# Nantucket Electric Company

Financial Statements

For the years ended March 31, 2015 and 2014

**NANTUCKET ELECTRIC COMPANY**

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**Independent Auditor's Report**

To the Board of Directors
of Nantucket Electric Company

We have audited the accompanying financial statements of Nantucket Electric Company (the "Company"), which comprise the balance sheets as of March 31, 2015 and 2014, and the related statements of income, comprehensive income, cash flows, capitalization, and changes in shareholder's equity for the years then ended.

***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.

***Auditor's 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 Nantucket Electric Company at March 31, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

August 19, 2015

**NANTUCKET ELECTRIC COMPANY**
**STATEMENTS OF INCOME**
*(in thousands of dollars)*

| | Years Ended March 31, | |
|---|---|---|
| | **2015** | 2014 |
| **Operating revenues** | **$ 34,379** | $ 28,271 |
| **Operating expenses:** | | |
| Purchased electricity | **13,950** | 10,283 |
| Operations and maintenance | **10,887** | 9,247 |
| Depreciation and amortization | **3,821** | 3,723 |
| Other taxes | **586** | 557 |
| Total operating expenses | **29,244** | 23,810 |
| **Operating income** | **5,135** | 4,461 |
| **Other income and (deductions):** | | |
| Interest on long-term debt | **(393)** | (445) |
| Other interest, including affiliate interest | **(209)** | (96) |
| Other income, net | **220** | 381 |
| Total other deductions, net | **(382)** | (160) |
| **Income before income taxes** | **4,753** | 4,301 |
| **Income tax expense** | **1,856** | 1,777 |
| **Net income** | **$ 2,897** | $ 2,524 |

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

**NANTUCKET ELECTRIC COMPANY**
**STATEMENTS OF COMPREHENSIVE INCOME**
*(in thousands of dollars)*

| | Years Ended March 31, | |
|---|---|---|
| | **2015** | 2014 |
| **Net income** | **$ 2,897** | $ 2,524 |
| **Other comprehensive income:** | | |
| Unrealized gains on securities | **19** | 7 |
| **Comprehensive income** | **$ 2,916** | $ 2,531 |
| **Related tax expense:** | | |
| Unrealized gains on securities | **$ (13)** | (5) |
| Total tax expense | **$ (13)** | $ (5) |

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

## NANTUCKET ELECTRIC COMPANY
## STATEMENTS OF CASH FLOWS
*(in thousands of dollars)*

| | Years Ended March 31, | |
|---|---|---|
| | **2015** | 2014 |
| **Operating activities:** | | |
| Net income | **$ 2,897** | $ 2,524 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | **3,821** | 3,723 |
| Provision for (benefit from) deferred income taxes | **207** | (813) |
| Bad debt expense | **62** | 123 |
| Amortization of debt issuance costs | **149** | 746 |
| Net postretirement benefits expense | **204** | 337 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net, and unbilled revenues | **(1,489)** | (693) |
| Inventory | **(44)** | 48 |
| Regulatory assets and liabilities, net | **2,434** | 2,289 |
| Prepaid and accrued taxes | **(244)** | 1,220 |
| Accounts payable and other liabilities | **2,860** | 273 |
| Other, net | **(534)** | (56) |
| Net cash provided by operating activities | **10,323** | 9,721 |
| **Investing activities:** | | |
| Capital expenditures | **(5,522)** | (2,954) |
| Affiliated money pool investing and receivables/payables, net | **13,205** | (25,899) |
| Cost of removal and other | **588** | (270) |
| Net cash provided by (used in) investing activities | **8,271** | (29,123) |
| **Financing activities:** | | |
| Payments on long-term debt | **(330)** | (305) |
| Advance from affiliate | **(20,000)** | 20,000 |
| Parent loss tax allocation | **1,917** | 356 |
| Net cash (used in) provided by financing activities | **(18,413)** | 20,051 |
| Net increase in cash and cash equivalents | **181** | 649 |
| Cash and cash equivalents, beginning of year | **1,003** | 354 |
| Cash and cash equivalents, end of year | **$ 1,184** | $ 1,003 |
| **Supplemental disclosures:** | | |
| Interest paid | $ (184) | $ (105) |
| Income taxes refunded (paid) | 1,389 | (938) |

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

**NANTUCKET ELECTRIC COMPANY**
**BALANCE SHEETS**
*(in thousands of dollars)*

| | March 31, | |
|---|---|---|
| | **2015** | 2014 |
| **ASSETS** | | |
| **Current assets:** | | |
| Cash and cash equivalents | **$ 1,184** | $ 1,003 |
| Restricted cash and special deposits | **-** | 47 |
| Accounts receivable | **3,044** | 1,859 |
| Allowance for doubtful accounts | **(165)** | (156) |
| Accounts receivable from affiliates | **6,732** | 449 |
| Intercompany money pool | **45,236** | 60,798 |
| Unbilled revenues | **1,454** | 1,203 |
| Inventory | **173** | 129 |
| Regulatory assets | **4,056** | 4,800 |
| Current portion of deferred income tax assets, net | **5,569** | 4,860 |
| Other | **7** | 44 |
| Total current assets | **67,290** | 75,036 |
| **Property, plant, and equipment, net** | **70,379** | 69,541 |
| **Other non-current assets:** | | |
| Regulatory assets | **6,041** | 4,698 |
| Goodwill | **15,706** | 15,706 |
| Financial investments | **907** | 829 |
| Other | **1,024** | 1,031 |
| Total other non-current assets | **23,678** | 22,264 |
| **Total assets** | **$ 161,347** | $ 166,841 |

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

**NANTUCKET ELECTRIC COMPANY**
**BALANCE SHEETS**
*(in thousands of dollars)*

| | March 31, 2015 | March 31, 2014 |
|---|---|---|
| **LIABILITIES AND CAPITALIZATION** | | |
| **Current liabilities:** | | |
| Accounts payable | $ 2,186 | $ 1,003 |
| Accounts payable to affiliates | 13,337 | 9,411 |
| Advance from affiliate | - | 20,000 |
| Current portion of long-term debt | 365 | 330 |
| Regulatory liabilities | 18,321 | 16,876 |
| Other | 3,493 | 3,710 |
| Total current liabilities | 37,702 | 51,330 |
| **Other non-current liabilities:** | | |
| Regulatory liabilities | 2,440 | 2,166 |
| Deferred income tax liabilities, net | 15,208 | 14,253 |
| Postretirement benefits | 5,830 | 5,071 |
| Other | 2,387 | 709 |
| Total other non-current liabilities | 25,865 | 22,199 |
| **Commitments and contingencies (Note 11)** | | |
| **Capitalization:** | | |
| Shareholders' equity | 46,480 | 41,647 |
| Long-term debt | 51,300 | 51,665 |
| **Total capitalization** | 97,780 | 93,312 |
| **Total liabilities and capitalization** | $ 161,347 | $ 166,841 |

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

**NANTUCKET ELECTRIC COMPANY**
**STATEMENTS OF CAPITALIZATION**
*(in thousands of dollars)*

| | | | March 31, | |
|---|---|---|---|---|
| | | | **2015** | 2014 |
| **Total shareholders' equity** | | | **$ 46,480** | $ 41,647 |
| **Long-term debt:** | Interest Rate | Maturity Date | | |
| *Unsecured notes:* | | | | |
| 2016 Series 1996 MIFA Tax exempt | Variable | March 1, 2016 | **365** | 695 |
| 2004 $10 Million MIFA Tax exempt | Variable | March 1, 2039 | **10,000** | 10,000 |
| 2005 $28 Million MIFA Tax exempt | Variable | December 1, 2040 | **28,000** | 28,000 |
| 2007 $13.3 Million 1996 MDFA Tax exempt | Variable | August 1, 2042 | **13,300** | 13,300 |
| Total debt | | | **51,665** | 51,995 |
| Current portion of long-term debt | | | **365** | 330 |
| Long-term debt | | | **51,300** | 51,665 |
| **Total capitalization** | | | **$ 97,780** | $ 93,312 |

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

## NANTUCKET ELECTRIC COMPANY
## STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
*(in thousands of dollars)*

| | Additional Paid-in Capital | Accumulated Other Comprehensive Income (Loss): Unrealized Gain (Loss) on Available for Sale Securities | Accumulated Other Comprehensive Income (Loss): Total Accumulated Other Comprehensive Income (Loss) | Retained Earnings | Total |
|---|---|---|---|---|---|
| **Balance as of March 31, 2013** | **$ 22,839** | **$ 66** | **$ 66** | **$ 15,855** | **$ 38,760** |
| Net income | - | - | - | 2,524 | 2,524 |
| Other comprehensive income (loss) | | | | | |
| Unrealized gains on securities, net of $5 tax expense | - | 7 | 7 | - | 7 |
| Total comprehensive income | | | | | 2,531 |
| Parent loss tax allocation | 356 | - | - | - | 356 |
| **Balance as of March 31, 2014** | **$ 23,195** | **$ 73** | **$ 73** | **$ 18,379** | **$ 41,647** |
| Net income | - | - | - | 2,897 | 2,897 |
| Other comprehensive income (loss) | | | | | |
| Unrealized gains on securities, net of $13 tax expense | - | 19 | 19 | - | 19 |
| Total comprehensive income | | | | | 2,916 |
| Parent loss tax allocation | 1,917 | - | - | - | 1,917 |
| **Balance as of March 31, 2015** | **$ 25,112** | **$ 92** | **$ 92** | **$ 21,276** | **$ 46,480** |

The Company had 1,201 shares of common stock authorized, with 1 share issued and outstanding at a par value of $1 per share at March 31, 2015 and 2014.

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

**NANTUCKET ELECTRIC COMPANY**
**NOTES TO THE FINANCIAL STATEMENTS**

## 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Nantucket Electric Company ("the Company") is a retail distribution company providing electric service to approximately 13,000 customers on the Island of Nantucket.

The Company is a wholly-owned subsidiary of National Grid USA ("NGUSA" or "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 August 19, 2015 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, 2015.

## 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") and the Massachusetts Department of Public Utilities ("DPU") regulate the rates the Company charges its customers. In certain cases, the rate actions of the DPU 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, or refunded to, customers through future rates. Regulatory assets and liabilities are amortized to 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 DPU, the Company is allowed to pass through commodity-related costs to customers and also bills for other approved rate adjustment mechanisms. In addition, the Company has a revenue decoupling mechanism 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.

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

## Income Taxes

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

The 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 company determines its current and deferred taxes based on the separate return method. The Company settles its current tax liability or benefit each year with NGNA pursuant to a tax sharing arrangement between NGNA and its subsidiaries. Tax benefits attributable to the tax attributes of other group companies and allocated by NGNA are treated as capital contributions.

## 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 and Special Deposits

Restricted cash and special deposits primarily include collateral paid to the Company’s counterparties for health insurance and worker’s compensation.

## 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. 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, 2015 or 2014.

**Fair Value Measurements**

The Company measures 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 DPU. The average composite rates for each of the years ended March 31, 2015 and 2014 was 4.9% and 4.8%, respectively. The average service lives for each of the years ended March 31, 2015 and 2014 was 44 years.

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 of removal recovered in excess of costs incurred of $1.3 million and $1.6 million at March 31, 2015 and 2014, respectively.

*Allowance for Funds Used During Construction*

In accordance with applicable accounting guidance, 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 $24 thousand and $11 thousand and AFUDC related to debt of $3 thousand and $2 thousand for the years ended March 31, 2015 and 2014, respectively. The average AFUDC rates for the years ended March 31, 2015 and 2014 were 3.9% and 2%, respectively.

**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, 2015 utilizing both income and market approaches.

- To estimate fair value utilizing the income approach, the Company used a discounted cash flow methodology incorporating its most recent business plan forecasts together with a projected terminal year calculation. Key assumptions used in the income approach were: (a) expected cash flows for the period from April 1, 2015 to March 31, 2020; (b) a discount rate of 5.2%, which was based on the Company's best estimate of its after-tax weighted-average cost of capital; and (c) a terminal growth rate of 2.25%, based on the Company's expected long-term average growth rate in line with estimated long-term U.S. economic inflation.

- To estimate fair value utilizing the market approach, the Company followed a market comparable methodology. Specifically, the Company applied a valuation multiple of earnings before interest, taxes, depreciation and amortization ("EBITDA"), derived from data of publicly-traded benchmark companies, to business operating data. Benchmark companies were selected based on comparability of the underlying business and economics. Key assumptions used in the market approach included the selection of appropriate benchmark companies and the selection of an EBITDA multiple of 11, which the Company believes is appropriate based on comparison of its business with the benchmark companies.

The Company determined the fair value of the business using 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, 2015 or 2014.

Prior to 2015, the Company utilized an annual impairment assessment date of January 31. Management has determined that the use of January 1 as its annual impairment assessment date is preferable to January 31 because it facilitates a more timely evaluation in advance of the Company's fiscal year end of March 31. The movement of the date has not resulted in a substantive change in the timing of recording any potential impairment.

**Available-For-Sale Securities**

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 in the accompanying balance sheets. Changes in the fair value of the assets are recorded within other comprehensive income.

**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 in 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 2015

*Reclassifications From Accumulated Other Comprehensive Income*

In February 2013, the FASB issued ASU 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income," to improve the reporting of reclassifications out of accumulated other comprehensive income ("AOCI"). The amendments require an entity to provide information either on the face of the financial statements or in a single footnote on significant amounts reclassified out of AOCI and the related income statement line items to the extent an amount is reclassified in its entirety to net income. For significant items not reclassified to net income in their entirety, an entity is required to cross-reference to other disclosures that provide additional information. For non-public entities, the amendments are effective prospectively for reporting periods beginning after December 15, 2013. Early adoption is permitted. The Company adopted this guidance effective April 1, 2014 with no impact on its financial position, results of operations or cash flows.

### Accounting Guidance Not Yet Adopted

*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 No. 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 also require additional disclosures relating to management's evaluation and conclusion. The amendments are effective for the annual reporting period ending after December 15, 2016 and interim periods thereafter. The application of this guidance is not expected to have a material impact on the Company's financial position, results of operations and cash flows.

*Revenue Recognition*

In May 2014, the FASB and the International Accounting Standards Board jointly issued a new revenue recognition standard ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." The objective of the new guidance is to provide a single comprehensive revenue recognition model for all contracts with customers to improve comparability. The standard contains principles that an entity will apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services in an amount that reflects the consideration the entity expects to receive. The new guidance must be adopted using either a full retrospective approach or a modified retrospective approach. For non-public entities, the new guidance is effective for periods beginning after December 15, 2018, with early adoption permitted for periods beginning after December 15, 2017. The Company is currently evaluating the impact of the new guidance on its financial position, results of operations and cash flows.

## 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 in the accompanying balance sheets.

| | March 31, | |
|---|---|---|
| | **2015** | 2014 |
| | *(in thousands of dollars)* | |
| **Regulatory assets** | | |
| Current: | | |
| Rate adjustment mechanisms | **$ 4,039** | $ 4,800 |
| Other | **17** | - |
| Total | **4,056** | 4,800 |
| Non-current: | | |
| Loss on reacquired debt | **148** | 231 |
| Postretirement benefits | **5,532** | 4,114 |
| Regulatory deferred tax asset | **361** | 336 |
| Other | **-** | 17 |
| Total | **6,041** | 4,698 |
| **Regulatory liabilities** | | |
| Current: | | |
| Energy efficiency | **6,450** | 6,202 |
| Rate adjustment mechanisms | **11,361** | 10,205 |
| Revenue decoupling mechanism | **510** | 469 |
| Total | **18,321** | 16,876 |
| Non-current: | | |
| Cost of removal | **1,300** | 1,568 |
| Second cable deferral | **1,140** | 598 |
| Total | **2,440** | 2,166 |
| Net regulatory liabilities | **$ (10,664)** | $ (9,544) |

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

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

**Postretirement benefits:** Represents the excess costs of the Company's pension and PBOP plans over amounts received in rates that are deferred to a regulatory asset to be recovered in the future, and the non-cash accrual of net actuarial gains and losses.

**Regulatory deferred tax asset:** Represents unrecovered federal and state deferred taxes of the Company primarily as a result of regulatory flow through accounting treatment and tax rate changes. The income tax benefits or charges for certain plant related timing differences, such as equity AFUDC, are immediately flowed through to or collected from customers. The amortization of the related regulatory deferred tax asset, for these items, follows the book life of the underlying plant asset.

**Rate adjustment mechanisms:** The Company is subject to a number of rate adjustment mechanisms such as for commodity costs, whereby an asset or liability is recognized resulting from differences between actual revenues and the underlying cost being recovered, or differences between actual revenues and targeted amounts as approved by the DPU.

**Revenue decoupling mechanism**: As approved by the DPU, the Company has a RDM which allows for annual adjustment to the Company's delivery rates as a result of the reconciliation between allowed revenue per customer and actual revenue per customer. Any difference between the allowed revenue per customer and the actual revenue per customer is recorded as a regulatory asset or regulatory liability.

The Company records carrying charges on all regulatory balances (with the exception of postretirement benefits), 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

Pursuant to a settlement agreement associated with NGUSA's purchase of the Company in 1996 approved by the DPU, the Company is considered, along with its affiliate Massachusetts Electric Company ("Massachusetts Electric") as one regulated entity for the purpose of recovering its costs and establishing its rates assessed to its customers, with the exception of the recovery of the Company's investment in two undersea electric cables. Pursuant to the settlement agreement, the recovery of this investment is from all of the Company's customers on the Island of Nantucket. Except for the Company's Cable Facilities Surcharge, all rates and charges of the Company and Massachusetts Electric are identical. In the recovery of certain regulatory assets, funding of the recovery is from the customers of both companies. However, the mechanism by which recovery is ultimately achieved is through a single regulatory asset recorded on the balance sheet of Massachusetts Electric. Costs deferred and recovered in this manner are incremental storm costs of qualifying storm events, site investigation and remediation costs, solar generation costs, and any other costs incurred by the companies when taken as a single entity. The Company's share of these costs and recoveries are reflected through the DPU approved return on equity mechanism between the Company and Massachusetts Electric, as discussed in Note 12.

The Company records its own regulatory assets and liabilities associated with rate adjustment mechanisms, loss on reacquired debt, income taxes, postretirement benefits, revenue decoupling mechanisms, and energy efficiency as they are specific to the Company. These regulatory assets and liabilities are shown in the table above.

*2009 Capital Investments Audit*

The DPU approved an RDM arising from the 2009 distribution rate case filed by the Company and its affiliate, Massachusetts Electric. As part of its RDM provision, the Company files a report by July 1st of each year on its capital investment for the prior calendar year. In connection with the Company's first capital expenditure ("CapEx") filing made in July 2010, the DPU opened a proceeding in March 2011, as requested by the Massachusetts Attorney General's Office ("Attorney General"), for an independent audit of the Company's 2009 capital investments which, in part, formed the basis for the Company's RDM rate. On July 31, 2014, the DPU issued an order approving the sole respondent's bid to perform the CapEx audit. The CapEx audit is currently underway. The Company cannot currently predict the outcome of this proceeding.

*DPU Audit Settlement Agreement*

In the general rate case involving the Company's Massachusetts gas distribution affiliates, the DPU opened an investigation to address the allocation and assignment of costs to the gas affiliates by the National Grid service companies. The audit was later expanded to include the Company's Massachusetts electric distribution affiliates. The Company and the Attorney General's Office executed a Settlement Agreement that the DPU approved on July 25, 2014. As a result of the approval of the Settlement, there is no need for an audit, the Company will implement reporting and review practices similar to those in place for its New York affiliates, and NGUSA contributed $1 million to the Massachusetts Association for Community Action that will be used for the benefit of the Company's electric customers and the customers of its Massachusetts gas distribution affiliates who are eligible for fuel assistance.

*Storm Management Audit*

In January 2011, the DPU opened an investigation into the Company and Massachusetts Electric's preparation and response to a December 2010 winter storm. The DPU has the authority to issue fines not to exceed approximately $0.3 million for each violation for each day that the violation persists. On September 22, 2011, the DPU approved a settlement between the Company and the Attorney General that included a $1.2 million refund to customers. The DPU also investigated the Company and Massachusetts Electric's response to Tropical Storm Irene and the October 2011 winter storm in a consolidated proceeding. On December 11, 2012, the DPU issued an order in which it assessed the Company and Massachusetts Electric a penalty of $18.7 million associated with the Company and Massachusetts Electric's performance in responding to these two weather events, consisting of $8.1 million for Tropical Storm Irene and $10.6 million for the October 2011 winter storm. The Company and Massachusetts Electric appealed this ruling and on September 4, 2014 the Court affirmed all but two violations, reducing the penalty by $0.9 million. Massachusetts Electric had recorded the original penalty and credited customers during March 2013. In addition, in the December 11, 2012 order, the DPU ordered a management audit of the Company and Massachusetts Electric's emergency planning, outage management, and restoration. The auditors have completed their audit, and submitted their Final Report to the DPU on July 9, 2014. The DPU adopted the auditor's thirty recommendations, which include items such as improving emergency response training and tracking of training, designating additional personnel for storm roles, and considering the expanded use of technology and communication tools. The Company has already implemented some of the recommendations and is in the process of implementing the remaining recommendations.

## 5. PROPERTY, PLANT AND EQUIPMENT

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

| | March 31, | |
|---|---|---|
| | **2015** | 2014 |
| | *(in thousands of dollars)* | |
| Plant and machinery | **$ 111,843** | $ 107,854 |
| Land and buildings | **4,465** | 4,436 |
| Assets in construction | **1,290** | 1,100 |
| Total property, plant and equipment | **117,598** | 113,390 |
| Accumulated depreciation and amortization | **(47,219)** | (43,849) |
| Property, plant and equipment, net | **$ 70,379** | $ 69,541 |

## 6. FAIR VALUE MEASUREMENTS

The following tables present available for sale securities measured and recorded at fair value in the accompanying balance sheets on a recurring basis and their level within the fair value hierarchy as of March 31, 2015 and 2014:

| | March 31, 2015 | | | |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Total** |
| | *(in thousands of dollars)* | | | |
| **Assets:** | | | | |
| Available-for-sale securities | $ 392 | $ 515 | $ - | $ 907 |

| | March 31, 2014 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | (in thousands of dollars) | | | |
| **Assets:** | | | | |
| Available-for-sale securities | $ 347 | $ 478 | $ - | $ 825 |

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, 2015 or 2014.

Available-for-sale securities are included in other non-current assets in the accompanying balance sheets 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).

**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 estimated using quoted market prices for similar debt. The fair value of this debt at March 31, 2015 and 2014 was $51 million and $52 million, respectively.

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

**7. 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 nonqualified, 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 each of the years ended March 31, 2015 and 2014, the Company made contributions of approximately $0.1 million and $0.3 million 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 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 is included in operations and maintenance expense in the accompanying statements of income.

The NGUSA companies' pension and PBOP plans that the Company participates in have unfunded obligations at March 31, 2015 and 2014 as follows:

| | March 31, 2015 | March 31, 2014 |
|---|---|---|
| | *(in thousands of dollars)* | |
| Pension | **$ 602,142** | $ 402,928 |
| PBOP | **447,780** | 302,360 |
| | **$ 1,049,922** | $ 705,288 |

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, 2015 and 2014 are as follows:

| | Years Ended March 31, 2015 | Years Ended March 31, 2014 |
|---|---|---|
| | *(in thousands of dollars)* | |
| Pension | **$ 417** | $ 390 |
| PBOP | **187** | 220 |
| | **$ 604** | $ 610 |

**Defined Contribution Plan**

NGUSA has a defined contribution pension plan that covers substantially all employees. For each of the years ended March 31, 2015 and 2014, the Company recognized an expense in the accompanying statements of income of $39 thousand, for matching contributions.

**Other Benefits**

At March 31, 2015 and 2014, the Company had accrued workers compensation, auto, and general insurance claims which have been incurred but not yet reported of $40 thousand and $125 thousand, respectively.

**8. ACCUMULATED OTHER COMPREHENSIVE INCOME**

The following table represents the changes in the Company's AOCI for the year ended March 31, 2015:

| | **Unrealized Gain (Loss) on Available for Sale Securities** | **Total** |
|---|---|---|
| | *(in thousands of dollars)* | |
| Balance as of the beginning of the year | $ 73 | $ 73 |
| Other comprehensive income before reclassifications: | | |
| Gain on investment (net of $31 tax expense) | 46 | 46 |
| Amounts reclassified from other comprehensive income: | | |
| Gain on investment (net of $18 tax benefit) [1] | (27) | (27) |
| **Net current period other comprehensive income** | 19 | 19 |
| Balance as of the end of the year | 92 | 92 |

[1] Amounts are reported as other income, net in the accompanying statements of income.

## 9. CAPITALIZATION

**Debt Authorizations**

The Company had regulatory approval from the FERC to issue up to $15 million of short-term debt, which expired on November 30, 2013. The Company's subsequent request for short-term borrowing authority was approved and became effective January 12, 2015 for a period of two years.

Effective April 25, 2014, the Company entered into an Equity Contribution Agreement with the Parent which provided the Company with the ability to call upon the Parent for contributions to the Company's capital, in an aggregate amount equal to the short-term borrowing limit, until such time as regulatory approval for short-term borrowing was regained. The Company did not make use of this Equity Contribution Agreement. Since the Company has regained its short-term borrowing authority, as of January 12, 2015, the Equity Contribution Agreement is no longer in effect. The Company had no short-term debt outstanding to third-parties as of March 31, 2015 or 2014.

**Long-term Debt**

At March 31, 2015, the Company had $51.7 million outstanding of Electric Revenue Bonds in tax exempt commercial paper mode with maturity dates ranging from 2016 through 2042. The debt is remarketed at periods of 1-270 days, and had variable interest rates ranging from 0.06% to 0.38% and from 0.30% to 0.50% for the years ended March 31, 2015 and 2014, respectively. The bonds were issued by the Massachusetts Development Finance Agency in connection with the Company's financing of its first and second underground and submarine cable projects. A sinking fund payment of $0.33 million was made during the year ended March 31, 2015.

The Company has a Standby Bond Purchase Agreement ("SBPA") of $52.6 million which expires on November 20, 2015. In November 2014, the SBPA agreement was renewed and is due to expire on November 20, 2019. This agreement was available to provide liquidity support for $52 million of the Company's long-term bonds in tax-exempt commercial paper mode. The Company has classified this debt as long-term due to its intent and ability to refinance the debt on a long-term basis if is not able to remarket it. At March 31, 2015 and 2014, there were no bond purchases made by the banks participating in this agreement.

Massachusetts Electric, an affiliated entity, unconditionally guarantees the full and prompt payment of the principal, premium, if any, and interest on certain tax exempt bonds issued by the Massachusetts Development Finance Agency in connection with the Company's financing of its first and second underground and submarine cable projects. Massachusetts Electric would be required to make any principal, premium, or interest payments if the Company failed to pay.

The aggregate maturities of long-term debt subsequent to March 31, 2015 are as follows:

*(in thousands of dollars)*

| Years Ending March 31, | |
|---|---|
| 2016 | $ 365 |
| 2017 | - |
| 2018 | - |
| 2019 | - |
| 2020 | - |
| Thereafter | 51,300 |
| Total | $ 51,665 |

**Dividend Restrictions**

The Company is obligated to meet certain financial and non-financial covenants as described below. The Company was in compliance with all such covenants during the years ended March 31, 2015 and 2014.

Pursuant to provisions in connection with the New England Electric System and Eastern Utilities Associates merger, payment of dividends on common stock are not permitted if, after giving effect to such payment of dividends, common equity becomes less than 30% of total capitalization. At March 31, 2015 and 2014 common equity was 47% and 44% of total capitalization, respectively. Under these provisions, none of the Company's retained earnings at March 31, 2015 and 2014 were restricted as to common dividends.

## 10. INCOME TAXES

### Components of Income Tax Expense

| | Years Ended March 31, | |
|---|---|---|
| | **2015** | 2014 |
| | *(in thousands of dollars)* | |
| Current tax expense : | | |
| Federal | **$ 1,264** | $ 1,924 |
| State | **385** | 666 |
| Total current tax expense | **1,649** | 2,590 |
| Deferred tax expense: | | |
| Federal | **235** | (692) |
| State | **(28)** | (121) |
| Total deferred tax expense | **207** | (813) |
| Total income tax expense | **$ 1,856** | $ 1,777 |

### Statutory Rate Reconciliation

The Company's effective tax rate for the years ended March 31, 2015 and 2014 is 39.0% and 41.3%, respectively. A reconciliation between the income tax expense at the federal statutory tax rate of 35% to the actual tax expense:

| | Years Ended March 31, | |
|---|---|---|
| | **2015** | 2014 |
| | *(in thousands of dollars)* | |
| Computed tax at the statutory rate | **$ 1,664** | $ 1,505 |
| Change in computed taxes resulting from: | | |
| State income tax, net of federal benefit | **232** | 354 |
| Adjustments related to prior year, federal and state | **(11)** | (20) |
| Other items, net | **(29)** | (62) |
| Total | **192** | 272 |
| Federal and state income taxes | **$ 1,856** | $ 1,777 |

The Company is a member of 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 September 2013, the U.S. Department of the Treasury issued final tangible property regulations ("TPR") which provide guidance for the application of IRC §162(a) and IRC §263(a) to amounts paid to acquire, produce, or improve tangible property. In August 2014, the Treasury also finalized the depreciable property disposition regulations. Both sets of regulations become effective for tax years beginning on or after January 1, 2014, which, for the Company, is the fiscal year ended March 31, 2015. The Company intends to adopt these regulations with its fiscal year 2015 federal tax return and has estimated a favorable §481(a) adjustment of $290 thousand..

On July 24, 2013, Massachusetts legislature enacted into law transportation finance legislation which included significant tax changes affecting the classification of utility corporations. For tax years beginning on or after January 1, 2014, Massachusetts utility corporations will be taxed in the same manner as general business corporations. The state income tax rate increased from 6.5% to 8.0%. Also, any unitary net operating loss generated post-2013 and allocated to the utilities is allowed as a carry forward tax attribute. As of March 31, 2014, all state deferred tax balances at the regulated utilities were remeasured to the 8% rate, resulting in an increase in deferred tax liabilities of $313 thousand with an offset to regulatory deferred tax asset.

Significant components of the Company's net deferred tax assets and liabilities at March 31, 2015 and 2014 are as follows:

| | March 31, | |
|---|---|---|
| | **2015** | 2014 |
| | *(in thousands of dollars)* | |
| **Deferred tax assets:** | | |
| Regulatory liabilities - other | **$ 8,363** | $ 7,250 |
| Pensions, OPEB and other employee benefits | **2,896** | 2,277 |
| Future federal benefit on state taxes | **620** | 613 |
| Other items | **121** | 262 |
| Total deferred tax assets [1] | **12,000** | 10,402 |
| **Deferred tax liabilities:** | | |
| Property related differences | **16,966** | 15,821 |
| Regulatory assets - pension and PBOP | **2,379** | 1,848 |
| Regulatory assets - other | **1,894** | 1,946 |
| Other items | **400** | 179 |
| Total deferred tax liabilities | **21,639** | 19,794 |
| Net deferred income tax liabilities | **9,639** | 9,392 |
| Deferred investment tax credits | **-** | 1 |
| Net deferred income tax liabilities and investment tax credits | **9,639** | 9,393 |
| Current portion of deferred income tax assets, net | **5,569** | 4,860 |
| **Deferred income tax liabilities, net** | **$ 15,208** | $ 14,253 |

(1) There were no valuation allowances for deferred tax assets at March 31, 2015 or 2014.

**Unrecognized Tax Benefits**

As of March 31, 2015 and 2014, the Company's unrecognized tax benefits totaled $1.6 million and $1.4 million, respectively, of which none would affect the effective tax rate, if recognized. The unrecognized tax benefits are included in other non-current liabilities in the accompanying balance sheets.

The following table presents changes to the Company's unrecognized tax benefits for the years ended March 31, 2015 and 2014:

| | Years Ended March 31, | |
|---|---|---|
| | **2015** | 2014 |
| | *(in thousands of dollars)* | |
| Balance as of the beginning of the year | **$ 1,447** | $ 1,229 |
| Gross increases related to prior periods | **111** | 218 |
| Gross increases related to current period | **42** | - |
| Balance as of the end of the year | **$ 1,600** | $ 1,447 |

As of March 31, 2015 and 2014, the Company has accrued for interest related to unrecognized tax benefits of $132 thousand and $17 thousand, respectively. During years ended March 31, 2015 and 2014, the Company recorded interest expense of $115 thousand and $10 thousand, respectively. The Company recognizes accrued interest related to unrecognized tax benefits in other interest, including affiliate interest and related penalties, if applicable, in other income, net in the accompanying statements of income. No penalties were recognized during the years ended March 31, 2015 and 2014.

It is reasonably possible that other events will occur during the next 12 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 their results of operations, financial position, or cash flows.

Federal income tax returns have been examined and all appeals and issues have been agreed with the Internal Revenue Service ("IRS") and the NGNA consolidated filing group, through March 31, 2007.

During fiscal year 2014 the IRS concluded its examination of the NGNA consolidated filing group's corporate income tax returns for the periods ended March 31, 2008 and March 31, 2009. The examinations were completed on March 31, 2014, with an agreement on the majority of income tax issues for the years referenced above, as well as an acknowledgment that certain discrete items remain disputed. NGNA is in the process of appealing these disputed items with the IRS Office of Appeals. The Company does not anticipate a change in its unrecognized tax positions in the next twelve months as a result of the appeals. However, pursuant to the Company's tax sharing agreement, the audit or appeals may result in a change to allocated tax. Fiscal years ended March 31, 2010 through March 31, 2015 remain subject to examination by the IRS.

The Company is a member of the National Grid USA Service Company Massachusetts unitary group since fiscal year ended March 31, 2010. The tax returns for the fiscal years ended March 31, 2010 through March 31, 2015 remain subject to examination by the State of Massachusetts.

The following table indicates the earliest tax year subject to examination:

| Jurisdiction | Tax Year |
|---|---|
| Federal | March 31, 2008* |
| Massachusetts | March 31, 2010 |

*The NGNA consolidated filing group is in the process of appealing certain disputed issues with the IRS Office of Appeals for the fiscal years ended March 31, 2008 through March 31, 2009.

## 11. COMMITMENTS AND CONTINGENCIES

### Capital Expenditure Commitments

The Company has various capital commitments related to the construction of property, plant and equipment. The Company's commitments under these contracts subsequent to March 31, 2015 are $53.8 million, which are due to be spent within one year.

### Legal Matters

The Company is subject to various legal proceedings, primarily injury claims, 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.

## 12. 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 balances is as follows:

| | Accounts Receivable from Affiliates | | Accounts Payable to Affiliates | |
|---|---|---|---|---|
| | March 31, | | March 31, | |
| | **2015** | 2014 | **2015** | 2014 |
| | *(in thousands of dollars)* | | *(in thousands of dollars)* | |
| Boston Gas Company | **$ -** | $ 177 | **$ 3** | $ - |
| KeySpan Gas East Corporation | **-** | 174 | **61** | |
| Massachusetts Electric Company | **-** | - | **12,975** | 8,380 |
| National Grid Engineering Services, LLC | **-** | 75 | **15** | - |
| New England Power Company | **-** | - | **194** | 571 |
| NGUSA Service Company | **6,726** | - | **-** | 234 |
| The Narragansett Electric Company | **6** | - | **-** | 185 |
| Other | **-** | 23 | **89** | 41 |
| Total | **$ 6,732** | $ 449 | **$ 13,337** | $ 9,411 |

**Advance from Affiliate**

The Company had an agreement with NGUSA whereby the Company can borrow up to $10 million from time to time for working capital needs. In November 2014, the Company entered into another agreement with NGUSA allowing the Company to borrow an additional $10 million for working capital needs until short term borrowing authority was regained. The advance was non-interest bearing. At March 31, 2015 and 2014, the Company had an outstanding advance from affiliate of zero and $20 million, respectively.

**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 statement of cash flows, it is assumed all amounts settled through 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 intercompany money pools, if necessary. The Company had short-term intercompany money pool investments of $45.2 million and $60.8 million at March 31, 2015 and 2014, respectively. The average interest rates for the intercompany money pool were 0.3% and 0.7% for the years ended March 31, 2015 and 2014, respectively.

**Related Party Reimbursement**

In accordance with the Credit and Operating Support Agreement dated March 26, 1996, Massachusetts Electric will reimburse the Company an amount equal to the difference between the Company's actual net income for the year and the net income necessary for the Company to earn a return on equity ("ROE") equivalent to the Company's DPU approved weighted average allowed ROE for the fiscal year, currently 10.35%. This reimbursement shall constitute additional revenue to the Company and expense to Massachusetts Electric. If the Company's actual ROE for the year exceeds the Company's allowed ROE, the Company reimburses to Massachusetts Electric the excess amount of the earnings. For the years ended March 31, 2015 and 2014, Massachusetts Electric reimbursed the Company $6.0 million and $5.8 million, 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 typically 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, total transmission and distribution expenditures, etc. Lastly, all other costs are allocated based on a general allocator determined using a 3-point formula based on net margin, net property, plant and equipment, and operations and maintenance expense.

Charges from the service companies of NGUSA to the Company for the years ended March 31, 2015 and 2014 were $3.8 million and $4.1 million, respectively.

**Holding Company Charges**

NGUSA received charges from National Grid Commercial Holdings Limited (an affiliated company in the U.K.) 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 effect on net income would be $113 thousand and $101 thousand before taxes and $68 thousand and $60 thousand after taxes, for the years ended March 31, 2015 and 2014, respectively, if these amounts were allocated to the Company.