable contribution carryforwards in the amount of $1.2 million and $0.9 million as of March 31, 2017 and 2016, respectively.

Net Operating Losses

The following table presents the amounts and expiration dates of net operating losses as of March 31, 2017:

Expiration of net operating losses:	Federal	NYS
	(in thousands of dollars)	
3/31/2029	$ 35,906	$ -
3/31/2033	12,085	-
3/31/2035	4,173	118,647
3/31/2036	187,708	-
3/31/2037	121,225	15,216

Unrecognized Tax Benefits

As of March 31, 2017, 2016, and 2015, the Company's unrecognized tax benefits totaled $89.3 million, $76.7 million, and $72.3 million, respectively, of which $1.9 million, $0.8 million, and $0.8 million, respectively, would affect the effective tax rate, if recognized. The unrecognized tax benefits are included in other non-current liabilities on the consolidated balance sheet.

The following table presents changes to the Company's unrecognized tax benefits:

	Years Ended March 31,		
	2017	2016	2015
		(in thousands of dollars)	
Balance as of the beginning of the year	**$ 76,735**	$ 72,315	$ 73,428
Gross increases - tax positions in prior periods	**6,294**	-	1,331
Gross decreases - tax positions in prior periods	**(626)**	(4,057)	(13,988)
Gross increases - current period tax positions	**6,886**	8,477	11,544
Balance as of the end of the year	**$ 89,289**	$ 76,735	$ 72,315

As of March 31, 2017 and 2016, the Company has accrued for interest related to unrecognized tax benefits of $6.1 million and $4.7 million, respectively. During the years ended March 31, 2017, 2016, and 2015, the Company recorded interest expense of $1.3 million, $1.2 million, and $1.4 million, respectively. The Company recognizes interest related to unrecognized tax benefits in other interest, including affiliate interest and related penalties, if applicable, in other income (deductions), net in the accompanying consolidated statements of income. During the years ended March 31, 2017 and 2016 the Company recorded a tax penalty expense of $0.3 million and $0.2 million, respectively. Immaterial tax penalties were recorded during the year ended March 31, 2015.

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.

The Company is included in NGNA and subsidiaries' administrative appeal with the Internal Revenue Service ("IRS") related to the issues disputed in the examination cycles for the years ended August 24, 2007, March 31, 2008, and March 31, 2009. The Company is expecting to reach a settlement with the IRS in the next fiscal year. The Company does not believe that the outcome of the settlement will have a material impact to its results of operations, financial position, or cash flows. The IRS continues its examination of the next cycle which includes 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. The income tax returns for the years ended March 31, 2013 through March 31, 2017 remain subject to examination by the IRS.

The state of New York concluded its examination of the Company's income tax returns for the years ended December 31, 2007 through March 31, 2008. The Company reached a settlement with the state of New York related to the transition property depreciation deduction. Pursuant to the settlement, the Company received a refund of $3.7 million. The state of New York is in the process of examining the Company's NYS income tax returns the years ended March 31, 2009 through March 31, 2012. The income tax returns for the years ended March 31, 20013 through March 31, 2017 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

11. 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.

During the year ended March 31, 2017, the Company received new information concerning the remediation work required and additional contamination discovered at three of the Company's largest sites (Gowanus Canal, Newtown Creek, and Fulton MGP), which resulted in the Company increasing its environmental reserve by approximately $613.9 million. The estimate increases were the result of new information arising from a Preliminary Design and Phase 2 investigation report submitted to the United States Environmental Protection Agency ("EPA") by the potentially responsible parties group as well as a Draft Order issued by the EPA requiring the Company to remediate under an active park. After recording an offsetting increase in regulatory assets relating to environmental remediation, there was no impact to the net assets of the Company.

In addition, the Company has identified other 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, 2017, 2016, and 2015 were $53.8 million, $45.9 million, and $42.6 million, respectively.

In fiscal year 2016 and prior years the Company reflected environmental liabilities on a discounted basis using a 6.5% discount factor. As noted above, in 2017 the EPA required the Company to revise their site remediation plans which increased the cost, complexity and potential time horizon to meet the EPA standards. The revised remediation plans and requirements no longer make it feasible for the Company to realistically determine if the payments for these liabilities are fixed and determinable and subject to discounting at March 31, 2017. In 2017 the Company revised its estimate for environmental liabilities and eliminated the discount factor for amounts accrued prior to fiscal year 2017 which resulted in a $267.5 million increase in the liability and corresponding regulatory asset. This change in estimate had no impact on the Company's results of operations or cash flows.

The Company estimated the remaining costs of environmental remediation activities were $1,276.4 million and $567.4 million at March 31, 2017 and 2016, respectively. These costs are expected to be incurred over approximately 47 years. 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, 2017 and 2016, the Company has recorded net environmental regulatory assets of $1,473.0 million and $761.0 million, 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.

12. COMMITMENTS AND CONTINGENCIES

Operating Lease Obligations

The Company has an operating lease for office space which is utilized by both the Company and its affiliates. A portion of the lease expense is allocated to the affiliated entities that benefit from its use. The gross rental expense for the office space was approximately $12.5 million, $12.2 million, and $11.9 million the years ended March 31, 2017, 2016, and 2015, respectively. The rental expense, net of amounts allocated to other affiliated entities, recognized by the Company in the accompanying consolidated statements of income was approximately $4.2 million, $4.1 million, and $4.0 million for the years ended March 31, 2017, 2016, and 2015, respectively.

The future minimum lease payments for the years subsequent to March 31, 2017 are as follows:

(in thousands of dollars) Years Ending March 31,	
2018	$ 12,658
2019	12,798
2020	12,953
2021	13,151
2022	13,098
Thereafter	39,131
Total	$ 103,789

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. In addition, the Company has various capital commitments related to the construction of property, plant and equipment.

The Company's commitments under these long-term contracts for the years subsequent to March 31, 2017 are summarized in the table below:

(in thousands of dollars) Years Ending March 31,	Gas Purchases	Capital Expenditures
2018	$ 186,432	$ 135,940
2019	156,568	-
2020	138,839	-
2021	100,506	-
2022	93,383	-
Thereafter	466,537	-
Total	$ 1,142,265	$ 135,940

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.

SuperStorm Sandy

In October 2012, SuperStorm Sandy hit the northeastern U.S. affecting energy supply to customers in the Company's service territory. Total costs associated with gas customer service restoration from this storm (including capital expenditures) through March 31, 2014 were approximately $69.1 million.

In December 2014, NGUSA reached a final settlement with its insurers, of which the Company's allocated portion was $52.2 million (inclusive of advance payments of $29.2 million), and received final payment for the remaining amounts due. This resulted in the Company recognizing a gain of $2.6 million for the year ended March 31, 2015, recorded as a reduction to operations and maintenance expense in the accompanying consolidated statements of income.

13. 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 net 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,**	
	2017	2016	**2017**	2016
		(in thousands of dollars)		
KeySpan Corporation	**$ -**	$ -	**$ 133,734**	$ 72,621
KeySpan Gas East Corporation	**-**	-	**8,368**	4,645
National Grid Engineering Services	**1,670**	1,619	**-**	-
National Grid Generation LLC	**155**	147	**-**	-
NGUSA Service Company	**-**	-	**29,320**	34,320
Other	**22**	2	**4,330**	3,656
Total	**$ 1,847**	$ 1,768	**$ 175,752**	$ 115,242

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 and accounts receivable from affiliates and accounts payable to affiliates balances are reflected as investing or financing activities in the accompanying consolidated statements of cash flows. In addition, for the purpose of presentation in the consolidated 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. Collectively, NGUSA and KeySpan have 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 borrowings of $301.3 million and a short-term intercompany money pool investment of $451.5 million at March 31, 2017 and 2016, respectively. NETCO had short-term intercompany money pool investments of $135.0 million and $129.8 million at March 31, 2017 and 2016, respectively. The average interest rates for the intercompany money pool were 1.1%, 0.7%, and 0.3% for the years ended March 31, 2017, 2016, and 2015, 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, when a specific cost/causation principle is not determinable, 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.

Net charges to and from the service companies of NGUSA, including but not limited to non-power goods and services, for the years ended March 31, 2017, 2016, and 2015 were $376.3 million, $374.3 million, and $288.8 million, respectively.

Holding Company Charges

NGUSA received charges from National Grid Commercial Holdings Limited (an affiliated company in the United Kingdom) for certain corporate and administrative services provided by the corporate functions of National Grid plc to its U.S. subsidiaries. These charges, which are recorded on the books of NGUSA, have not been reflected in these consolidated financial statements. The estimated amount related to the Company would be $4.8 million, $3.7 million, and $5.1 million for the years ended March 31, 2017, 2016, and 2015, respectively.