

National Grid Generation LLC and Subsidiaries
Consolidated Financial Statements
For the years ended March 31, 2015 and 2014

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES

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Independent Auditor's Report

To the Board of Directors of
National Grid Generation LLC

We have audited the accompanying consolidated financial statements of National Grid Generation LLC (the "Company"), which comprise the consolidated balance sheets as of March 31, 2015 and 2014, and the related consolidated statements of income, cash flows, capitalization, and changes in member's equity for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the 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 consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of National Grid Generation LLC at March 31, 2015 and 2014, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Emphasis of Matter

As discussed in Note 2 to the financial statements, the Company has restated its fiscal 2014 financial statements to correct an error. Our opinion is not modified with respect to this matter.

PricewaterhouseCoopers LLP

July 2, 2015

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(in thousands of dollars)

	Years Ended March 31,	
	2015	2014 (Restated)
Operating revenues	\$ 464,276	\$ 477,336
Operating expenses:		
Operations and maintenance	176,385	176,417
Depreciation and amortization	51,691	50,086
Other taxes	189,179	195,584
Total operating expenses	417,255	422,087
Operating income	47,021	55,249
Other income and (deductions):		
Interest on long-term debt	(7,220)	(7,212)
Other interest, including affiliate interest	(12,817)	(13,608)
Loss from equity investments	(1,515)	-
Other income, net	2,088	3,493
Total other deductions, net	(19,464)	(17,327)
Income before income taxes	27,557	37,922
Income tax expense	11,530	17,436
Net income	\$ 16,027	\$ 20,486

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

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands of dollars)

	Years Ended March 31,	
	2015	2014 <i>(Restated)</i>
Operating activities:		
Net income	\$ 16,027	\$ 20,486
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	51,691	50,086
Provision for deferred income taxes	14,541	11,192
Bad debt expense	4,854	161
Loss from equity investments, net of dividends received	1,515	-
Decommissioning charges, net of payments	(14,595)	(18,601)
Amortization of debt discount and issuance costs	149	149
Amortization of postretirement benefit transition obligation	-	5,359
Share based compensation	20	11
Changes in operating assets and liabilities:		
Accounts receivable, net, and unbilled revenues	(7,619)	(7,577)
Inventory	(833)	(1,364)
Emission credits, net	(2,887)	(8,306)
Prepaid and accrued taxes	(18,208)	19,053
Accounts payable and other liabilities	36,663	1,318
Other, net	3,015	2,352
Net cash provided by operating activities	84,333	74,319
Investing activities:		
Capital expenditures	(37,844)	(41,531)
Affiliated money pool investing and receivables/payables, net	(52,795)	(34,265)
Investment in joint venture	(1,800)	-
Net cash used in investing activities	(92,439)	(75,796)
Financing activities:		
Parent loss tax allocation	8,106	1,538
Share based compensation	-	(61)
Net cash provided by financing activities	8,106	1,477
Net increase in cash and cash equivalents	-	-
Cash and cash equivalents, beginning of year	-	-
Cash and cash equivalents, end of year	\$ -	\$ -
Supplemental disclosures:		
Interest paid	\$ (21,078)	\$ (25,694)
Income taxes (paid) refunded	(3,676)	23,288
State income taxes paid	(1,102)	(6,833)
Significant non-cash items:		
Capital-related accruals included in accounts payable	2,867	2,430
Share based compensation	20	11

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

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands of dollars)

	March 31,	
	2015	2014
		(Restated)
ASSETS		
Current assets:		
Accounts receivable, net of allowance of \$3,047 and \$80	\$ 5,484	\$ 118
Accounts receivable from affiliates	5,857	134
Intercompany money pool	651,654	558,283
Unbilled revenues, net of allowance of \$2,558 and \$680	18,711	21,312
Inventory	82,031	65,688
Prepaid taxes	12,485	12,712
Other	202	-
Total current assets	776,424	658,247
Equity investments	285	-
Property, plant and equipment, net	713,210	719,624
Other non-current assets	13,041	11,892
Total assets	\$ 1,502,960	\$ 1,389,763

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

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands of dollars)

	March 31,	
	2015	2014 (Restated)
LIABILITIES AND CAPITALIZATION		
Current liabilities:		
Accounts payable	\$ 55,161	\$ 25,734
Accounts payable to affiliates	180,968	134,669
Taxes accrued	21,432	39,867
Interest accrued	7,379	8,930
Current portion of deferred income tax liabilities, net	43,251	28,117
Other	4,778	4,218
Total current liabilities	312,969	241,535
Other non-current liabilities:		
Asset retirement obligations	16,533	19,766
Deferred income tax liabilities, net	111,633	111,021
Emission credits reserve	32,952	20,329
Other	35,096	27,637
Total other non-current liabilities	196,214	178,753
Commitments and contingencies (Note 9)		
Capitalization:		
Member's equity	594,145	569,992
Long-term debt	267,764	267,615
Advances from KeySpan Corporation	131,868	131,868
Total capitalization	993,777	969,475
Total liabilities and capitalization	\$ 1,502,960	\$ 1,389,763

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

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CAPITALIZATION
(in thousands of dollars)

			March 31,	
			2015	2014
				(Restated)
Total member's equity			\$ 594,145	\$ 569,992
Long-term debt:				
	Interest Rate	Maturity Date		
Authority financing notes				
Pollution Control Revenue Bonds - Series 1999A	Variable	October 1, 2028	41,125	41,125
Electric Facilities Revenue Bonds - Series 1997A	Variable	December 1, 2027	24,880	24,880
Total authority financing notes			66,005	66,005
Tax-exempt bonds				
Nassau County Industrial Development Revenue Bonds	5.25%	June 1, 2027	53,275	53,275
Suffolk County Industrial Development Revenue Bonds	5.25%	June 1, 2027	75,000	75,000
Total tax-exempt bonds			128,275	128,275
Promissory notes to Parent				
Pollution Control Revenue Bonds - Series 1985B	5.15%	March 1, 2016	27,900	27,900
Electric Facilities Revenue Bonds - Series 1993B	5.30%	November 1, 2023	29,600	29,600
Electric Facilities Revenue Bonds - Series 1994A	5.30%	October 1, 2024	2,600	2,600
Electric Facilities Revenue Bonds - Series 1995A	5.30%	August 1, 2025	15,200	15,200
Total promissory notes to Parent			75,300	75,300
Unamortized debt discounts			(1,816)	(1,965)
Total debt			267,764	267,615
Advances from KeySpan Corporation	6.15%	June 30, 2016	131,868	131,868
Total capitalization			\$ 993,777	\$ 969,475

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

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN MEMBER'S EQUITY
(in thousands of dollars)

	Additional Paid-in Capital	Retained Earnings	Total
Balance as of March 31, 2013 - restated	\$ 457,563	\$ 90,455	\$ 548,018
Net income	-	20,486	20,486
Parent loss tax allocation	1,538	-	1,538
Share based compensation	(50)	-	(50)
Balance as of March 31, 2014 - restated	\$ 459,051	\$ 110,941	\$ 569,992
Net income	-	16,027	16,027
Parent loss tax allocation	8,106	-	8,106
Share based compensation	20	-	20
Balance as of March 31, 2015	\$ 467,177	\$ 126,968	\$ 594,145

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

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

National Grid Generation LLC (“the Company”) is a New York limited liability company that owns and operates 53 electric generation units with approximately 4,100 megawatts of electric generation capacity located in Long Island. The Company, together with its wholly-owned subsidiaries, National Grid Glenwood Energy Center LLC (“Glenwood”) and National Grid Port Jefferson Energy Center LLC (“Port Jefferson”), sell capacity, energy conversion, and ancillary services to the Long Island Power Authority (“LIPA”).

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

Through its wholly-owned subsidiary, National Grid Generation Ventures LLC, the Company owns a 50% interest in Island Park Energy Center LLC, formed to construct, install, hold, own, protect, finance, manage, operate and maintain projects consisting of the repowering of the E.F. Barrett Steam Unit and Barrett CT Units all located in Nassau County, New York.

Additionally, National Grid Generation Ventures LLC owns a 50% interest in three LLCs (LI Solar Generation LLC, LI Energy Storage System LLC, and LI Peaker Generation LLC). These LLC’s were formed to jointly respond to LIPA’s Request for Proposals (“RFP’s”) for Generation, Energy Storage and Demand Response Resources and to jointly develop, construct, install, hold, own, protect, finance, manage, operate and maintain the respective RFP projects (none were awarded) or future proposals for similar projects.

The Company uses the equity method of accounting for its investments in affiliates when it has the ability to exercise significant influence over the operating and financial policies, but does not control the affiliates. The Company’s share of the earnings or losses of such affiliates is included as loss from equity investments in the accompanying consolidated statements of income.

The Company earns all of its revenue from contracts with LIPA based upon an agreement with LIPA (the “Power Supply Agreement” or “PSA”) which provides for the sale of all capacity and requested energy from its oil and gas-fired generating facilities. In addition, Glenwood and Port Jefferson have 25-year Power Purchase Agreements (the “PPAs”) with LIPA to sell capacity, energy conversion, and ancillary services to LIPA. Glenwood and Port Jefferson each own plants designed to produce 79.9 megawatts of electricity.

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”).

The Company has evaluated subsequent events and transactions through July 2, 2015, the date of issuance of these consolidated financial statements, and concluded that there were no events or transactions that require adjustment to, or disclosure in, the consolidated financial statements as of and for the year ended March 31, 2015.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

In preparing consolidated financial statements that conform to U.S. GAAP, the Company must make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses, and the disclosure of

contingent assets and liabilities included in the consolidated financial statements. Actual results could differ from those estimates.

Revenue Recognition

Revenues are recognized for sales of capacity and energy to LIPA under terms of the PSA, with rates approved by the Federal Energy Regulatory Commission ("FERC"). Please see Note 9, "Commitments and Contingencies" for additional information on the PSA. The Company records unbilled revenues for the estimated amount of energy delivered from the bill date to the end of the accounting period.

Income Taxes

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

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

NGNA files consolidated federal tax returns including all of the activities of its subsidiaries. Each subsidiary 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.

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 taking into account historical collection and write-off experience and management's assessment of collectability from LIPA. 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 balances are deemed to be uncollectible.

Inventory

Inventory is comprised of materials and supplies and emission credits. 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. Emission credits are comprised of sulfur dioxide ("SO₂"), nitrogen oxide ("NO_x"), and carbon dioxide ("CO₂") credits. Emission credits are held primarily for consumption or may be sold to third-party purchasers.

At March 31, 2015 and 2014 the Company had material and supplies of \$38.4 million and \$37.5 million and emission credits of \$43.7 million and \$28.1 million, respectively.

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 capitalized interest.

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. The average composite rate for the years ended March 31, 2015 and 2014 was 3.4% and 3.3%, respectively. The average service life for each of the years ended March 31, 2015 and 2014 was 39 years.

When property, plant and equipment is retired, the original cost, less salvage, is charged to accumulated depreciation.

Asset Retirement Obligations

Asset retirement obligations are recognized for legal obligations associated with the retirement of property, plant and equipment. 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's asset retirement obligations primarily relate to the legal obligation to dismantle the Glenwood and Far Rockaway facilities and remediate the associated sites. These facilities were shut down and decommissioning began in July 2012; demolition and remediation activities are expected to be completed by July 2015.

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

	Years Ended March 31,	
	2015	2014
	<i>(in thousands of dollars)</i>	
Balance as of the beginning of the year	\$ 19,766	\$ 38,367
Accretion expense	1,014	1,523
Liabilities settled	(11,265)	(20,124)
Revaluations to present values of estimated cashflows	7,018	-
Balance as of the end of the year	<u>\$ 16,533</u>	<u>\$ 19,766</u>

At March 31, 2015 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 enhanced asset replacement programs.

Employee Benefits

The Company follows the accounting guidance for multi-employer accounting to record pension and postretirement benefits other than pension ("PBOP") expenses. Under multi-employer accounting, expenses are allocated to the Company and the liability is recorded at the Parent. The Company makes required contributions to the plan.

New and Recent Accounting Guidance - 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.

Financial Statement Restatement

During 2015, management determined that certain accounting transactions were not properly recorded in the Company's previously issued financial statements. The Company corrected the accounting by restating the prior period financial statements, the impacts of which are described below.

During management's review of the Company's billings to LIPA, management determined there were certain accounting errors related to the timing of recognition of rate resets and true-ups, in accordance with the terms of the PSA. A cumulative adjustment of \$6.4 million (net of income taxes) was recorded in the financial statements for the year ended March 31, 2014, of which \$0.3 million was recorded as an increase to opening retained earnings (as of March 31, 2013) and \$6.7 million was recorded as a decrease to net income within operating revenues for the year ended March 31, 2014.

Further, the Company has corrected for certain service company charges that were improperly allocated. A cumulative adjustment of \$2.1 million (net of income taxes) was recorded in the financial statements for the year ended March 31, 2014, which was recorded as an increase to net income for the year ended March 31, 2014.

In addition, the Company has corrected various other account balances that were improperly recorded. A cumulative adjustment of \$0.8 million (net of income taxes) was recorded in the financial statements for the year ended March 31, 2014, of which \$0.2 million was recorded as a decrease to opening retained earnings (as of March 31, 2013) and \$0.6 million was recorded as a decrease to net income for the year ended March 31, 2014 related to these corrections.

The following table shows the amounts previously reported as restated:

	As Previously Reported	Adjustments	As Restated
	<i>(in thousands of dollars)</i>		
Consolidated Statement of Income	March 2014		March 2014
Operating revenues	\$ 493,451	\$ (16,115)	\$ 477,336
Operating income	65,130	(9,881)	55,249
Total other deductions, net	(18,627)	1,300	(17,327)
Income before income taxes	46,503	(8,581)	37,922
Income tax expense	20,936	(3,500)	17,436
Net income	25,567	(5,081)	20,486
Consolidated Statement of Cash Flows	March 2014		March 2014
Net cash provided by operating activities	\$ 69,573	\$ 4,746	\$ 74,319
Net cash used in investing activities	(71,050)	(4,746)	(75,796)
	As Previously Reported	Adjustments	As Restated
	<i>(in thousands of dollars)</i>		
Consolidated Balance Sheet	March 2014		March 2014
Total current assets	\$ 660,147	\$ (1,900)	\$ 658,247
Property, plant and equipment, net	719,797	(173)	719,624
Total current liabilities	230,015	11,520	241,535
Total other non-current liabilities	187,339	(8,586)	178,753
Retained Earnings			
March 31, 2014	115,948	(5,007)	110,941
March 31, 2013	90,381	74	90,455

3. PROPERTY, PLANT AND EQUIPMENT

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

	March 31,	
	2015	2014
	<i>(in thousands of dollars)</i>	
Plant and machinery	\$ 1,610,925	\$ 1,543,670
Land and buildings	305,512	303,453
Assets in construction	24,077	52,388
Software and other intangibles	7,958	8,023
Total property, plant and equipment	1,948,472	1,907,534
Accumulated depreciation and amortization	(1,235,262)	(1,187,910)
Property, plant and equipment, net	\$ 713,210	\$ 719,624

4. FAIR VALUE MEASUREMENTS

The Company's consolidated balance sheets reflect long-term debt at amortized cost. The fair value of the Company's long-term debt was based on quoted market prices when available, or estimated using quoted market prices for similar debt. The fair value of this debt at March 31, 2015 and 2014 was \$440.2 million and \$426.2 million, respectively.

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

5. EMPLOYEE BENEFITS

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

The Pension Plans provide union employees, as well as all non-union employees hired before January 1, 2011, with a retirement benefit. Supplemental non-qualified, non-contributory executive retirement programs provide additional defined pension benefits for certain executives.

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

During the years ended March 31, 2015 and 2014, the Company made contributions of approximately \$9.7 million and \$15.5 million, respectively, to the Plans. The difference between the amount of expense allocated to the Company and the amount of contributions made by the Company is included in accounts payable to affiliates in the accompanying consolidated balance sheets.

The Plans' assets are commingled and cannot be specifically allocated to an individual company. The Plans' costs are first directly charged to the Company based on the Company's employees that participate in the Plans. Costs associated with affiliated service companies' employees are then allocated as part of the labor burden for work performed on the Company's behalf. Pension and PBOP expense are included in operations and maintenance expense in the accompanying consolidated statements of income.

KeySpan's unfunded obligations at March 31, 2015 and 2014 are as follows:

	March 31,	
	2015	2014
	<i>(in thousands of dollars)</i>	
Pension	\$ 1,005,558	\$ 704,169
PBOP	985,669	916,706
	<u>\$ 1,991,227</u>	<u>\$ 1,620,875</u>

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	2014
	<i>(in thousands of dollars)</i>	
Pension	\$ 13,436	\$ 11,532
PBOP	7,479	16,312
	\$ 20,915	\$ 27,844

In 1993, LIPA agreed to scheduled payments for PBOP, which the Company recorded as a contractual receivable. All contractual payments have been received and the final payment was made in February 2014.

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 consolidated statements of income of \$0.3 million 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 \$5.9 million and \$5.1 million, respectively.

6. CAPITALIZATION

Debt Authorizations

The Company had regulatory approval from the FERC to issue up to \$250 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 NGUSA which provided the Company with the ability to call upon NGUSA 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.

Authority Financing Notes

At March 31, 2015 and 2014, \$41.1 million of 1999 Series A Pollution Control Revenue Bonds due October 1, 2028 were outstanding. The interest rate ranged from 0.10% to 1.44% for the year ended March 31, 2015 and 0.15% to 1.35% for the year ended March 31, 2014.

The Company also has outstanding \$24.9 million of variable rate 1997 Series A Electric Facilities Revenue Bonds due December 1, 2027 at March 31, 2015 and 2014 respectively. The interest rate on these bonds is reset weekly and ranged from 0.13% to 0.28% during the year ended March 31, 2015 and from 0.04% to 0.25% for the year ended March 31, 2014. In relation to these bonds, under the standby letter of credit and reimbursement agreement, the Company has a percent of indebtedness covenant that cannot exceed 70%. During the years ended March 31, 2015 and 2014, the Company was in compliance with this covenant.

Industrial Development Revenue Bonds

At March 31, 2015 and 2014, the Company had outstanding \$128.3 million of 5.25% tax-exempt bonds due June 1, 2027. Of this amount, \$53.3 million was issued through the Nassau County Industrial Development Authority for the construction of the Glenwood electric-generation peaking plant and the balance of \$75 million was issued by the Suffolk County Industrial Development Authority for the Port Jefferson electric-generation peaking plant. KeySpan Corporation has fully and unconditionally guaranteed the payment obligations of its subsidiaries with regard to these tax-exempt bonds.

Promissory Notes

The Parent had issued promissory notes to LIPA representing an amount equivalent to certain Authority Financing Notes. These notes were extinguished through a "Settlement and Release" agreement with LIPA dated December 31, 2013, which took effect March 28, 2014. The "Settlement and Release" has no effect on \$75.3 million of these notes which the Parent had allocated to the Company, and which were outstanding at March 31, 2015 and 2014, respectively. The notes consist of \$27.9 million, 5.15% notes due March 1, 2016 and \$47.4 million, 5.30% notes with maturities ranging from November 1, 2023 to August 1, 2025.

Advance from Parent

At March 31, 2015 and 2014, a \$131.9 million Advance due to the Parent remains outstanding, and matures in June 2016. The interest rate of this advance is 6.15%.

Debt Maturities

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

<i>(in thousands of dollars)</i>	
<u>Years Ended March 31,</u>	
2016	\$ 27,900
2017	131,868
2018	-
2019	-
2020	-
Thereafter	<u>241,680</u>
Total	<u>\$ 401,448</u>

Restrictions on Payment of Dividends

The Company is obligated to meet certain non-financial covenants pursuant to the participation agreement with New York State Energy Research and Development Authority. During the years ended March 31, 2015 and 2014, the Company was in compliance with all such covenants.

Pursuant to FERC regulations, payment of dividends would not be permitted if, after giving effect to such payment of dividends, member's equity becomes less than 30% of total capitalization. At March 31, 2015 and 2014 member's equity was 59.8% and 58.8% of total capitalization, respectively. Under these provisions, none of the Company's retained earnings at March 31, 2015 or 2014 were restricted as to payment of dividends.

7. INCOME TAXES

Components of Income Tax Expense

	Years Ended March 31,	
	2015	2014
	<i>(in thousands of dollars)</i>	
Current tax expense (benefit):		
Federal	\$ (5,975)	\$ 4,554
State	2,964	1,690
Total current tax (benefit) expense	<u>(3,011)</u>	<u>6,244</u>
Deferred tax expense:		
Federal	14,300	7,455
State	241	3,737
Total deferred tax expense	<u>14,541</u>	<u>11,192</u>
Total income tax expense	<u>\$ 11,530</u>	<u>\$ 17,436</u>

Statutory Rate Reconciliation

The Company's effective tax rates for the years ended March 31, 2015 and 2014 are 41.8% and 46%, 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,	
	2015	2014
	<i>(in thousands of dollars)</i>	
Computed tax	\$ 9,645	\$ 13,272
Change in computed taxes resulting from:		
State income tax, net of federal benefit	2,084	3,528
Other items, net	(199)	636
Total	<u>1,885</u>	<u>4,164</u>
Federal and state income taxes	<u>\$ 11,530</u>	<u>\$ 17,436</u>

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 September 2013, the U.S. Department of the Treasury issued final tangible property regulations 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 U.S. Department of 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 adoption of these regulations did not have an impact on the Company's financial position, results of operations, or cash flows.

On March 31, 2014, New York's legislature enacted, as part of the 2014-15 budget package, legislation which included significant tax changes. For tax years beginning on or after January 1, 2016, the New York corporate franchise rate is reduced from 7.1% to 6.5%. Additionally, for tax years beginning on or after January 1, 2015, New York State will generally require combined reporting if the taxpayer is engaged in a unitary business and a 50% common ownership test is met. The

Metropolitan Transportation Authority (“MTA”) surcharge rate increased from 17% to 25.6% of the New York rate for taxable years beginning after 2014 and before 2016. For subsequent years, the rate is to be adjusted by the Commissioner of the New York State Department of Taxation and Finance. As of March 31, 2014, the Company remeasured its New York State deferred tax assets and liabilities based upon the enacted law that will apply when the corresponding state temporary differences are expected to be realized or settled. Specifically, to reflect the decrease in tax rate, the Company decreased its New York State and MTA deferred tax liability, net of federal benefit by \$0.9 million with an offset to tax expense. During the year ended March 31, 2015, the Company updated the impact of the tax rate change and increased its New York State and MTA deferred tax liability by \$0.1 million with an offset to tax expense.

Deferred Tax Components

	March 31,	
	2015	2014
	<i>(in thousands of dollars)</i>	
Deferred tax assets:		
Net operating losses	\$ 12,569	\$ 11,387
Future federal benefit on state taxes	8,394	8,465
Reserves not currently being deducted	5,373	5,384
Allowance for doubtful accounts	2,422	331
Postretirement benefits and other employee benefits	1,504	2,277
Other items	<u>10,625</u>	<u>10,186</u>
Total deferred tax assets ⁽¹⁾	<u>40,887</u>	<u>38,030</u>
Deferred tax liabilities:		
Property related differences	145,155	138,040
Property taxes	30,734	39,128
Other items	<u>19,882</u>	<u>-</u>
Total deferred tax liabilities	<u>195,771</u>	<u>177,168</u>
Net deferred income tax liabilities	154,884	139,138
Current portion of deferred income tax liabilities, net	<u>43,251</u>	<u>28,117</u>
Deferred income tax liabilities, net	<u>\$ 111,633</u>	<u>\$ 111,021</u>

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

The following table presents the amounts and expiration dates of operating losses as of March 31, 2015:

<u>Expiration of net operating losses:</u>	
	<i>(in thousands of dollars)</i>
03/31/2033 Federal	\$ 36,879
03/31/2034 Federal	206
03/31/2035 Federal	1,025
03/31/2035 New York State	30,136
03/31/2035 New York City	254

Unrecognized Tax Benefits

As of March 31, 2015 and 2014, the Company’s unrecognized tax benefits totaled \$7.7 million and \$4.2 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:

	Years Ended March 31,	
	2015	2014
	<i>(in thousands of dollars)</i>	
Balance as of the beginning of the year	\$ 4,231	\$ 10,405
Gross increases related to prior period	3,444	1,811
Gross decreases related to prior period	(396)	(726)
Gross increases related to current period	378	489
Settlements with tax authorities	-	(7,748)
Balance as of the end of the year	<u>\$ 7,657</u>	<u>\$ 4,231</u>

As of March 31, 2015 and 2014, the Company has accrued for interest related to unrecognized tax benefits of \$0.4 million and \$1.7 million, respectively. During the years ended March 31, 2015 and 2014, the Company recorded interest expense of \$0.6 million and \$1.8 million, respectively. The Company recognizes interest related to unrecognized tax benefits in other interest, including affiliate interest and related penalties, if applicable, in other income, net in the accompanying consolidated statements of income. No tax penalties were recognized during the years ended March 31, 2015 or 2014.

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

During the year ended March 31, 2014, the IRS concluded its examination of the NGNA consolidated filing group's corporate income tax returns, which includes corporate income tax returns of KeySpan Corporation and subsidiaries for the short period ended August 24, 2007, and of NGNA and subsidiaries for the periods ended March 31, 2008 and 2009. These examinations were completed on March 27, 2014 and March 31, 2014, respectively, 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 issues 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. The tax returns for the years ended March 31, 2010 through March 31, 2015 remain subject to examination by the IRS.

The Company was a member of KeySpan and subsidiaries combined New York State ("NYS") income tax return for calendar years ended December 31, 2003 through December 31, 2006, the short period ended August 24, 2007, and the fiscal year ended March 31, 2008. The Company is no longer a member of KeySpan and subsidiaries combined NYS income tax return and is filing a separate NYS income tax return beginning with the fiscal year ended March 31, 2009. The State of New York is in the process of examining the Company's NYS income tax return for KeySpan and subsidiaries for the period starting January 1, 2003 through March 31, 2008. The tax returns for the years ended March 31, 2009 through March 31, 2015 remain subject to examination by the State of New York.

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

Jurisdiction	Tax Year
Federal	August 24, 2007 *
New York	December 31, 2003
New York City	December 31, 2003

* The KeySpan consolidated filing group for the tax year ended August 24, 2007 and the NGNA consolidated filing group for the fiscal years ended March 31, 2008 and 2009, are in the process of appealing certain disputed issues with the IRS Office of Appeals.

8. ENVIRONMENTAL MATTERS

Ordinary business operations subject the Company to various federal, state, and local laws, rules, and regulations dealing with the environment, including air, water, and hazardous waste. The Company's business operations are regulated by various federal, regional, state, and local authorities, including the U.S. Environmental Protection Agency ("EPA"), the New York State Department of Environmental Conservation ("DEC"), the New York City Department of Environmental Protection, and the Nassau and Suffolk County Departments of Health.

Except as set forth below, no material proceedings relating to environmental matters have been commenced or, to the Company's knowledge, are contemplated by any federal, state, or local agency against the Company and the Company is not a defendant in any material litigation with respect to any matter relating to the protection of the environment. The Company believes that its operations are in substantial compliance with environmental laws and that requirements imposed by environmental laws are not likely to have a material adverse impact on the Company's financial position or results of operations.

Air

The Company's generating facilities are subject to increasingly stringent emissions limitations under current and anticipated future requirements of the EPA and the DEC. In addition to efforts to improve both ozone and particulate matter air quality, there has been an increased focus on greenhouse gas emissions in recent years. The Company's previous investments in low NO_x boiler combustion modifications, the use of natural gas firing systems at its steam electric generating stations, and the compliance flexibility available under cap and trade programs have enabled the Company to achieve its prior emission reductions in a cost-effective manner. Recently completed investments include the installation of enhanced NO_x controls and efficiency improvement projects at certain of the Company's Long Island based electric generating facilities. The total cost of these improvements was approximately \$103 million, all of which have been placed in service as of the date of this report; a mechanism for recovery from LIPA of these investments has been established. The Company has developed a compliance strategy to address anticipated future requirements and is closely monitoring the regulatory developments to identify any necessary changes to its compliance strategy. At this time, the Company is unable to predict what effect, if any, these future requirements will have on its consolidated financial position, results of operations, and cash flows.

Water

Additional capital expenditures associated with the renewal of the surface water discharge permits for the Company's power plants will likely be required by the DEC at each of the Long Island power plants pursuant to Section 316 of the Clean Water Act to mitigate the plants' alleged cooling water system impacts to aquatic organisms. The Company is currently engaged in discussions with the DEC and environmental groups regarding the nature of capital upgrades or other mitigation measures necessary to reduce any impacts. Although these discussions have been productive and have led to mutually agreeable final permits at some of the plants, it is possible that the determination of required capital improvements and the issuance of final renewal permits for the remaining plants could involve adjudicatory hearings among the Company, the agency, and the environmental groups. Capital costs for expected mitigation requirements at the plants had been estimated at approximately \$76 million and do not anticipate a need for cooling towers at any of the plants. Depending on the outcome of the adjudicatory process, which could extend beyond the next fiscal year, ultimate costs could be substantially higher. Costs associated with any finally ordered capital improvements would be reimbursable from LIPA under the PSA.

9. 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 long-term contracts for the years subsequent to March 31, 2015 are summarized in the table below:

<i>(in thousands of dollars)</i>	
<u>Years Ended March 31,</u>	
2016	\$ 40,029
2017	42,519
2018	60,489
2019	45,339
2020	29,844
Thereafter	-
Total	<u>\$ 218,220</u>

Legal Matters

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

On September 29, 2014, a jury rendered a verdict in favor of a worker for asbestos-related injuries involving his limited work as a subcontractor at one of the Company's Long Island power plants during its construction in the 1960's and early 1970's. The Company believes that this jury verdict is not supported by the facts or law and that it has strong legal and factual arguments to overturn this decision on the merits on appeal. The Company's cost and expenses related to asbestos litigation are subject to reimbursement pursuant to the PSA more fully described below. Although it is not possible to predict the outcome, the Company does not believe that resolution of this matter will be material to its financial position or results of operations.

Power Supply Agreement

Effective May 28, 2013, the Company provides services to LIPA under an amended and restated PSA. Under the PSA, the Company has a revenue requirement of \$418.6 million, a return on equity of 9.75% and a capital structure of 50% debt and 50% equity. The PSA has a term of fifteen years, provided LIPA has the option to terminate the agreement as early as April 2025 on two years advance notice. The Company accounts for the PSA as an operating lease.

The PSA provides potential penalties to the Company if it does not maintain the output capability of the generating facilities, as measured by annual industry-standard tests of operating capability, plant availability, and efficiency. These penalties may total \$4 million annually. Although the PSA provides LIPA with all of the capacity from the generating facilities, LIPA has no obligation to purchase energy from the generating facilities and can purchase energy on a least-cost basis from all available sources consistent with existing transmission interconnection limitations of the transmission and distribution system. The Company must, therefore, operate its generating facilities in a manner such that the Company can remain competitive with other producers of energy. To date, the Company has dispatched to LIPA and LIPA has accepted the level of energy generated at the agreed to price per megawatt hour. Under the terms of the PSA, LIPA is obligated to pay for capacity at rates that reflect recovery of an agreed level of the overall cost of maintaining and operating the generating facilities, including recovery of depreciation and return on its investment in plant. A monthly variable maintenance charge is billed for each unit of energy actually acquired from the generating facilities. The billings to LIPA under the PSA do not include a provision for fuel costs, as such fuel is owned by LIPA.

In June 2011, LIPA and the Company executed an amendment to the then-current PSA pursuant to which the parties agreed that LIPA would reduce purchases of capacity from specified generating facilities, specifically the Glenwood and Far Rockaway, New York steam facilities. The Company has retired these generating facilities and removed them from the PSA and is in the process of dismantling these facilities. As part of this amendment, the Company paid an Economic Equivalent Payment (“EEP”) of \$18 million which represented the economic benefit to LIPA which would have been realized under the original agreement. Half of the EEP was paid on July 3, 2012, with the remaining balance on May 28, 2013. The EEP was accrued on a straight-line basis over the 24-month term, from June 2011 through May 2013, as a reduction in operating revenues.

Included in unbilled revenues is an allowance for doubtful accounts of \$2.6 million and \$0.7 million related to unbilled carrying charges on employee benefit-related items at March 31, 2015 and 2014, respectively.

10. 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,	
	2015	2014	2015	2014
	<i>(in thousands of dollars)</i>		<i>(in thousands of dollars)</i>	
KeySpan Corporation	\$ -	\$ -	\$ 176,466	\$ 87,180
KeySpan Engineering Services	5,856	-	-	25,190
NGUSA Service Company	-	-	1,844	18,539
Other	1	134	2,658	3,760
Total	\$ 5,857	\$ 134	\$ 180,968	\$ 134,669

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 Unregulated Money Pool and can both borrow and invest funds. Borrowings from the Unregulated Money Pool bear interest in accordance with the terms of the Unregulated Money Pool Agreement. As the Company fully participates in the Unregulated 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 consolidated statements of cash flows. In addition, for the purpose of presentation in the consolidated 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 Unregulated Money Pool is funded by operating funds from participants. Collectively, NGUSA and KeySpan, have the ability to borrow up to \$3 billion from National Grid plc for working capital needs including funding of the Unregulated Money Pool, if necessary. The Company had short-term intercompany money pool investments of \$651.7 million and \$558.3 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.

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, 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 from the service companies of NGUSA to the Company for the years ended March 31, 2015 and 2014 were \$236.4 million and \$282.5 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 consolidated financial statements. The estimated effect on net income would be \$2.2 million and \$2.5 million before taxes and \$1.3 million and \$1.6 million after taxes, for the years ended March 31, 2015 and 2014, respectively, if these amounts were allocated to the Company.