THE NARRAGANSETT ELECTRIC COMPANY

FINANCIAL STATEMENTS

FOR THE TWELVE MONTHS ENDED

MARCH 31, 2017
(unaudited)

I hereby certify that I am Vice-President, NE Controller of The Narragansett Electric Company and that the enclosed financial statements for the twelve months ended March 31, 2017, have been prepared in accordance with generally accepted accounting principles, and are, in my opinion, correct, subject to year-end audit adjustments and footnote disclosure. These financial statements should be read in conjunction with the audited financial statements for the year ended March 31, 2017.

George Carlin

George Carlin, Vice-President, NE Controller

7/14/17

Date

The Narragansett Electric Company

Financial Statements

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

THE NARRAGANSETT ELECTRIC COMPANY

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Report of Independent Auditors

To the Board of Directors of
The Narragansett Electric Company

We have audited the accompanying financial statements of The Narragansett Electric Company, which comprise the balance sheets and statements of capitalization as of March 31, 2017 and 2016, and the related 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 Financial Statements

Management is responsible for the preparation and fair presentation of the 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 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the financial position of The Narragansett Electric Company as of March 31, 2017 and 2016, and the results of its operations and its 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

July 14, 2017

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THE NARRAGANSETT ELECTRIC COMPANY
STATEMENTS OF INCOME
(in thousands of dollars)

	Years Ended March 31,		
	2017	2016	2015
Operating revenues:			
Electric services	**$ 892,452**	$ 944,547	$ 1,081,135
Gas distribution	**370,902**	361,702	420,080
Operating revenues	**1,263,354**	1,306,249	1,501,215
Operating expenses:			
Purchased electricity	**302,210**	372,846	499,701
Purchased gas	**132,919**	139,547	206,080
Operations and maintenance	**418,499**	385,873	430,815
Depreciation	**103,923**	96,914	90,746
Other taxes	**120,461**	118,776	127,924
Total operating expenses	**1,078,012**	1,113,956	1,355,266
Operating income	**185,342**	192,293	145,949
Other income and (deductions):			
Interest on long-term debt	**(43,758)**	(43,963)	(44,103)
Other interest, including affiliate interest	**(3,199)**	(1,680)	(4,682)
Loss on sale of assets	**(2,468)**	-	-
Other income, net	**749**	1,512	5,872
Total other deductions, net	**(48,676)**	(44,131)	(42,913)
Income before income taxes	**136,666**	148,162	103,036
Income tax expense	**48,524**	53,004	36,239
Net income	**$ 88,142**	$ 95,158	$ 66,797

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

THE NARRAGANSETT ELECTRIC COMPANY
STATEMENTS OF COMPREHENSIVE INCOME
(in thousands of dollars)

	Years Ended March 31,		
	2017	2016	2015
Net income	**$ 88,142**	$ 95,158	$ 66,797
Other comprehensive income, net of taxes:			
Unrealized gains (losses) on securities	**110**	(62)	125
Change in pension and other postretirement obligations	**(4)**	9	1,176
Unrealized gains on hedges	**471**	494	494
Total other comprehensive income	**577**	**441**	**1,795**
Comprehensive income	**$ 88,719**	$ 95,599	$ 68,592
Related tax (expense) benefit:			
Unrealized (gains) losses on securities	**$ (60)**	$ 34	$ (68)
Change in pension and other postretirement obligations	**2**	(5)	(633)
Unrealized gains on hedges	**(254)**	(266)	(266)
Total tax expense	**$ (312)**	$ (237)	$ (967)

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

THE NARRAGANSETT ELECTRIC COMPANY
STATEMENTS OF CASH FLOWS
(in thousands of dollars)

	Years Ended March 31,		
	2017	2016	2015
Operating activities:			
Net income	$ **88,142**	$ 95,158	$ 66,797
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	**103,923**	96,914	90,746
Regulatory amortizations	**714**	706	(1,145)
Provision for deferred income taxes	**27,470**	45,818	23,013
Bad debt expense	**14,105**	8,480	28,269
Amortization of debt discount and issuance costs	**293**	294	293
Net postretirement benefits expense (contributions)	**3,886**	(10,559)	10,310
Net environmental remediation payments	**(4,889)**	(3,058)	(283)
Changes in operating assets and liabilities:			
Accounts receivable and other receivable, net, and unbilled revenues	**(35,989)**	74,882	(63,582)
Inventory	**4,330**	(2,662)	(725)
Regulatory assets and liabilities, net	**97,822**	39,235	(64,237)
Derivative instruments	**(23,469)**	(6,897)	21,319
Prepaid and accrued taxes	**5,418**	(3,490)	41,190
Accounts payable and other liabilities	**19,284**	(46,330)	36,357
Other, net	**(1,827)**	(9,144)	4,635
Net cash provided by operating activities	**299,213**	279,347	192,957
Investing activities:			
Capital expenditures	**(295,621)**	(278,050)	(281,992)
Proceeds from restricted cash	**58,044**	73,370	73,151
Payments on restricted cash	**(43,887)**	(43,985)	(87,766)
Affiliated money pool investing and receivables/payables, net	**-**	-	153,189
Cost of removal	**(17,883)**	(17,959)	(13,260)
Other	**1,250**	376	(163)
Net cash used in investing activities	**(298,097)**	(266,248)	(156,841)
Financing activities:			
Preferred stock dividends	**(110)**	(110)	(110)
Payments on long-term debt	**(1,375)**	(1,375)	(1,375)
Affiliated money pool borrowing and receivables/payables, net	**(6,238)**	(16,514)	222,142
Advance from affiliate	**-**	-	(250,000)
Net cash used in financing activities	**(7,723)**	(17,999)	(29,343)
Net (decrease) increase in cash and cash equivalents	**(6,607)**	(4,900)	6,773
Cash and cash equivalents, beginning of year	**14,410**	19,310	12,537
Cash and cash equivalents, end of year	$ **7,803**	$ 14,410	$ 19,310
Supplemental disclosures:			
Interest paid	$ **(42,574)**	(42,683)	(42,887)
Income taxes refunded (paid)	**63**	71	(17,111)
Significant non-cash items:			
Capital-related accruals included in accounts payable	**15,775**	26,990	16,028
Share based compensation	**31**	25	18

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

THE NARRAGANSETT ELECTRIC COMPANY
BALANCE SHEETS
(in thousands of dollars)

	March 31,	
	2017	2016
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 7,803**	$ 14,410
Restricted cash	**956**	15,113
Accounts receivable	**212,572**	196,654
Allowance for doubtful accounts	**(25,192)**	(25,404)
Accounts receivable from affiliates	**6,354**	18,689
Unbilled revenues	**57,817**	52,063
Inventory	**24,216**	32,458
Regulatory assets	**52,446**	104,033
Derivative instruments	**6,189**	1,316
Prepaid taxes	**9,821**	5,587
Other	**1,805**	3,434
Total current assets	**354,787**	418,353
Property, plant and equipment, net	**2,785,811**	2,576,636
Other non-current assets:		
Regulatory assets	**464,135**	526,590
Goodwill	**724,810**	724,810
Derivative instruments	**167**	398
Other	**13,905**	12,738
Total other non-current assets	**1,203,017**	1,264,536
Total assets	**$ 4,343,615**	$ 4,259,525

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

THE NARRAGANSETT ELECTRIC COMPANY
BALANCE SHEETS
(in thousands of dollars)

	March 31, 2017	March 31, 2016
LIABILITIES AND CAPITALIZATION		
Current liabilities:		
Accounts payable	$ **124,895**	$ 127,141
Accounts payable to affiliates	**80,085**	29,109
Current portion of long-term debt	**1,375**	1,375
Taxes accrued	**29,624**	19,972
Customer deposits	**12,514**	13,496
Interest accrued	**5,434**	5,450
Regulatory liabilities	**106,788**	76,126
Intercompany money pool	**125,659**	195,208
Derivative instruments	**392**	18,154
Renewable energy certificate obligations	**11,841**	17,839
Other	**20,701**	20,031
Total current liabilities	**519,308**	523,901
Other non-current liabilities:		
Regulatory liabilities	**245,856**	222,710
Asset retirement obligations	**10,150**	10,080
Deferred income tax liabilities, net	**538,229**	510,222
Postretirement benefits	**121,799**	181,829
Environmental remediation costs	**135,529**	132,651
Derivative instruments	**1,224**	2,289
Other	**25,230**	17,111
Total other non-current liabilities	**1,078,017**	1,076,892
Capitalization:		
Shareholders' equity	**1,904,300**	1,815,660
Long-term debt	**841,990**	843,072
Total capitalization	**2,746,290**	2,658,732
Total liabilities and capitalization	$ **4,343,615**	$ 4,259,525

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

THE NARRAGANSETT ELECTRIC COMPANY
STATEMENTS OF CAPITALIZATION
(in thousands of dollars)

			March 31,	
			2017	2016
Total shareholders' equity			**$ 1,904,300**	$ 1,815,660
Long-term debt:	Interest Rate	Maturity Date		
Unsecured notes:				
Senior Note	4.53%	March 15, 2020	**250,000**	250,000
Senior Note	5.64%	March 15, 2040	**300,000**	300,000
Senior Note	4.17%	December 10, 2042	**250,000**	250,000
			800,000	800,000
First Mortgage Bonds ("FMB"):				
FMB Series S	6.82%	April 1, 2018	**14,464**	14,464
FMB Series N	9.63%	May 30, 2020	**10,000**	10,000
FMB Series O	8.46%	September 30, 2022	**12,500**	12,500
FMB Series P	8.09%	September 30, 2022	**3,750**	4,375
FMB Series R	7.50%	December 15, 2025	**6,750**	7,500
			47,464	48,839
Total debt			**847,464**	848,839
Unamortized debt discount			**(2,301)**	(2,525)
Unamortized debt issuance costs			**(1,798)**	(1,867)
Current portion of long-term debt			**1,375**	1,375
Long-term debt			**841,990**	843,072
Total capitalization			**$ 2,746,290**	**$ 2,658,732**

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

THE NARRAGANSETT ELECTRIC COMPANY
STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(in thousands of dollars)

	Common Stock	Cumulative Preferred Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss): Unrealized Gain (Loss) on Available-For-Sale Securities	Pension and Other Postretirement Benefits	Hedging Activity	Total Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
Balance as of March 31, 2014	**$ 56,624**	**$ 2,454**	**$ 1,354,934**	**$ 732**	**$ 21**	**$ (4,660)**	**$ (3,907)**	**$ 241,541**	**$ 1,651,646**
Net income	-	-	-	-	-	-	-	66,797	66,797
Other comprehensive income (loss):									
Unrealized gains on securities, net of $68 tax expense	-	-	-	125	-	-	125	-	125
Change in pension and other postretirement obligations, net of $633 tax expense	-	-	-	-	1,176	-	1,176	-	1,176
Unrealized gains on hedges, net of $266 tax expense	-	-	-	-	-	494	494	-	494
Total comprehensive income									68,592
Share based compensation	-	-	18	-	-	-	-	-	18
Preferred stock dividends	-	-	-	-	-	-	-	(110)	(110)
Balance as of March 31, 2015	**$ 56,624**	**$ 2,454**	**$ 1,354,952**	**$ 857**	**$ 1,197**	**$ (4,166)**	**$ (2,112)**	**$ 308,228**	**$ 1,720,146**
Net income	-	-	-	-			-	95,158	95,158
Other comprehensive income (loss):									
Unrealized losses on securities, net of $34 tax benefit	-	-	-	(62)	-	-	(62)	-	(62)
Change in pension and other postretirement obligations, net of $5 tax expense	-	-	-	-	9	-	9	-	9
Unrealized gains on hedges, net of $266 tax expense	-	-	-	-	-	494	494	-	494
Total comprehensive income									95,599
Share based compensation	-	-	25	-	-	-	-	-	25
Preferred stock dividends	-	-	-	-	-	-	-	(110)	(110)
Balance as of March 31, 2016	**$ 56,624**	**$ 2,454**	**$ 1,354,977**	**$ 795**	**$ 1,206**	**$ (3,672)**	**$ (1,671)**	**$ 403,276**	**$ 1,815,660**
Net income	-	-	-	-			-	88,142	88,142
Other comprehensive income (loss):									
Unrealized gains on securities, net of $60 tax expense	-	-	-	110	-	-	110	-	110
Change in pension and other postretirement obligations, net of $2 tax benefit	-	-	-	-	(4)	-	(4)	-	(4)
Unrealized gains on hedges, net of $254 tax expense	-	-	-	-	-	471	471	-	471
Total comprehensive income									88,719
Share based compensation	-	-	31	-	-	-	-	-	31
Preferred stock dividends	-	-	-	-	-	-	-	(110)	(110)
Balance as of March 31, 2017	**$ 56,624**	**$ 2,454**	**$ 1,355,008**	**$ 905**	**$ 1,202**	**$ (3,201)**	**$ (1,094)**	**$ 491,308**	**$ 1,904,300**

The Company had 1,132,487 shares of common stock authorized, issued and outstanding, with a par value of $50 per share and 49,089 shares of cumulative preferred stock authorized, issued and outstanding, with a par value of $50 per share at March 31, 2017 and 2016.

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

THE NARRAGANSETT ELECTRIC COMPANY
NOTES TO THE FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

The Narragansett Electric Company (“the Company”) is a retail distribution company providing electric service to approximately 500,000 customers and gas service to approximately 268,000 customers in 38 cities and towns in Rhode Island. The Company’s service area covers substantially all of Rhode Island.

The Company is a wholly-owned subsidiary of National Grid USA (“NGUSA” or the “Parent”), a public utility holding company with regulated subsidiaries engaged in the generation of electricity and the transmission, distribution, and sale of both natural gas and electricity. NGUSA is a direct wholly-owned subsidiary of National Grid North America Inc. (“NGNA”) and an indirect wholly-owned subsidiary of National Grid plc, a public limited company incorporated under the laws of England and Wales.

The accompanying 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 financial statements reflect the ratemaking practices of the applicable regulatory authorities.

The Company has evaluated subsequent events and transactions through July 14, 2017, the date of issuance of these financial statements, and concluded that there were no events or transactions that require adjustment to, or disclosure in, the financial statements as of and for the year ended March 31, 2017.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

In preparing 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 financial statements. Actual results could differ from those estimates.

Regulatory Accounting

The Federal Energy Regulatory Commission (“FERC”), the Rhode Island Public Utilities Commission (“RIPUC”), and the Rhode Island Division of Public Utilities and Carriers (“Division”) regulate the rates the Company charges its customers. In certain cases, the rate actions of the FERC and RIPUC 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 in the statements of income consistent with the treatment of the related costs in the ratemaking process.

Revenue Recognition

Revenues are recognized for energy service 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.

As approved by the RIPUC, the Company is allowed to pass through commodity-related costs to customers and also bills for approved rate adjustment mechanisms. In addition, the Company has an electric revenue decoupling mechanism (“RDM”) which requires the Company to adjust its base rates annually to reflect the over or under recovery of the Company’s targeted base distribution revenues from the prior fiscal year. Further, the Company has a gas RDM, which requires the Company to adjust its base rates annually to reflect the over or under recovery of the Company’s allowed revenue per customer from the year.

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 and electricity. The Company accounts for taxes that are imposed on customers (such as sales taxes) on a net basis (excluded from revenues).

The Company's policy is to accrue for property taxes on a calendar year basis, taking into account the assessment period. The Company had accrued for property taxes of $17.7 million and $17.3 million at March 31, 2017 and 2016, respectively.

Income Taxes

Federal income taxes have been computed utilizing the asset and liability approach that requires the recognition of deferred tax assets and liabilities for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. Deferred income taxes also reflect the tax effect of net operating losses, capital losses, and general business credit carryforwards.

The effects of tax positions are recognized in the financial statements when it is more likely than not that the position taken, or expected to be taken, in a tax return will be sustained upon examination by taxing authorities based on the technical merits of the position. The financial effect of changes in tax laws or rates is accounted for in the period of enactment. Deferred investment tax credits are amortized over the useful life of the underlying property.

NGNA files consolidated federal tax returns including all of the activities of its subsidiaries. Each subsidiary determines its 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. The Company did not record a difference this year since it was in a taxable loss position.

Cash and Cash Equivalents

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

Restricted Cash

Restricted cash consists of collateral paid to the Company's counterparties for outstanding derivative instruments. The Company had restricted cash of $1.0 million and $15.1 million at March 31, 2017 and 2016, respectively.

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 RIPUC.

The Company had materials and supplies of $10.2 million and $12.1 million, purchased renewable energy certificates ("RECs") of $7.5 million and $11.5 million, and gas in storage of $6.5 million and $8.9 million at March 31, 2017 and 2016, respectively. (See Renewable Energy Certificates below for more information on RECs).

Derivative Instruments

Commodity Derivative Instruments – Regulated Accounting

The Company uses derivative instruments (including purchase, futures, and swap contracts) to manage commodity price risk. All derivative instruments, except those that qualify for the normal purchase normal sale exception, are recorded on the balance sheet at their fair value. All commodity costs, including the impact of derivative instruments, are passed on to customers through the Company's commodity rate adjustment mechanisms. 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 has certain non-trading instruments for the physical purchase of electricity that qualify for the normal purchase normal sale exception and are accounted for upon settlement. If the Company were to determine that a contract no longer qualifies for the normal purchase normal sale exception, then the Company would recognize the fair value of the contract in accordance with the regulatory accounting described above.

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 balance sheet.

Commodity Derivative Instruments – Non-Regulated Accounting

The Company also uses derivative instruments related to storage optimization, such as gas purchase and swaps contracts to maximize the value of its storage and transportation assets and to reduce the cash flow variability associated with forecasted purchases and sales of various energy-related commodities. The gains and losses on these contracts are shared between the company and its customers. The company does not apply regulatory accounting treatment on these contracts since this optimization program is not done solely on behalf of rate payers. All such derivative instruments are accounted for at fair value on the balance sheet with all changes in fair value reported in the accompanying statements of income.

Renewable Energy Certificate Obligations

RECs are stated at cost and are used to measure compliance with renewable energy standards. RECs are held primarily for consumption. At March 31, 2017 and 2016 the Company recorded purchased RECs of $7.5 million and $11.5 million within inventory and a compliance liability based on retail electricity sales of $11.8 million and $17.8 million .

Power Purchase Arrangements

The Company enters into power purchase agreements to procure commodity to serve its electric service customers. The Company evaluates whether such agreements are leases, derivative instruments, or executory contracts. Power purchase agreements that do not qualify as leases or derivative instruments are accounted for as executory contracts and are, therefore, recognized as the electricity is purchased. In making its determination of the accounting for power purchase agreements, the Company considers many factors, including: the source of the electricity; the level of output from any specified facility that the Company is taking under the contract; the involvement, if any, that the Company has in operating the specified facility; and the pricing mechanisms in the contract.

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. Similar to the power purchase agreements noted above, 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 available-for-sale securities 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 FERC and RIPUC. The average composite rates for the years ended March 31, 2017, 2016, and 2015 are as follows:

	Electric			**Gas**		
	Years Ended March 31,			**Years Ended March 31,**		
	2017	2016	2015	**2017**	2016	2015
Composite rates	**2.9%**	3.0%	3.0%	**3.2%**	3.2%	3.5%

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 $206.7 million and $194.9 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 statements of income as non-cash income in other income, 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 $(0.1) million, $(0.8) million, and $1.3 million and AFUDC related to debt of $1.0 million, $0.2 million, and $0.6 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 1.1%, 0.7%, and 6.2%, 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 year ended March 31, 2017, there was $2.5 million of impairment losses recognized for long-lived assets. For the years ended March 31, 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 both income and market approaches. The Company uses a 50% weighting for each valuation methodology, as it believes that each methodology provides equally valuable 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.

Available-For-Sale Securities

The Company provides certain executives with nonqualified retirement and deferred compensation benefits which have been partially secured through separate fund arrangements. As a result, the Company holds available-for-sale securities that include equities, municipal bonds, and corporate bonds. These investments are recorded at fair value and are included in other non-current assets on the balance sheet. Changes in the fair value of these assets are recorded within other comprehensive income.

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 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 balance sheets. 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	**$ 10,080**	$ 2,061
Accretion expense	**389**	119
Liabilities settled	**(319)**	(243)
Revaluations to present values of estimated cash flows	**-**	8,143
Balance as of the end of the year	**$ 10,150**	$ 10,080

At March 31, 2016, the Company carried out a revaluation study that resulted in a net upward revaluation in estimated costs related to the asset retirement obligations. These increases were due to changes in remediation cost and revised replacement programs.

Employee Benefits

The Company participates with other subsidiaries in defined benefit pension plans and postretirement benefit other than pension ("PBOP") plans for its employees, administered by NGUSA. The Company recognizes its portion of the pension and PBOP plans' funded status on the balance sheets 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 10, "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 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 operations, cash flows, and financial position of the Company if any.

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 operations, cash flows, and financial position of the Company.

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.

Reclassifications

Certain reclassifications have been made to the 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.

Financial Statement Revision

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

During the Company's review of its regulatory account balances for fiscal year 2017, management identified corrections that were necessary to align certain recorded account balances to recently concluded rate filings, as well as to adjust carrying charge appropriately. A cumulative adjustment of $2.0 million (net of income taxes) was recorded, of which $0.3 million was recorded as a decrease to opening retained earnings as of March 31, 2015. Additionally, a $2.0 million decrease and a $0.3 million increase were recorded to net income for the years ended March 31, 2016 and 2015, respectively.

In addition, during a review of the Company's Pension and Other Post Retirement Benefit deferrals, management identified that amounts recovered through the electric transmission rates were not correctly incorporated into the calculation of these deferral balances. A cumulative adjustment of $4.5 million (net of income taxes) was recorded, of which $1.1 million was recorded as a decrease to opening retained earnings as of March 31, 2015. Additionally, $2.2 million and $1.2 million were recorded as a decrease to net income for the years ended March 31, 2016 and 2015, respectively.

The cumulative adjustments did not result in any changes to the Statement of Cash Flows and the Statement of Comprehensive Income for March 2016 and 2015.

	As Previously Reported	Adjustments	As Revised
		(in thousands of dollars)	
Statement of Income	**March 2016**		**March 2016**
Total operating revenues	$ 1,308,524	$ (2,275)	$ 1,306,249
Total operating expenses	1,110,777	3,179	1,113,956
Operating income	197,747	(5,454)	192,293
Total other deductions, net	(43,047)	(1,084)	(44,131)
Income before income taxes	154,700	(6,538)	148,162
Income tax expense	55,292	(2,288)	53,004
Net income	99,408	(4,250)	95,158
Statement of Income	**March 2015**		**March 2015**
Total operating revenues	$ 1,500,035	$ 1,180	$ 1,501,215
Total operating expenses	1,353,475	1,791	1,355,266
Operating income	146,560	(611)	145,949
Other deductions, net	(42,163)	(750)	(42,913)
Income before income taxes	104,397	(1,361)	103,036
Income tax expense	36,715	(476)	36,239
Net income	67,682	(885)	66,797

	As Previously Reported	Adjustments	As Revised
		(in thousands of dollars)	
Balance Sheet	**March 2016**		**March 2016**
Total current assets	$ 419,496	$ (1,143)	$ 418,353
Total other non-current assets	1,271,388	(6,852)	1,264,536
Total assets	4,267,520	(7,995)	4,259,525
Total current liabilities	521,852	2,049	523,901
Total other non-current liabilities	1,080,408	(3,516)	1,076,892
Total liabilities and capitalization	4,267,520	(7,995)	4,259,525
Retained Earnings			
March 31, 2016	$ 409,804	$ (6,528)	$ 403,276
March 31, 2015	310,506	(2,278)	308,228
March 31, 2014	242,934	(1,393)	241,541
Shareholders' equity			
March 31, 2016	$ 1,822,188	$ (6,528)	$ 1,815,660
March 31, 2015	1,722,424	(2,278)	1,720,146
March 31, 2014	1,653,039	(1,393)	1,651,646

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 balance sheet.

	March 31, 2017	March 31, 2016
	(in thousands of dollars)	
Regulatory assets:		
Current:		
Derivative instruments	**$ -**	$ 18,757
Gas costs adjustment	**1,246**	3,276
Rate adjustment mechanisms	**37,395**	58,228
Renewable energy certificates	**4,307**	6,394
Revenue decoupling mechanism	**9,498**	10,087
Other	**-**	7,291
Total	**52,446**	104,033
Non-current:		
Environmental response costs	**139,024**	135,785
Postretirement benefits	**201,626**	264,980
Storm costs	**93,764**	96,428
Other	**29,721**	29,397
Total	**464,135**	526,590
Regulatory liabilities:		
Current:		
Derivative Instruments	**4,525**	-
Energy efficiency	**39,897**	**24,596**
Rate adjustment mechanisms	**51,300**	**37,273**
Revenue decoupling mechanism	**10,839**	**13,280**
Other	**227**	**977**
Total	**106,788**	76,126
Non-current:		
Cost of removal	**206,750**	194,908
Environmental response fund	**6,916**	5,440
Postretirement benefits	**10,910**	10,317
Other	**21,280**	**12,045**
Total	**245,856**	222,710
Net regulatory assets	**$ 163,937**	$ 331,787

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

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

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

Environmental response costs: The regulatory asset represents deferred costs associated with the Company's share of the estimated costs to investigate and perform certain remediation activities at sites with which it may be associated. The Company's rate plans provide for specific rate allowances for these costs, with variances deferred for future recovery from, or return to, customers. The Company believes future costs, beyond the expiration of current rate plans, will continue to be recovered through rates. The regulatory liability represents the excess of amounts received in rates over the Company's actual site investigation and remediation costs.

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 state regulators. These amounts will be refunded to, or recovered from, customers over the next year.

Postretirement benefits: The regulatory asset represents the Company's deferral related to the underfunded status of its pension and PBOP plans. The regulatory liability primarily represents the excess of amounts received in rates over actual costs of the Company's pension and PBOP plans to be refunded in future periods.

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 RIPUC.

Renewable energy certificates: Represents deferred costs associated with the Company's compliance obligation with the Rhode Island Renewable Portfolio Standard ("RPS"). The RPS is legislation established to foster the development of new renewable energy sources. The regulatory asset will be recovered over the next year.

Revenue decoupling mechanism: As approved by the RIPUC, the Company has an electric RDM which allows for an annual adjustment to the Company's delivery rates as a result of the reconciliation between annual target revenue and actual billed delivery service revenue. Any difference between the annual target revenue and actual billed delivery service revenue is recorded as a regulatory asset or regulatory liability. The Company also has a gas RDM which allows for an 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.

Storm costs: On December 29, 2016, the Company filed with the RIPUC a petition to implement a Storm Fund Replenishment Factor effective April 1, 2017 to collect approximately $84.3 million over a four-year period to be credited to the Company's Storm Contingency Fund ("Storm Fund"), to restore the Storm Fund to a positive balance. In addition, the Company also requested to extend the annual $3.0 million of supplemental base distribution rate contributions beyond the current expiration date of January 31, 2019 to coincide with the four-year replenishment period. The RI Division of Public Utilities and Carriers (Division), which is the primary intervenor in RI on rate matters, filed testimony challenging the recovery of $10.6 million of the $84.3 million being sought through the Storm Fund Replenishment Factor ("SFRF"). On June 21, 2017, the RIPUC unanimously approved the Company's request to collect the $84.3 million, however it has not ruled on the Division's request to deny the $10.6 million. It is uncertain at this time when the RIPUC will rule or what the outcome will be on this matter. The SFRF is applicable to all retail delivery service customers for effect July 1, 2017 for a four-year period. In addition, the PUC unanimously approved the Company's request to extend the annual $3.0 million of supplemental base distribution rate contributions to the Storm Fund, which the PUC authorized in the Company's last rate case, for an additional 26-month period beyond its current expiration to March 31, 2021.

The Company records carrying charges on regulatory balances related to rate adjustment mechanisms, storm costs, postretirement benefits, and environmental response costs 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.

4. RATE MATTERS

General Rate Case

The RIPUC approved a settlement agreement among the Division, the Department of the Navy, and the Company, which provided for an increase in electric base distribution revenue of $21.5 million and an increase in gas base distribution revenue of $11.3 million based on a 9.5% allowed return on equity ("ROE") and a common equity ratio of approximately 49.1%, effective February 1, 2013. The settlement also included reinstatement of base rate recovery of storm fund contributions and implementation of a Pension Adjustment Mechanism for pension and PBOP expenses for the electric business identical to the mechanism in place for the gas business.

Recovery of Transmission Costs

New England Power ("NEP" a company affiliate) operates the transmission facilities of its New England affiliates as a single integrated system and reimburses the Company for the cost of its transmission facilities in Rhode Island, including a return on those facilities under NEP's Tariff No. 1. In turn, these costs are allocated among transmission customers in New England in accordance with the ISO New England Open Access Transmission Tariff ("ISO-NE OATT"). According to the FERC order, the Company is compensated for its actual monthly transmission costs with its authorized maximum ROE of 11.74% on certain transmission assets. The amounts reimbursed to the Company by NEP for the years ended March 31, 2017, 2016, and 2015 were $143.0 million, $129.3 million, and $114.4 million, respectively, which are included within the accompanying statements of income. On October 16, 2014, the FERC issued an order, Opinion No. 531-A, resetting the base ROE applicable to transmission assets under the ISO-NE OATT from 11.14% to 10.57% effective as of October 16, 2014 and establishing a maximum ROE of 11.74%. On March 3, 2015, the FERC issued an Order on Rehearing, Opinion No. 531-B, affirming the 10.57% base ROE and clarifying that the 11.74% maximum ROE applies to all individual transmission projects with ROE incentives previously granted by the FERC. On April 14, 2017, the U.S. Court of Appeals for the D.C. Circuit (Court of Appeals) vacated and remanded FERC's Opinion No. 531 (and successor orders), through which FERC had lowered NETO return on equity from 11.14% to 10.57% and capped the total incentives at 11.74%. Due to this vacatur, on June 5, 2017, the New England Transmission Owners made a filing with FERC to reinstate the base ROE of 11.14% effective June 6, 2017. The final resolution of procedural posture of ROE complaints is unclear at this time.

New England East-West Solution ("NEEWS") Project

In September 2008, the Company, NEP and Northeast Utilities jointly filed an application with the FERC to recover financial incentives for the NEEWS project, pursuant to the FERC's Transmission Pricing Policy Order No. 679. NEEWS consists of a series of inter-related transmission upgrades identified in the New England Regional System Plan and is being undertaken to address a number of reliability problems in Connecticut, Massachusetts, and Rhode Island. The Company's share of the NEEWS-related transmission investment was approximately $575 million. The Company is fully reimbursed for its transmission revenue requirements on a monthly basis by NEP through NEP's Tariff No. 1. Effective November 18, 2008, the FERC granted (1) an incentive ROE of 12.89% (125 basis points above the approved base ROE of 11.64%), (2) 100% construction work in progress ("CWIP") in rate base, and (3) recovery of plant abandoned for reasons beyond the companies' control. As discussed in the preceding section, effective October 16, 2014, the FERC issued a series of orders establishing a maximum ROE of 11.74% that effectively caps the NEEWS incentive ROE at that level. The NEEWS upgrades were placed in service in December 2015.

5. PROPERTY, PLANT AND EQUIPMENT

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

	March 31, 2017	March 31, 2016
	(in thousands of dollars)	
Plant and machinery	**$ 3,451,718**	$ 3,212,116
Land and buildings	**111,808**	123,082
Assets in construction	**135,537**	136,360
Software and other intangibles	**20,611**	30,589
Property held for future use	**15,028**	15,127
Total property, plant and equipment	**3,734,702**	3,517,274
Accumulated depreciation and amortization	**(948,891)**	(940,638)
Property, plant and equipment, net	**$ 2,785,811**	$ 2,576,636

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	March 31, 2016
	(in thousands)	
Gas future contracts	**2,600**	14,270
Gas purchase contracts	**3,318**	1,416
Gas swap contracts	**27,415**	22,543
Total	**33,333**	38,229

Amounts Recognized on the Balance Sheets

	Asset Derivatives March 31, 2017	Asset Derivatives March 31, 2016		Liability Derivatives March 31, 2017	Liability Derivatives March 31, 2016
	(in thousands of dollars)			*(in thousands of dollars)*	
Current assets:			Current liabilities:		
Rate recoverable contracts:			Rate recoverable contracts:		
Gas future contracts	**$ 329**	$ 903	Gas future contracts	**$ 24**	$ 12,472
Gas purchase contracts	**-**	16	Gas purchase contracts	**344**	-
Gas swap contracts	**5,643**	263	Gas swap contracts	**22**	5,576
Contracts not subject to rate recovery:			Contracts not subject to rate recovery:		
Gas purchase contracts	**10**	12	Gas purchase contracts	**-**	-
Gas swap contracts	**207**	122	Gas swap contracts	**2**	106
	6,189	1,316		**392**	18,154
Other non-current assets:			Other non-current liabilities:		
Rate recoverable contracts:			Rate recoverable contracts:		
Gas future contracts	**-**	-	Gas future contracts	**-**	1,622
Gas swap contracts	**167**	398	Gas swap contracts	**337**	667
Gas purchase contracts	**-**	-	Gas purchase contracts	**887**	-
	167	398		**1,224**	2,289
Total	**$ 6,356**	$ 1,714	Total	**$ 1,616**	$ 20,443

The changes in fair value of the Company's rate recoverable contracts are offset by changes in regulatory assets and liabilities. As a result, the changes in fair value of those contracts had no impact in the accompanying statements of income. For the years ended March 31, 2017, 2016, and 2015, the Company recorded a gain of $0.2 million, and losses of $0.4 million and $0.8 million, respectively, within purchased gas in the accompanying statements of income for changes in fair value for contracts not subject to rate recovery.

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 Company enters into commodity transactions on the New York Mercantile Exchange ("NYMEX"). The NYMEX clearing houses act as the counterparty to each trade. Transactions on the NYMEX must adhere to comprehensive collateral and margining requirements. As a result, transactions on the NYMEX are significantly collateralized and have limited counterparty credit risk.

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, normal purchase normal sale contracts, and applicable payables and receivables, net of collateral, and instruments that are subject to master netting agreements, was a liability of $5.3 million and $6.8 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 $0.05 million and $5.7 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 $0.06 million and $6.2 million additional collateral to its counterparties at March 31, 2017 and 2016, respectively.

Offsetting Information for Derivative Instruments Subject to Master Netting Arrangements

March 31, 2017
Gross Amounts Not Offset in the Balance Sheets
(in thousands of dollars)

ASSETS:	Gross amounts of recognized assets *A*	Gross amounts offset in the Balance Sheets *B*	Net amounts of assets presented in the Balance Sheets *C=A+B*	Financial Instruments *Da*	Cash collateral received *Db*	Net amount *E=C-D*
Derivative instruments						
Gas future contracts	$ 329	$ -	$ 329	$ -	$ 329	$ -
Gas purchase contracts	10	-	10	-	-	10
Gas swap contracts	6,016	-	6,016	-	-	6,016
Total	$ 6,355	$ -	$ 6,355	$ -	$ 329	$ 6,026

LIABILITIES:	Gross amounts of recognized liabilities *A*	Gross amounts offset in the Balance Sheets *B*	Net amounts of liabilites presented in the Balance Sheets *C=A+B*	Financial Instruments *Da*	Cash collateral paid *Db*	Net amount *E=C-D*
Derivative instruments						
Gas future contracts	$ 24	$ -	$ 24	$ -	$ 24	$ -
Gas purchase contracts	1,231	-	1,231	-	-	1,231
Gas swap contracts	361	-	361	-	-	361
Total	$ 1,616	$ -	$ 1,616	$ -	$ 24	$ 1,592

March 31, 2016
Gross Amounts Not Offset in the Balance Sheets
(in thousands of dollars)

ASSETS:	Gross amounts of recognized assets *A*	Gross amounts offset in the Balance Sheets *B*	Net amounts of assets presented in the Balance Sheets *C=A+B*	Financial Instruments *Da*	Cash collateral received *Db*	Net amount *E=C-D*
Derivative instruments						
Gas future contracts	$ 903	$ -	$ 903	$ -	$ 903	$ -
Gas purchase contracts	28	-	28	-	-	28
Gas swap contracts	783	-	783	-	-	783
Total	$ 1,714	$ -	$ 1,714	$ -	$ 903	$ 811

LIABILITIES:	Gross amounts of recognized liabilities *A*	Gross amounts offset in the Balance Sheets *B*	Net amounts of liabilites presented in the Balance Sheets *C=A+B*	Financial Instruments *Da*	Cash collateral paid *Db*	Net amount *E=C-D*
Derivative instruments						
Gas future contracts	$ 14,094	$ -	$ 14,094	$ -	$ 14,094	$ -
Gas swap contracts	6,349	-	6,349	-	-	6,349
Total	$ 20,443	$ -	$ 20,443	$ -	$ 14,094	$ 6,349

7. FAIR VALUE MEASUREMENTS

The following tables present assets and liabilities measured and recorded at fair value on the 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 future contracts	$ 329	$ -	$ -	$ 329
Gas purchase contracts	-	10	-	10
Gas swap contracts	-	6,016	-	6,016
Available-for-sale securities	2,500	3,286	-	5,786
Total	$ 2,829	$ 9,312	$ -	$ 12,141
Liabilities:				
Derivative instruments				
Gas future contracts	$ 24	$ -	$ -	$ 24
Gas purchase contracts	-	-	1,231	1,231
Gas swap contracts	-	361	-	361
Total	24	361	1,231	1,616
Net (liabilities) assets	$ 2,805	$ 8,951	$ (1,231)	$ 10,525

	March 31, 2016							
	Level 1		Level 2		Level 3		Total	
			(in thousands of dollars)					
Assets:								
Derivative instruments								
Gas future contracts	$	903	$	-	$	-	$	903
Gas purchase contracts		-		12		16		28
Gas swap contracts		-		783		-		783
Available-for-sale securities		2,391		3,018		-		5,409
Total	$	3,294	$	3,813	$	16	$	7,123
Liabilities:								
Derivative instruments								
Gas future contracts	$	14,094	$	-	$	-	$	14,094
Gas purchase contracts								-
Gas swap contracts		-		6,349		-		6,349
Total		14,094		6,349		-		20,443
Net (liabilities) assets	$	(10,800)	$	(2,536)	$	16	$	(13,320)

Derivative instruments: The Company's Level 1 fair value derivative instruments consist of active exchange-based derivative instruments (e.g. natural gas futures traded on NYMEX) valued based on quoted prices (unadjusted) in active markets for identical assets or liabilities at the measurement date.

The Company's Level 2 fair value derivative instruments consist of over-the-counter ("OTC") gas swaps and purchase contracts with pricing inputs obtained from the NYMEX 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 consist of OTC 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.

Available-for-sale securities: Available-for-sale securities are included in other non-current assets on the balance sheet and primarily include equity and debt investments based on quoted market prices (Level 1) and municipal and corporate bonds based on quoted prices of similar traded assets in open markets (Level 2).

Changes in Level 3 Derivative Instruments

	Years Ended March 31,	
	2017	2016
	(in thousands of dollars)	
Balance as of the beginning of the year	**$ 16**	$ 18
Net losses	**(1,454)**	(2,915)
Settlements:		
included in earnings	**(33)**	317
included in regulatory assets and liabilities	**240**	2,596
Balance as of the end of the year	**$ (1,231)**	$ 16
The amount of total gains or losses for the year included in net income attributed to the change in unrealized gains or losses related to non-regulatory assets and liabilities at year-end	$ -	$ -

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:

Quantitative Information About Level 3 Fair Value Measurements

Commodity	Level 3 Position	Fair Value as of March 31, 2017			Valuation Technique(s)	Significant Unobservable Input	Range
		Assets	(Liabilities)	Total			
		(thousands of dollars)					
Gas	Purchase contracts	$ -	$ (1,231)	$ (1,231)	Discounted Cash Flow	LNG Forward Curve	$9.8418-$10.8906/dth
	Total	$ -	$ (1,231)	$ (1,231)			

Commodity	Level 3 Position	Fair Value as of March 31, 2016			Valuation Technique(s)	Significant Unobservable Input	Range
		Assets	(Liabilities)	Total			
		(thousands of dollars)					
Gas	Purchase contracts	$ 16	$ -	$ 16	Discounted Cash Flow	LNG Forward Curve	$1.903-$1.959/dth
	Total	$ 16	$ -	$ 16			

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 derivative instruments are forward liquefied natural gas commodity prices and gas forward curves. A relative change in commodity price at various locations underlying the open positions can result in significantly different fair value estimates.

Other Fair Value Measurements

The Company's 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 $0.9 billion and $1 billion, respectively.

All other financial instruments on the 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 other NGUSA subsidiaries in a qualified and non-qualified non-contributory defined benefit plan (the "Pension Plan") and PBOP plan (together with the Pension Plan (the "Plan")), covering substantially all employees.

The Pension Plan is a defined benefit plan which provides union employees, as well as non-union employees hired before January 1, 2011, with a retirement benefit. Supplemental non-qualified, non-contributory executive retirement programs provide additional defined pension benefits for certain executives. 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 $16.5 million, $30.6 million, and $20.4 million, respectively, to the Plan.

Plan assets are commingled and cannot be allocated to an individual company. The Plan's costs are first directly charged to the Company based on the Company's employees that participate in the Plan. Costs associated with affiliated service companies' employees are then allocated as part of the labor burden for work performed on the Company's behalf. The Company applies deferral accounting for pension and PBOP expenses associated with its regulated gas and electric operations. Any differences between actual pension costs and amounts used to establish rates are deferred and collected from, or refunded to, customers in subsequent periods. Pension and PBOP expense are included within operations and maintenance expense in the accompanying statements of income.

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

	March 31,	
	2017	2016
	(in thousands of dollars)	
Pension	**$ 481,066**	$ 591,400
PBOP	**336,314**	468,020
	$ 817,380	$ 1,059,420

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	**$ 24,074**	$ 15,706	$ 21,368
PBOP	**10,573**	5,979	7,283
	$ 34,647	$ 21,685	$ 28,651

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 statements of income of $2.8 million, $2.8 million, and $2.7 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 $3.5 million and $3.2 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. ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table represents the changes in the Company's AOCI for the years ended March 31, 2017 and 2016:

	Unrealized Gain (Loss) on Available-For-Sale Securities	Pension and Other Postretirement Benefits	Hedging Activity	Total
		(in thousands of dollars)		
Balance as of March 31, 2015	**$ 857**	**$ 1,197**	**$ (4,166)**	**$ (2,112)**
Other comprehensive income before reclassifications:				
Unrecognized net acturial gain (net of $3 tax benefit)	-	(6)	-	(6)
Gain on investment (net of $50 tax expense)	93	-	-	93
Amounts reclassified from other comprehensive income (loss):				
Amortization of net actuarial loss (net of $8 tax expense) (1)	-	15	-	15
Amortization of treasury lock (net of $266 tax expense) (2)	-	-	494	494
Gain on investment (net of $84 tax benefit) (1)	(155)	-	-	(155)
Net current period other comprehensive income	(62)	9	494	441
Balance as of March 31, 2016	**$ 795**	**$ 1,206**	**$ (3,672)**	**$ (1,671)**
Other comprehensive income before reclassifications:				
Unrecognized net acturial loss (net of $11 tax benefit)	-	(21)	-	(21)
Gain on investment (net of $83 tax benefit)	265	-	-	265
Amounts reclassified from other comprehensive income (loss):				
Amortization of net actuarial loss (net of $9 tax expense) (1)	-	17	-	17
Amortization of treasury lock (net of $254 tax expense) (2)	-	-	471	471
Gain on investment (net of $143 tax benefit) (1)	(155)	-	-	(155)
Net current period other comprehensive (loss) income	110	(4)	471	577
Balance as of March 31, 2017	**$ 905**	**$ 1,202**	**$ (3,201)**	**$ (1,094)**

(1) Amounts are reported as other income, net in the accompanying statements of income.
(2) Amounts are reported as interest on long-term debt in the accompanying statements of income.

10. 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 $1.9 million as of March 31, 2016. Debt issuance costs were $1.8 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	$ 1,375
2019	15,839
2020	251,375
2021	11,375
2022	1,375
Thereafter	566,125
Total	$ 847,464

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.

Debt Authorizations

Since January 12, 2015, the Company had regulatory approval from the FERC to issue up to $400 million of short-term debt. The authorization was effective for a period of two years which expired on January 11, 2017 and which has now been extended to January 10, 2019. The Company had no short-term debt outstanding to third-parties as of March 31, 2017 or 2016.

First Mortgage Bonds

At March 31, 2017, the Company had $47.5 million of FMB outstanding. Substantially all of the assets used in the gas business of the Company are subject to the lien of the mortgage indentures under which these FMB have been issued. The FMB have annual sinking fund requirements totaling approximately $1.4 million.

The Company has a maximum 70% of debt-to-capitalization covenant. Furthermore, if at any time the Company's debt exceeds 60% of the total capitalization, each holder of bonds then outstanding shall receive effective as of the first date of such occurrence, a one time, and permanent 0.20% increase in the interest rate paid by the Company on its bonds. During the years ended March 31, 2017 and 2016, the Company was in compliance with this covenant. At March 31, 2017 and 2016, the Company's debt-to-capitalization ratio was 31% and 32%, respectively.

Dividend Restrictions

Pursuant to the preferred stock arrangement, as long as any preferred stock is outstanding, certain restrictions on payment of common stock dividends would come into effect if the common stock equity was, or by reason of payment of such dividends became, less than 25% of total capitalization. Common stock equity at March 31, 2017 and 2016 was approximately 69% and 68%, respectively, of total capitalization. Accordingly, the Company was not restricted as to the payment of common stock dividends under the foregoing provisions at March 31, 2017 or 2016**.**

Cumulative Preferred Stock

The Company has certain issues of non-participating cumulative preferred stock outstanding which can be redeemed at the option of the Company. There are no mandatory redemption provisions on the Company's cumulative preferred stock. A summary of cumulative preferred stock is as follows:

	Shares Outstanding		**Amount**		
	March 31,		**March 31,**		Call
Series	**2017**	2016	**2017**	2016	Price
	(in thousands of dollars, except per share and number of shares data)				
$50 par value - 4.50% Series	**49,089**	49,089	**$ 2,454**	$ 2,454	$ 55.000

The Company did not redeem any preferred stock during the years ended March 31, 2017, 2016, or 2015. The annual dividend requirement for cumulative preferred stock was $0.1 million for each of the years ended March 31, 2017, 2016, and 2015.

11. INCOME TAXES

Components of Income Tax Expense

	Years Ended March 31,		
	2017	2016	2015
	(in thousands of dollars)		
Current federal income tax expense (benefit)	**$ 21,054**	$ 7,186	$ 13,226
Deferred federal tax expense (benefit)	**27,576**	45,963	23,192
Amortized investment tax credits, net	**(106)**	(145)	(180)
Total deferred tax expense	**27,470**	45,818	23,012
Total income tax expense	**$ 48,524**	$ 53,004	$ 36,238

Statutory Rate Reconciliation

The Company's effective tax rates for the years ended March 31, 2017, 2016 and 2015 are 35.5%, 35.8% and 35.2% 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	**$ 47,833**	$ 51,856	$ 36,061
Change in computed taxes resulting from:			
Temporary difference flowed through	**834**	1,075	642
Other items, net	**(143)**	73	(465)
Total	**691**	1,148	177
Total income tax expense	**$ 48,524**	$ 53,004	$ 36,238

The Company is included in the NGNA and subsidiaries consolidated federal 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.

Deferred Tax Components

	March 31,	
	2017	2016
	(in thousands of dollars)	
Deferred tax assets:		
Environmental remediation costs	**$ 47,435**	$ 46,428
Net operating losses	**119,984**	119,045
Postretirement benefits and other employee benefits	**47,831**	68,775
Regulatory liabilities - other	**41,932**	30,396
Other items	**20,876**	25,010
Total deferred tax assets (1)	**278,058**	289,654
Deferred tax liabilities:		
Amortization of goodwill	**54,767**	48,512
Property related differences	**584,330**	534,658
Regulatory assets - environmental	**46,238**	45,620
Regulatory assets - postretirement benefits	**66,071**	88,839
Regulatory assets - other	**59,866**	41,430
Other items	**4,936**	40,632
Total deferred tax liabilities	**816,208**	799,691
Net deferred income tax liabilities	**538,150**	510,037
Deferred investment tax credits	**79**	185
Deferred income tax liabilities, net	**$ 538,229**	$ 510,222

(1) The company established a valuation allowance for deferred tax assets related to expiring charitable contribution carryforwards in the amount of $0.6 million at March 31, 2017 and $0.5 million at March 31, 2016.

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
	(in thousands of dollars)
3/31/2029	$ 2,078
3/31/2030	13,689
3/31/2032	30,224
3/31/2033	50,226
3/31/2034	123,509
3/31/2035	89,467
3/31/2036	79,607

Unrecognized Tax Benefits

As of March 31, 2017, 2016 and 2015 the Company's unrecognized tax benefits totaled $34.0 million, $29.4 million and $27 million, respectively, of which none for each of the years would affect the effective tax rate, if recognized. The unrecognized tax benefits are included in other non-current liabilities on the 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	**$ 29,407**	$ 27,025	$ 22,651
Gross increases related to prior periods	**1,855**	-	2,303
Gross decreases related to prior periods	**-**	(1,285)	(1,992)
Gross increases related to current period	**2,727**	3,667	4,063
Balance as of the end of the year	**$ 33,989**	$ 29,407	$ 27,025

As of March 31, 2017, 2016, and 2015, the Company has no interest accrued related to unrecognized tax benefits. During years ended March 31, 2017, 2016, and 2015 the Company recorded no interest expense. The Company recognizes interest related to unrecognized tax benefits in other interest expense, including affiliate interest and related penalties, if applicable, in other deductions, net in the accompanying statements of income. No tax penalties were recognized during the years ended March 31, 2017, 2016 or 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 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 following table indicates the earliest tax year subject to examination for each major jurisdiction:

Jurisdiction	**Tax Year**
Federal	March 31, 2010

12. ENVIRONMENTAL MATTERS

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

The United States Environmental Protection Agency ("EPA"), the Massachusetts Department of Environmental Protection ("DEP"), and the Rhode Island Department of Environmental Management ("DEM") have alleged that the Company is a potentially responsible party under state or federal law for the remediation of number of sites at which hazardous waste is alleged to have been disposed. The Company's most significant liabilities relate to former Manufactured Gas Plant ("MGP") facilities formerly owned by the Blackstone Valley Gas and Electric Company and the Rhode Island gas distribution assets of New England Gas. The Company is currently investigating and remediating, as necessary, those MGP sites and certain other properties under agreements with the EPA, DEM and DEP. Expenditures incurred for the year ended March 31, 2017, 2016, and 2015 were $4.9 million, $3.1 million, and $0.3 million, respectively.

The Company estimated the remaining costs of environmental remediation activities were $135.5 million and $132.7 million at March 31, 2017 and 2016, respectively. These costs are expected to be incurred over approximately 40 years, and these undiscounted amounts have been recorded as reserves on the balance sheet. However, remediation costs for each site may be materially higher than estimated, depending on changing technologies and regulatory standards, selected end use for each site, and actual environmental conditions encountered. The Company has recovered amounts from certain insurers and potentially responsible parties, and, where appropriate, the Company may seek additional recovery from other insurers and from other potentially responsible parties, but it is uncertain whether, and to what extent, such efforts will be successful.

The RIPUC has approved a settlement agreement that provides for rate recovery of remediation costs of former MGP sites and certain other hazardous waste sites located in Rhode Island. Under that agreement, qualified costs related to these sites are paid out of a special fund established as a regulatory liability on the balance sheet. Rate-recoverable contributions of approximately $3 million are added annually to the fund along with interest and any recoveries from insurance carriers and other third-parties. Accordingly, as of March 31, 2017 and 2016, the Company has recorded environmental regulatory assets of $139.0 million and $135.8 million, respectively, and environmental regulatory liabilities of $6.9 million and $5.4 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.

13. COMMITMENTS AND CONTINGENCIES

Purchase Commitments

The Company has several long-term contracts for the purchase of electric power. Substantially all of these contracts require power to be delivered before the Company is obligated to make payment. Additionally, 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,	Energy Purchases	Capital Expenditures
2018	263,809	38,718
2019	102,394	-
2020	32,981	-
2021	29,308	-
2022	21,031	-
Thereafter	113,565	-
Total	$ 449,523	$ 38,718

The Company purchases additional energy to meet load requirements from independent power producers, other utilities, energy merchants or the ISO-NE at market prices.

Long-term Contracts for Renewable Energy

Deepwater Agreement

The 2009 Rhode Island law also required the Company to solicit proposals for a small scale renewable energy generation project of up to eight wind turbines with an aggregate nameplate capacity of up to 30 MW to benefit the Town of New Shoreham. The renewable energy generation project also included a transmission cable to be constructed between Block Island and the mainland of Rhode Island. On June 30, 2010, the Company entered into a 20-year Amended Power Purchase Agreement ("PPA") with Deepwater Wind Block Island LLC, which was approved by the RIPUC in August 2010. The wind turbines reached commercial operation on December 12, 2016 and the PPA is being accounted for as an operating lease. The Company also negotiated a Transmission Facilities Purchase Agreement ("Facilities Purchase Agreement") with Deepwater Wind Block Island Transmission, LLC ("Deepwater") to purchase from Deepwater the permits, engineering, real estate, and other site development work for construction of the undersea transmission cable (collectively, the "Transmission Facilities"). On April 2, 2014, the Division issued its Consent Decision for the Company to execute the Facilities Purchase Agreement with Deepwater. In July 2014, four agreements were filed with the FERC, in part, for approval to recover the costs associated with the transmission cable and related facilities (the "Project") that will be allocated to the Company and Block Island Power Company through transmission rates. On September 2, 2014, the FERC accepted all four agreements thus approving cost recovery for the Project, with no conditions, that will apply to the Company's costs as well as those of NEP. The agreements went into effect on September 30, 2014. On January 30, 2015, the Company closed on its purchase of the Transmission Facilities from Deepwater. The Company placed the Transmission Facilities into service on October 31, 2016.

Annual Solicitations

The 2009 Rhode Island law also requires that, beginning on July 1, 2010, the Company conduct four annual solicitations for proposals from renewable energy developers and, provided commercially reasonable proposals have been received, enter into long-term contracts for the purchase of capacity, energy, and attributes from newly developed renewable energy resources. The Company's four solicitations have resulted in four PPAs that have been approved by the RIPUC:

- First Solicitation: On July 28, 2011, the RIPUC approved a 15-year PPA with Orbit Energy Rhode Island, LLC for a 3.2 MW anaerobic digester biogas project.
- Second Solicitation: On May 11, 2012, the RIPUC approved a 15-year PPA with Black Bear Development Holdings, LLC for a 3.9 MW run-of-river hydroelectric plant located in Orono, Maine. The facility reached commercial operation on November 22, 2013.
- Third Solicitation: On October 25, 2013, the RIPUC approved a 15-year PPA with Champlain Wind, LLC for a 48 MW land-based wind project located in Carroll Plantation and Kossuth Township, Maine. The PPA was terminated on January 23, 2017 because one of the required permits for the project was rejected. The impact of this termination

is that the Company will need to backfill the MW capacity from that project to meet the 90 MW minimum long-term capacity requirements under the state statute.

- Fourth Solicitation: On October 29, 2015, the RIPUC approved a 15-year PPA with Copenhagen Wind Farm, LLC for an 80 MW land-based wind project located in Denmark, New York.

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.

14. RELATED PARTY TRANSACTIONS

Accounts Receivable from and Accounts Payable to Affiliates

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

The Company records short-term receivables from, and payables to, certain of its affiliates in the ordinary course of business. The amounts receivable from, and payable to, its affiliates do not bear interest and are settled through the intercompany money pool. A summary of 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)			
Massachusetts Electric Company	**$ -**	$ -	**$ 53,278**	$ 20,843
New England Power Company	**4,322**	16,670	**-**	-
NGUSA Service Company	**1,816**	1,817	**22,387**	4,256
Other	**216**	202	**4,420**	4,010
Total	**$ 6,354**	$ 18,689	**$ 80,085**	$ 29,109

Advance from Affiliate

In December 2008, the Company entered into an agreement with NGUSA whereby the Company can borrow up to $250 million from time to time for working capital needs. The advance is non-interest bearing. At March 31, 2017 and 2016, the Company had no outstanding advance from affiliate.

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 and can both borrow and invest funds. Borrowings from the Regulated Money Pool bear interest in accordance with the terms of the Regulated Money Pool Agreement. As the Company fully participates in the Regulated Money Pool 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 statements of cash flows. In addition, for the purpose of presentation in the statements of cash flows, it is assumed all amounts settled through the intercompany money pool are constructive cash receipts and payments, and therefore are presented as such.

The Regulated Money Pool is funded by operating funds from participants. Collectively, NGUSA and its subsidiary, KeySpan, have the ability to borrow up to $3 billion from National Grid plc for working capital needs including funding of the Regulated Money Pool, if necessary. The Company had short-term intercompany money pool borrowings of $125.7 million and $195.2 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 $229.9 million, $217.8 million, and $180.3 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 financial statements. The estimated amount related to the Company would be $4.8 million, $3.5 million, and $4.7 million for the years ended March 31, 2017, 2016, and 2015, respectively.