National Grid Generation LLC and Subsidiaries

Consolidated Financial Statements

For the years ended March 31, 2013 and March 31, 2012

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES

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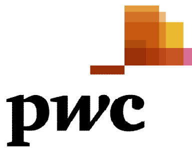

Independent Auditor's Report

To the Member's and Board of Directors of National Grid Generation LLC and Subsidiaries:

We have audited the accompanying consolidated financial statements of National Grid Generation LLC and its subsidiaries, which comprise the consolidated balance sheets as of March 31, 2013 and March 31, 2012, 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 consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of National Grid Generation LLC and its subsidiaries at March 31, 2013 and March 31, 2012, 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

PricewaterhouseCoopers LLP

September 27, 2013

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

	March 31, 2013	March 31, 2012
ASSETS		
Current assets:		
Accounts receivable	**$ 3,277**	$ 3,746
Allowance for doubtful accounts	**(680)**	-
Accounts receivable from affiliates	**939**	695
Intercompany money pool	**477,424**	430,145
Unbilled revenues	**11,780**	5,248
Materials and supplies	**36,181**	38,877
Emission credits	**9,231**	873
Prepaid taxes	**6,446**	-
Prepaid and other current assets	**2,191**	2,126
Total current assets	**546,789**	481,710
Property, plant, and equipment, net	**725,749**	735,344
Deferred charges and other assets:		
Contractual receivable from Long Island Power Authority	**5,359**	11,713
Other deferred charges	**10,284**	9,105
Total deferred charges and other assets	**15,643**	20,818
Total assets	**$ 1,288,181**	$ 1,237,872
LIABILITIES AND CAPITALIZATION		
Current liabilities:		
Accounts payable	**$ 25,385**	$ 21,671
Account payable to affiliates	**84,320**	91,385
Property and other taxes accrued	**18,409**	25,093
Interest accrued	**7,181**	8,022
Current portion of deferred income tax liabilities	**27,674**	15,731
Emission credits reserve	**-**	376
Other current liabilities	**12,438**	12,193
Total current liabilities	**175,407**	174,471
Deferred credits and other liabilities:		
Asset retirement obligations	**38,367**	54,794
Deferred income tax liabilities	**98,191**	77,161
Emission credits reserve	**9,703**	-
Other deferred liabilities	**19,235**	18,819
Total deferred credits and other liabilities	**165,496**	150,774
Member's equity	**547,944**	513,445
Long-term debt	**267,466**	267,314
Advances from KeySpan Corporation	**131,868**	131,868
Total capitalization	**947,278**	912,627
Total liabilities and capitalization	**$ 1,288,181**	$ 1,237,872

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

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

	Years Ended March 31,	
	2013	2012
Operating revenues	**$ 500,123**	$ 481,574
Operating expenses:		
Operations and maintenance	**172,375**	170,421
Impairment of emission credits	**17**	91
Decommissioning charges	**2,330**	46,417
Depreciation and amortization	**48,298**	50,125
Other taxes	**202,943**	194,696
Total operating expenses	**425,963**	461,750
Operating income	**74,160**	19,824
Other income and (deductions):		
Interest on long-term debt	**(7,289)**	(7,602)
Other interest, including affiliate interest	**(12,648)**	(11,507)
Other income, net	**5,208**	4,333
Total other deductions, net	**(14,729)**	(14,776)
Income before income taxes	**59,431**	5,048
Income tax expense (benefit):		
Current	**(8,315)**	5,597
Deferred	**32,973**	(3,608)
Total income tax expense	**24,658**	1,989
Net income	**$ 34,773**	$ 3,059

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,	
	2013	2012
Operating activities:		
Net income	**$ 34,773**	$ 3,059
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**48,298**	50,125
Provision (benefit) for deferred income taxes	**32,973**	(3,608)
Bad debt expense	**680**	(1,470)
Impairment of emission credits	**17**	91
Decommissioning charges, net of payments	**(11,403)**	46,327
Amortization of debt discount	**151**	151
Amortization of postretirement benefit transition obligation	**6,354**	6,354
Changes in operating assets and liabilities:		
Accounts receivable, net	**(6,063)**	(586)
Materials and supplies	**2,696**	161
Accounts payable and accrued expenses	**(5,618)**	3,463
Other liabilities	**661**	6,015
Prepaid and accrued taxes	**(12,512)**	2,423
Accounts receivable from/payable to affiliates, net	**11,789**	(700)
Other, net	**1,218**	1,069
Net cash provided by operating activities	**104,014**	112,874
Investing activities:		
Capital expenditures	**(36,745)**	(49,609)
Affiliated money pool borrowing and other	**(66,995)**	(66,455)
Net cash used in investing activities	**(103,740)**	(116,064)
Financing activities:		
Parent loss tax allocation	**(358)**	3,190
Share based compensation	**84**	-
Net cash (used in) provided by financing activities	**(274)**	3,190
Net change in cash and cash equivalents	**-**	-
Cash and cash equivalents, beginning of year	**-**	-
Cash and cash equivalents, end of year	**$ -**	$ -
Supplemental disclosures:		
Interest paid	**$ 19,368**	$ 19,641
Income taxes paid to (refunded from) Parent	**30,358**	(876)
State income taxes paid	**15,778**	1,640
Significant non-cash items:		
Capital-related accruals included in accounts payable	**-**	3,467

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)

	Interest Rate	Maturity Date	March 31, 2013	March 31, 2012
Total member's equity			**$ 547,944**	$ 513,445
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
Long-term debt to affiliates:				
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 discounts			**(2,114)**	(2,266)
Total long-term debt			**267,466**	267,314
Advances from KeySpan Corporation	6.15%	June 30, 2014	**131,868**	131,868
Total capitalization			**$ 947,278**	$ 912,627

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)

	Paid-in Capital	Retained Earnings	Total
Balance at March 31, 2011	$ 454,647	$ 52,549	$ 507,196
Net income	-	3,059	3,059
Parent loss tax allocation	3,190	-	3,190
Balance at March 31, 2012	457,837	55,608	513,445
Net income	-	34,773	34,773
Share based compensation	84	-	84
Parent loss tax allocation	(358)	-	(358)
Balance at March 31, 2013	$ 457,563	$ 90,381	$ 547,944

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

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

A. Nature of Operations

National Grid Generation LLC (the "Company," "we," and "our") 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. Our 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"). KeySpan 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 an indirectly-owned subsidiary of National Grid plc, a public limited company incorporated under the laws of England and Wales.

The Company has an agreement with LIPA (the "Power Supply Agreement" or "PSA") which provides for the sale of all capacity to LIPA and, to the extent LIPA requests, energy conversion from the oil and gas-fired generating facilities covered by the PSA. LIPA represents our only customer for capacity and energy. In 2001, Glenwood and Port Jefferson entered into 25-year Power Purchase Agreements (the "PPAs") with LIPA. Under the terms of the PPAs, these subsidiaries sell capacity, energy conversion, and ancillary services to LIPA. Both plants are designed to produce 79.9 megawatts of electricity.

In June 2011, LIPA and the Company executed an amendment to the 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 demolishing these facilities. Demolition and remediation activities are expected to be completed between October 2014 and April 2015.

In October 2012, the Company and LIPA reached an agreement to amend and restate the current PSA for a maximum term of fifteen years. The Company received the required regulatory approvals from the New York State Comptroller, the New York State Attorney General, and the Federal Energy Regulatory Commission ("FERC"), and the amended and restated PSA became effective as of May 28, 2013.

The Company has evaluated subsequent events and transactions through September 27, 2013, 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, 2013.

B. Basis of Presentation

The consolidated financial statements for the years ended March 31, 2013 and March 31, 2012 are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Within the statements of cash flows, all amounts that are settled through the Unregulated Money Pool (refer to Note 9, "Related Party Transactions") are treated as constructive cash receipts and payments, and therefore are recorded as such.

C. Revenue Recognition

Electric revenues are derived from billings to LIPA for the electric generation capacity and, to the extent requested, energy from our existing oil and gas-fired generating plants. Sales of capacity and energy are made under terms of the PSA with rates approved by the FERC. Revenues are determined based on these billings plus an estimate for unbilled energy delivered between the bill date and the end of the accounting period. These amounts are billed to customers in the next billing cycle following the month-end.

D. Property, Plant and Equipment

Property, plant and equipment is stated at original cost. The cost of additions to property, plant and equipment and replacements of retired units of property are capitalized. Costs include direct material, labor, overhead, and capitalized interest. The cost of renewals and betterments that extend the useful life of property, plant and equipment are also capitalized. The cost of repairs, replacements, and major maintenance projects, which do not extend the useful life or increase the expected output of the asset, are expensed as incurred. Depreciation is generally computed over the estimated useful life of the assets using the composite straight-line method. Depreciation studies are conducted periodically to update the composite rates. Whenever property, plant and equipment is retired, the original cost, less salvage, is charged to accumulated depreciation.

The average composite rates and average service lives for the years ended March 31, 2013 and March 31, 2012 are as follows:

	March 31,	
	2013	2012
Composite rates	**2.6%**	2.6%
Average service lives	**39 years**	39 years

E. Material and Supplies

Materials and supplies are stated at the lower of weighted average cost or market and are expensed or capitalized into specific capital additions as used. At March 31, 2013 and March 31, 2012, materials and supplies were $36.2 million and $38.9 million, respectively. The Company's policy is to write-off obsolete inventory. Write-offs of obsolete inventory amounted to $1.8 million for the year ended March 31, 2013. There were no material write-offs for the year ended March 31, 2012.

F. Income and Other 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. National Grid North America Inc. (“NGNA”), (formerly National Grid Holdings Inc.), an indirectly-owned subsidiary of National Grid plc and the intermediate holding company of NGUSA, files consolidated federal tax returns including all of the activities of its subsidiaries. Each subsidiary company is included in the consolidated group and 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 included subsidiaries. Benefits allocated by NGNA are treated as capital contributions. The Company has joint and several liability for any potential assessments against the consolidated group.

Deferred income taxes reflect the tax effect of net operating losses, capital losses and general business credit carryforwards and the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial statement and income tax purposes, as determined under enacted tax laws and rates. 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. Additionally, the Company follows the current accounting guidance relating to uncertainty in income taxes which applies to all income tax positions reflected in the accompanying consolidated balance sheets that have been included in previous tax returns or are expected to be included in future tax returns. The accounting guidance for

uncertainty in income taxes provides that the financial effects of a tax position shall initially be recognized in the financial statements when it is more likely than not, based on the technical merits, that the position will be sustained upon examination, assuming the position will be audited and the taxing authority has full knowledge of all relevant information.

The Company collects from customers various taxes that are levied by state or local governments on the sale or distribution of electricity. The Company presents taxes that are imposed on customers (such as sales taxes) on a net basis (i.e.,excluded from revenues).

G. Employee Benefits

The Company follows the accounting guidance for multi-employer accounting to record pension and postretirement benefits other than pensions ("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. These contributions are calculated by the Parent.

H. New and Recent Accounting Guidance

Accounting Guidance Adopted in Fiscal Year 2013

Fair Value Measurements

In May 2011, the Financial Accounting Standards Board ("FASB") issued accounting guidance that amended existing fair value measurement guidance. The amendment was issued with a goal of achieving common fair value measurement and disclosure requirements in GAAP and International Financial Reporting Standards. Consequently, the guidance changes the wording used to describe many of the requirements in GAAP for measuring fair value, requires new disclosures about fair value measurements, and changes specific applications of the fair value measurement guidance. Some of the amendments clarify the FASB's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements including, but not limited to: fair value measurement of a portfolio of financial instruments; fair value measurement of premiums and discounts; and additional disclosures about fair value measurements. This guidance became effective for financial statements issued for annual periods (for non-public entities such as the Company) beginning after December 15, 2011. The Company adopted this guidance for the fiscal year ended March 31, 2013, which only impacted its fair value disclosures. There were no changes to our approach to measuring fair value as a result of adopting the new guidance.

Accounting Guidance Not Yet Adopted

Offsetting Assets and Liabilities

In December 2011, the FASB issued accounting guidance requiring enhanced disclosure related to offsetting assets and liabilities. Under the new guidance, reporting entities will be required to disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting agreement, such as for derivatives. In January 2013, the FASB issued additional guidance to clarify that the specific instruments and activities that should be considered in these disclosures will be limited to recognized derivatives, repurchase and reverse repurchase agreements, and securities lending transactions. This guidance is effective for fiscal years, and interim periods within those years, beginning after January 1, 2013, and is to be applied retrospectively. The Company will begin including the new required disclosures in its fiscal year 2014 interim financial statements as applicable and does not expect any impact on its financial position, results of operations, or cash flows.

I. Reclassifications

Certain reclassifications have been made to the consolidated financial statements to conform prior year's data to the current year's presentation. The Company reclassified $1.8 million of accretion expense related to the asset retirement obligation from operations and maintenance to decommissioning charges on the consolidated income statement and from other, net to decommissioning charges, net of payments in the operating activities section of the consolidated statements of cash flows

for the year ended March 31, 2012. These reclassifications had no effect on the Company's results of operations and cash flows.

Note 2. Employee Benefits

The Company participates with certain other KeySpan subsidiaries in qualified and non-qualified non-contributory defined benefit plans (the "Pension Plan") and a PBOP plan (together with the Pension Plan (the "Plan")), covering substantially all employees. The Company follows multi-employer accounting. The Pension Plan provides union employees with a retirement benefit and 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 Company participates in the following plans: Retirement Income Plan of KeySpan Corporation, National Grid USA Companies' Executive SERP (Version III-KeySpan) (ESRP), Excess Benefit Plan of KeySpan Corp., Supplemental Retirement of KeySpan Corp., Retirement Income Restoration Plan (former Lilco Plan), Supplemental Death and Retirement Plan (former Lilco Plan), KeySpan Benefit Plan for Retired (East) Union Employees, and KeySpan Benefit Plan for Retired (East) Management Employees.

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.

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. Pension and PBOP expense are included in operations and maintenance expenses in the accompanying consolidated statements of income.

KeySpan companies' pension and PBOP plans that the Company participates in have unfunded obligations at March 31, 2013 and March 31, 2012 as follows:

	March 31,	
	2013	2012
	(in thousands of dollars)	
Pension	**$ 892,701**	$ 929,794
PBOP	**1,339,788**	1,267,919
	$ 2,232,489	$ 2,197,713

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, 2013 and March 31, 2012 are as follows:

	Years Ended March 31,	
	2013	2012
	(in thousands of dollars)	
Pension	**$ 11,989**	$ 9,942
PBOP	**18,638**	17,780
	$ 30,627	$ 27,722

During the years ended March 31, 2013 and March 31, 2012, the Company made contributions of approximately $17.6 million and $11.5 million, respectively, to the Plan. The difference between the amount of expense allocated to the Company and the amount of contributions made by the Company is included in the amounts due to affiliates.

In 1993, LIPA agreed to scheduled payments for postretirement benefits, other than pensions, which the Company recorded

as a contractual receivable. As of March 31, 2013 and March 31, 2012, the remaining balance is $5.4 million and $11.7 million, respectively. All contractual payments have been received to date.

Defined Contribution Plan

The Company has a defined contribution pension plan that covers substantially all employees. For the years ended March 31, 2013 and March 31, 2012, we recognized $0.3 million of expense in the accompanying consolidated statements of income for matching contributions.

Other Benefits

The Company accrued $0.2 million and $0.7 million at March 31, 2013 and March 31, 2012, respectively, regarding workers compensation, auto and general insurance claims which have been incurred but not yet reported.

Note 3. Property, Plant and Equipment

At March 31, 2013 and March 31, 2012, property, plant and equipment at cost along with accumulated depreciation and amortization are as follows:

	March 31,	
	2013	2012
	(in thousands of dollars)	
Plant and machinery	**$ 1,444,560**	$ 1,529,556
Land and buildings	**286,692**	330,993
Assets in construction	**54,629**	40,556
Software	**7,282**	7,282
Total	**1,793,163**	1,908,387
Accumulated depreciation and amortization	**(1,067,414)**	(1,173,043)
Property, plant and equipment, net	**$ 725,749**	$ 735,344

Note 4. Emission Credits

The Company has an inventory of SO_2 and NOx emission credits that may be sold to third party purchasers. The number of emission credits available for sale varies from year to year relative to the level of emissions from the generating facilities, which is greatly dependent on the mix of natural gas and fuel oil used for generation and the amount of purchased power that is imported to Long Island. In accordance with the PSA, 33% of emission credits sales revenue is retained by the Company and the other 67% is credited to LIPA. LIPA also has a right of first refusal on any potential emission credits sales. Additionally, we are bound by a memorandum of understanding with the New York State Department of Environmental Conservation ("DEC") which prohibits the sale of SO_2 credits into certain states and requires the purchaser to be bound by the same restriction, which may affect the credits' market value.

The Company is required to purchase CO_2 credits through the Regional Greenhouse Gas Initiative auctions. The Regional Greenhouse Gas Initiative is a cooperative effort by ten northeastern states to reduce emissions of carbon dioxide.

At March 31, 2013 and March 31, 2012, the emission credits had a fair value of $9.2 million and $0.9 million, respectively. For the years ended March 31, 2013 and March 31, 2012, the Company recorded an impairment charge of $.02 million and $0.09 million, respectively, in the accompanying consolidated statements of income.

Note 5. Fair Value Measurements

The fair market value of the Company's long-term debt was estimated based on the quoted market prices for similar issues or on the current rates offered to the Company for debt of the same remaining maturity. The fair value of our long-term debt at March 31, 2013 and March 31, 2012 was $446.9 million and $422.1 million, respectively.

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

Note 6. Income Taxes

The components of federal and state income tax expense (benefit) are as follows:

	Years Ended March 31,	
	2013	2012
	(in thousands of dollars)	
Current tax expense:		
Federal	**$ (11,764)**	$ 3,461
State	**3,449**	2,136
Total current tax expense	**(8,315)**	5,597
Deferred tax expense (benefit):		
Federal	**30,291**	(585)
State	**2,682**	(3,023)
Total deferred tax expense (benefit)	**32,973**	(3,608)
Total income tax expense	**$ 24,658**	$ 1,989

A reconciliation between the expected federal income tax expense, using the federal statutory rate of 35%, to the Company's actual income tax expense for the years ended March 31, 2013 and March 31, 2012 is as follows:

	Years Ended March 31,	
	2013	2012
	(in thousands of dollars)	
Computed tax	**$ 20,801**	$ 1,766
Change in computed taxes resulting from:		
State income tax, net of federal benefit	**3,985**	(577)
Other items, net	**(128)**	800
Total	**3,857**	223
Federal and state income taxes	**$ 24,658**	$ 1,989

Significant components of the Company's net deferred tax assets and liabilities at March 31, 2013 and March 31, 2012 are as follows:

	March 31,	
	2013	**2012**
	(in thousands of dollars)	
Deferred tax assets:		
Future federal benefit on state taxes	**$ 6,358**	$ 5,918
Reserves not currently deducted	**6,313**	4,209
Pensions, PBOP and other employee benefits	**5,949**	18,570
Other items	**299**	6,643
Total deferred tax assets [1]	**18,919**	35,340
Deferred tax liabilities:		
Property related differences	**111,415**	102,136
Property taxes	**32,755**	18,480
Other items	**614**	7,616
Total deferred tax liabilities	**144,784**	128,232
Net deferred income tax liability	**125,865**	92,892
Current portion of net deferred tax liability	**27,674**	15,731
Non-current portion of net deferred income tax liability	**$ 98,191**	$ 77,161

(1) There were no valuation allowances for deferred tax assets at March 31, 2013 and March 31, 2012.

The Company is included in the NGNA and subsidiaries' consolidated federal income tax return.

As of March 31, 2013 and March 31, 2012, the Company's current federal income tax balances receivable and payable to its parent are $4.2 million and $35.9 million, respectively. As of March 31, 2013, the Company has a balance of prepaid taxes of $6.4 million related to state tax overpayments.

Unrecognized Tax Benefits

As of March 31, 2013 and March 31, 2012, the Company's unrecognized tax benefits totaled $10.4 million and $10.1 million, respectively, none of which would affect the effective tax rate, if recognized.

The following table reconciles the changes to the Company's unrecognized tax benefits for the years ended March 31, 2013 and March 31, 2012:

	March 31,	
	2013	2012
	(in thousands of dollars)	
Balance at the beginning of the year	**$ 10,138**	$ 9,399
Gross increases related to prior period	**710**	1,188
Gross decreases related to prior period	**(295)**	(757)
Gross increases related to current period	**109**	308
Gross decreases related to current period	**(257)**	-
Balance at the end of the year	**$ 10,405**	$ 10,138

As of March 31, 2013 and March 31, 2012, the Company has no accrued interest related to unrecognized tax benefits. During the years ended March 31, 2013 and March 31 2012, the Company recorded interest expense of $0.7 million and zero, respectively. The Company recognizes accrued interest related to unrecognized tax benefits in interest expense or interest income and related penalties, if applicable, in other deductions in the accompanying consolidated statements of income. No tax penalties were recognized during the years ended March 31, 2013 and March 31, 2012.

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 liquidity.

In September 2011, the Internal Revenue Service ("IRS") commenced an audit of KeySpan and subsidiaries for the short year ended August 24, 2007 and NGNA and subsidiaries for the fiscal years ending March 31, 2008 and March 31, 2009. Fiscal years ended March 31, 2010 through March 31, 2013 remain subject to examination by the IRS.

The Company was a member of the KeySpan and subsidiaries combined New York State ("NYS") income tax return for calendar years ended December 31, 2003 through December 31, 2006, short period ended August 24, 2007 and fiscal year ended March 31, 2008. The tax returns for these years are under examination by the State of New York. The Company is no longer a member of KeySpan and subsidiaries combined NYS income tax return and filed a separate NYS income tax return beginning with the fiscal year ended March 31, 2009. The tax returns for the separately filed years ended March 31, 2009 through March 31, 2013 remain subject to examination by the State of New York.

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

Jurisdiction	Tax Year
Federal	August 24, 2007
New York	March 31, 2009

Note 7. Debt

Short-term debt

The Company has regulatory approval from the FERC to issue up to $250 million of short-term debt. The Company had no short-term debt outstanding to third-parties as of March 31, 2013 and March 31, 2012.

Authority Financing Notes

At March 31, 2013 and March 31, 2012, $41.1 million of 1999 Series A Pollution Control Revenue Bonds due October 1, 2028 were outstanding. The interest rate ranged from 0.25% to 1.60% for the year ended March 31, 2013. As of March 31, 2013 the rate was 0.61%. The interest rate ranged from 0.35% to 3.00% for the year ended March 31, 2012. As of March 31, 2012 the rate was 0.97%. Interest expense related to these notes for each of the years ended March 31, 2013 and March 31, 2012 was approximately $0.5 million and $0.7 million, respectively.

We also have outstanding $24.9 million variable rate 1997 Series A Electric Facilities Revenue Bonds due December 1, 2027. The interest rate on these bonds is reset weekly and during the year ended March 31, 2013 ranged from 0.10% to 0.27%. The interest rate on these bonds ranged from 0.07% to 0.28% for the year ended March 31, 2012. The interest rate was 0.12% and 0.20% at March 31, 2013 and March 31, 2012, respectively. Interest expense related to these notes for each of the years ended March 31, 2013 and March 31, 2012 was approximately $0.1 million, respectively. In relation to theses bonds, under the standby letter of credit and reimbursement agreement, the Company has a percent of indebtedness covenant that can not exceed 70%. During the years ended March 31, 2013 and March 31, 2012, the Company was in compliance with this covenant.

Promissory Notes

The Parent has issued promissory notes to LIPA representing an amount equivalent to certain Authority Financing Notes. The Parent then allocated a portion of these notes to the Company. At March 31, 2013 we had outstanding $75.3 million of such notes, consisting 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. Interest expense related to these notes for each of the years ended March 31, 2013 and March 31, 2012 was $3.9 million and is included in other interest, including affiliate interest in the accompanying consolidated statements of income.

Industrial Development Revenue Bonds

At March 31, 2013 and March 31, 2012, we had outstanding $128.3 million of 5.25% tax-exempt bonds due June 1, 2027 - $53.3 million of these Industrial Development Revenue Bonds were 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.

Upon acquisition by National Grid plc, the Company revalued its outstanding debt. The fair value adjustment is being amortized over the future lives of the underlying debt.

Advances from Parent

At March 31, 2013 and March 31, 2012, $131.9 million due to the Parent remains outstanding. The interest rate of this advance is 6.15% which matures in June 2014. Interest expense for each of the years ended March 31, 2013 and March 31, 2012 was $8.1 million and is included in other interest, including affiliate interest in the accompanying consolidated statements of income.

The aggregate maturities of long-term debt for the five years subsequent to March 31, 2013 are as follows:

(in thousands of dollars) Years Ended March 31,		
2014	$	-
2015		131,868
2016		27,900
2017		-
2018		-
Thereafter		241,680
Total	$	401,448

The Company is obligated to meet its non-financial covenants and during the years ended March 31, 2013 and March 31, 2012, the Company was in compliance with all of such covenants.

Note 8. 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 years subsequent to March 31, 2013, are summarized in the table below:

(in thousands of dollars)

Years Ended March 31,	Capital Commitments
2014	$ 27,206
2015	20,087
2016	61,454
2017	2,000
2018	-
Thereafter	-
Total	$ 110,747

Asset Retirement Obligations

The Company has various asset retirement obligations primarily associated with its electric generation activities. Generally, our largest asset retirement obligations relate to: (i) cleaning and removal requirements associated with storage tanks containing waste oil and other waste contaminants; (ii) legal requirements to remove asbestos upon major renovation or demolition of structures and facilities; and (iii) waste water treatment pond removal.

The Company has a legal obligation to remediate/demolish the Glenwood and Far Rockaway facilities following their retirement. These facilities were shut down and decommissioning began in July 2012; demolition and remediation activities are expected to be completed between October 2014 and April 2015. Pursuant to the existence of this legal obligation, the Company has recorded an asset retirement obligation; the remaining balance of this obligation was $38.4 million as of March 31, 2013.

The following table represents the changes in the asset retirement obligations for the years ended March 31, 2013 and March 31, 2012:

	March 31,	
	2013	2012
	(in thousands of dollars)	
Balance at beginning of year	**$ 54,794**	$ 9,182
Accretion expense	**2,330**	1,819
Liabilities settled	**(18,757)**	(805)
Liabilities incurred in the current year	**-**	44,598
Balance at end of year	**$ 38,367**	$ 54,794

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 condition, or cash flows.

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. Our business operations are regulated by various federal, regional, state, and local authorities, including the United States Environmental Protection Agency ("EPA"), the New York State Department of Environmental Conservation ("DEC"), the New York City Department of Environmental Protection ("NYC DEP"), 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 our knowledge, are contemplated by any federal, state, or local agency against us, and we are not a defendant in any material litigation with respect to any matter relating to the protection of the environment. We believe that the Company's 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 financial conditions or results of operations.

Air

Our 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. Our previous investments in low NO_x boiler combustion modifications, the use of natural gas firing systems at our 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. Ongoing investments include the installation of enhanced NO_x controls and efficiency improvement projects at certain of our Long Island based electric generating facilities. The total cost of these improvements is estimated to be approximately $92 million ($72 million had been placed in service and the Company expects to spend another $20 million); a mechanism for recovery from LIPA of these investments has been established. We are currently developing a compliance strategy to address anticipated future requirements. At this time, we are unable to predict what effect, if any, these future requirements will have on our financial condition, results of operation, and cash flows.

Water

Additional capital expenditures associated with the renewal of the surface water discharge permits for our 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. We are 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 on the order of approximately $100 million and did 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.

Power Supply Agreement

The PSA provides penalties for the Company to 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 $4.0 million annually. The PSA provides LIPA with all of the capacity from the generating facilities. However, LIPA has no obligation to purchase energy from the generating facilities and is able to purchase energy on a least-cost basis from all available sources consistent with existing transmission interconnection limitations of the transmission and distribution system. We must, therefore, operate our generating facilities in a manner such that we can remain competitive with other producers of energy. To date, we have dispatched to LIPA and LIPA has accepted the level of energy generated at the agreed to price per megawatt hour. However, no assurances can be given as to the level of energy to be dispatched to LIPA in the future. 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 it's investment in plant. A variable maintenance charge is imposed for each unit of energy actually acquired from the

generating facilities. The variable maintenance charge is billed to LIPA on a monthly basis. The billings to LIPA under the PSA include no provision for fuel costs, as such fuel is owned by LIPA, and LIPA reimburses the Company for the cost of all fuel deliveries.

On February 1, 2010, the Company filed at the FERC revisions to Appendix A of the PSA to add the mechanism for calculating the annual capacity charge for certain turbine upgrades and new emission controls and otherwise implement the Fourth Amendment to the PSA. LIPA intervened and protested various aspects of the Company's formula. On March 31, 2010, the FERC issued an order accepting and suspending the Company's proposed tariff sheets and establishing hearing and Settlement Judge procedures. Following the issuance of that order, the Company and LIPA entered into settlement discussions that resulted in a Stipulation and Settlement Agreement ("Settlement Agreement") which was filed at the FERC on May 13, 2010. The Administrative Law Judge certified the uncontested Settlement Agreement to the FERC on June 7, 2010. On September 24, 2010, the FERC issued a letter order approving, subject to rehearing, the uncontested Settlement Agreement between the Company and LIPA which details the revisions to Appendix A of the PSA that adds the mechanism for calculating the annual capacity charge for turbine upgrades and new emission controls and otherwise implement the Fourth Amendment to the PSA.

Based on the Settlement Agreement, the capacity charge for turbine upgrades and new emission controls will reflect a capitalized interest rate of 4.95% through March 31, 2010, and a 4.85% return thereafter, with all such rates reflecting 100% tax exempt debt financing. In addition, the Settlement Agreement provides that the rate for calculating the return on plant in service will be 4.85% with such rate reflecting 100% tax exempt debt financing. Finally, Article I of the Settlement Agreement contains the method for calculating the fuel and emission savings attributable to the turbine upgrades and new emission controls.

Additions to plant for turbine upgrades and emission controls went into service April 2, 2010 and June 1, 2010 at a combined cost of $25.8 million with measured fuel and emission savings sufficient enough to recover the associated capacity costs in 2010.

In October 2009, the FERC approved a revenue requirement of $435.7 million, an annual increase of approximately $65.7 million, a ROE of 10.75% and a capital structure of 50% debt and 50% equity. The FERC approved the settlement on January 5, 2010. The order accepting the settlement is no longer subject to rehearing and the settlement became effective on March 1, 2010. All outstanding balances associated with the revenue increase were settled in March 2010.

In June 2011, LIPA and the Company executed an amendment to the 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 demolishing these facilities. Demolition and remediation activities are expected to be completed between October 2014 and April 2015. As part of this amendment, the Company was required to make an Economic Equivalent Payment ("EEP") of $18 million which represented the economic benefit to LIPA which would have been realized under the original agreement. One-half of the EEP was paid in June 2012 upon confirmation from LIPA that the transmission improvements were completed and units became retirement eligible. The remaining balance was paid upon the termination of the original PSA (on May 28, 2013). The EEP was accrued on a straight-line basis over the 24-month term, from June 2011 thru May 2013, as a reduction in operating revenues.

On October 2, 2012, the Company announced it had reached an agreement with LIPA to amend and restate the current PSA (the "A&R PSA") upon expiration of the current agreement. Pursuant to the A&R PSA, LIPA will continue to purchase all of the energy and capacity from the PSA generating units. The A&R PSA has a term of fifteen years, expiring April 2028, provided LIPA has the option to terminate the agreement as early as April 2025 on two years advance notice. In March 2013, the Company received the required regulatory approvals from the New York State Comptroller and the New York State Attorney General. On May 23, 2013, the FERC accepted the A&R PSA, and approved a revenue requirement of $418.6 million, an annual decrease of $27.4 million, a ROE of 9.75% and a capital structure of 50% debt and 50% equity. The A&R PSA became effective as of May 28, 2013.

Note 9. Related Party Transactions

Accounts Receivable from Affiliates 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 payables to and receivables from certain of its affiliates in the ordinary course of business. The amounts payable to and receivable from its affiliates do not bear interest and are settled through the money pool. At March 31, 2013, and March 31, 2012, the Company had net outstanding accounts receivable from affiliates/accounts payable to affiliates balances as follows:

	Accounts Receivable from Affiliates		Accounts Payable to Affiliates	
	March 31,		March 31,	
	2013	2012	**2013**	2012
	(in thousands of dollars)		*(in thousands of dollars)*	
KeySpan Engineering Services	**$ -**	$ -	**$ 26,560**	$ 37,305
NGUSA Service Company	**-**	-	**31,286**	15,324
KeySpan Corporation	**-**	-	**26,113**	34,652
Other	**939**	695	**361**	4,104
Total	**$ 939**	$ 695	**$ 84,320**	$ 91,385

Money Pool

The settlement of the Company's various transactions with NGUSA and other affiliates generally occurs via the money pool. As of November 1, 2012, NGUSA and its affiliates established a new Regulated Money Pool and an Unregulated Money Pool. Financing and any excess funds related to the Company's working capital is obtained through participation in the Unregulated Money Pool. The Company, as a participant in the Unregulated Money Pool, can both borrow and lend funds. Borrowings from the Regulated and Unregulated Money Pools bear interest in accordance with the terms of the applicable money pool agreement.

The Regulated and Unregulated Money Pools are funded by operating funds from participants in the applicable Pool. 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 Money Pools, if necessary. The Company had a short-term money pool receivable of $477.4 million and $430.1 million at March 31, 2013 and March 31, 2012, respectively. The average interest rate for the money pool was 1.45% and 1.23% for the years ended March 31, 2013 and March 31, 2012, 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.

Charges from the service companies of NGUSA to the Company for the years ended March 31, 2013 and March 31, 2012 were $244.7 million and $113.0 million, respectively.

Holding Company Charges

NGUSA received charges from National Grid Commercial Holdings Limited, an affiliated company in the UK, for certain corporate and administrative services provided by the corporate functions of National Grid plc to its US subsidiaries. These charges, which are recorded on the books of NGUSA, have not been reflected on these consolidated financial statements. Were these amounts allocated to the Company, the estimated effect on net income would be approximately $1.6 million and $1.7 million before taxes, and $1.0 million and $1.1 million after taxes, for the years ended March 31, 2013 and March 31, 2012, respectively.

Note 10. Restrictions on Payment of Dividends

Pursuant to the provisions of the long-term note agreement, 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, 2013 and March 31, 2012 member’s equity was 57.8% and 54.7% of total capitalization, respectively. Under these provisions, none of the Company’s retained earnings at March 31, 2013 and March 31, 2012 were restricted as to common dividends.