National Grid Generation LLC and Subsidiaries

Consolidated Financial Statements

For the years ended March 31, 2014 and 2013

NATIONAL GRID GENERATION LLC AND SUBSIDIARIES

TABLE OF CONTENTS

Independent Auditor's Report	3
Consolidated Statements of Income Years Ended March 31, 2014 and 2013	4
Consolidated Statements of Cash Flows Years Ended March 31, 2014 and 2013	5
Consolidated Balance Sheets March 31, 2014 and 2013	6
Consolidated Statements of Capitalization March 31, 2014 and 2013	8
Consolidated Statements of Changes in Member's Equity Years Ended March 31, 2014 and 2013	9
Notes to the Consolidated Financial Statements	10
1 - Nature of Operations and Basis of Presentation	10
2 - Summary of Significant Accounting Policies	10
3 - Property, Plant and Equipment	13
4 - Emission Credits	13
5 - Fair Value Measurements	13
6 - Employee Benefits	14
7 - Capitalization	15
8 - Income Taxes	16
9 - Commitments and Contingencies	20
10 - Related Party Transactions	22

Independent Auditor's Report

To the Member and 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, 2014 and 2013, 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 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, 2014 and 2013, 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

July 29, 2014

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

	Years Ended March 31,	
	2014	2013
Operating revenues	**$ 493,451**	$ 500,123
Operating expenses:		
Operations and maintenance	**179,850**	174,722
Depreciation and amortization	**50,086**	48,298
Other taxes	**198,385**	202,943
Total operating expenses	**428,321**	425,963
Operating income	**65,130**	74,160
Other income and (deductions):		
Interest on long-term debt	**(7,212)**	(7,289)
Other interest, including affiliate interest	**(14,908)**	(12,648)
Other income, net	**3,493**	5,208
Total other deductions, net	**(18,627)**	(14,729)
Income before income taxes	**46,503**	59,431
Income tax expense	**20,936**	24,658
Net income	**$ 25,567**	$ 34,773

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,	
	2014	**2013**
Operating activities:		
Net income	**$ 25,567**	$ 34,773
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**50,086**	48,298
Provision for deferred income taxes	**14,692**	32,973
Bad debt expense	**161**	680
Accretion expense	**1,523**	2,330
Amortization of debt discount and issuance costs	**149**	151
Amortization of postretirement benefit transition obligation	**5,359**	6,354
Share based compensation	**11**	-
Changes in operating assets and liabilities:		
Accounts receivable, net, and unbilled revenues	**(9,114)**	(6,063)
Accounts receivable from/payable to affiliates, net	**-**	11,789
Inventory	**(1,364)**	2,696
Emission credits, net	**(8,306)**	952
Prepaid and accrued taxes	**19,053**	(12,512)
Accounts payable and other liabilities	**(10,472)**	67
Asset retirement obligations	**(20,124)**	(18,757)
Other, net	**2,352**	283
Net cash provided by operating activities	**69,573**	104,014
Investing activities:		
Capital expenditures	**(41,704)**	(36,745)
Affiliated money pool investing and receivables/payables, net	**(29,346)**	(66,995)
Net cash used in investing activities	**(71,050)**	(103,740)
Financing activities:		
Parent loss tax allocation	**1,538**	(358)
Share based compensation	**(61)**	84
Net cash provided by (used in) financing activities	**1,477**	(274)
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	**$ (25,694)**	$ (19,368)
Income taxes refunded from (paid to) Parent	**23,288**	(30,358)
State income taxes paid	**(6,833)**	(15,778)
Significant non-cash item:		
Capital-related accruals included in accounts payable	**2,430**	-
Share based compensation	**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,	
	2014	2013
ASSETS		
Current assets:		
Accounts receivable, net of allowance of $80 and $0	**$ 118**	$ 3,277
Unbilled revenues, net of allowance of $680 and $680	**23,212**	11,100
Accounts receivable from affiliates	**134**	939
Intercompany money pool	**558,283**	477,424
Inventory	**37,545**	36,181
Emission credits	**28,143**	9,231
Prepaid taxes	**12,712**	10,369
Other	**-**	2,191
Total current assets	**660,147**	550,712
Property, plant, and equipment, net	**719,797**	725,749
Other non-current assets:		
Contractual receivable - from Long Island Power Authority	**-**	5,359
Other	**11,892**	10,284
Total other non-current assets	**11,892**	15,643
Total assets	**$ 1,391,836**	$ 1,292,104

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,	
	2014	2013
LIABILITIES AND CAPITALIZATION		
Current liabilities:		
Accounts payable	**$ 14,432**	$ 25,385
Accounts payable to affiliates	**139,588**	88,880
Taxes accrued	**39,867**	18,471
Interest accrued	**8,930**	7,181
Current portion of deferred income tax liabilities, net	**22,980**	27,674
Other	**4,218**	12,438
Total current liabilities	**230,015**	180,029
Other non-current liabilities:		
Asset retirement obligations	**19,766**	38,367
Emission credits reserve	**20,329**	9,703
Deferred income tax liabilities, net	**119,607**	98,191
Other	**27,637**	18,536
Total non-current liabilities	**187,339**	164,797
Commitments and contingencies (Note 9)		
Capitalization:		
Member's equity	**574,999**	547,944
Long-term debt	**267,615**	267,466
Advances from KeySpan Corporation	**131,868**	131,868
Total capitalization	**974,482**	947,278
Total liabilities and capitalization	**$ 1,391,836**	$ 1,292,104

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, 2014	March 31, 2013
Total member's equity			**$ 574,999**	$ 547,944
Long-term debt:				
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			**(1,965)**	(2,114)
Long-term debt			**267,615**	267,466
Advances from KeySpan Corporation	6.15%	June 30, 2015	**131,868**	131,868
Total capitalization			**$ 974,482**	$ 947,278

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, 2012	**$ 457,837**	**$ 55,608**	**$ 513,445**
Net income	-	34,773	34,773
Parent loss tax allocation	(358)	-	(358)
Share based compensation	84	-	84
Balance as of March 31, 2013	**457,563**	**90,381**	**547,944**
Net income	-	25,567	25,567
Parent loss tax allocation	1,538	-	1,538
Share based compensation	(50)	-	(50)
Balance as of March 31, 2014	**$ 459,051**	**$ 115,948**	**$ 574,999**

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.

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").

Management recorded out-of-period adjustments during the current fiscal year that resulted in net reductions of net income of $1.6 million. The adjustments primarily related to correction of operations and maintenance expense and income tax expense. Management concluded that the impact of recording these adjustments was not material to the current fiscal year or any prior period.

The Company has evaluated subsequent events and transactions through July 29, 2014, 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, 2014.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

In preparing financial statements that conform to U.S. GAAP, the Company must make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses, and the disclosure of contingent assets and liabilities included in the 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"). The Company records unbilled revenues for the estimated amount of energy delivered from the bill date and 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 based on a variety of factors, including for each type of receivable, applying an estimated reserve percentage to each aging category, taking into account historical collection and write-off experience and management's assessment of collectability from individual customers as appropriate. Management continuously assesses the collectability of receivables, 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. 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 year ended March 31, 2014. Write-offs of obsolete inventory amounted to $1.8 million for the year ended March 31, 2013.

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, 2014 and 2013 was 3.3% and 3.0%, respectively. The average service life for each of the years ended March 31, 2014 and 2013 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 between October 2014 and April 2015.

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

	Years Ended March 31,			
	2014		2013	
	(in thousands of dollars)			
Balance as of the beginning of the year	**$**	**38,367**	$	54,794
Accretion expense		**1,523**		2,330
Liabilities settled		**(20,124)**		(18,757)
Balance as of the end of the year	**$**	**19,766**	$	38,367

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

Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists

In July 2013, the FASB issued amendments to address diversity in practice related to the presentation of unrecognized tax benefits in certain situations. The amendments require a liability related to an unrecognized tax benefit to be presented on a net basis with its associated deferred tax asset when utilization of such deferred tax assets is required or expected in the event the uncertain tax position is disallowed. Otherwise, the unrecognized tax benefit will be presented as a liability and will not be netted against deferred tax assets. The Company early adopted this guidance effective April 1, 2013 with no material impact on its financial position, results of operations or cash flows.

3. PROPERTY, PLANT AND EQUIPMENT

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

	March 31,	
	2014	2013
	(in thousands of dollars)	
Plant and machinery	**$ 1,543,670**	$ 1,444,560
Land and buildings	**303,453**	286,692
Assets in construction	**52,561**	54,629
Software and other intangibles	**8,023**	7,282
Total property, plant and equipment	**1,907,707**	1,793,163
Accumulated depreciation and amortization	**(1,187,910)**	(1,067,414)
Property, plant and equipment, net	**$ 719,797**	$ 725,749

4. EMISSION CREDITS

The Company is issued sulfur dioxide (“SO_2”) and nitrogen oxide (“NO_X”) emission credits each year by the U.S. Environmental Protection Agency (“EPA”) at zero cost. Emission credits are held primarily for consumption or 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 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, the Company is 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 carbon dioxide credits through the Regional Greenhouse Gas Initiative (“RGGI”) auctions. The RGGI is a cooperative effort by nine northeastern states to reduce emissions of carbon dioxide.

Emission credits are accounted for as inventory and recorded in the accompanying balance sheets at the lower of weighted average cost or market. At March 31, 2014 and 2013 the Company recorded emission credits of $28.1 million and $9.2 million and a compliance reserve of $20.3 million and $9.7 million respectively.

5. 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 estimated using quoted market prices for similar debt. The fair value of this debt at March 31, 2014 and 2013 was $426.2 million and $446.9 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.

6. 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.

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 are as follows:

	March 31,	
	2014	2013
	(in thousands of dollars)	
Pension	**$ 704,169**	$ 892,701
PBOP	**916,706**	1,339,788
	$ 1,620,875	$ 2,232,489

The Company's net pension and PBOP expenses directly charged and allocated from affiliated service companies, net of capital are as follows:

	March 31,	
	2014	2013
	(in thousands of dollars)	
Pension	**$ 11,532**	$ 11,989
PBOP	**16,312**	18,638
	$ 27,844	$ 30,627

During the years ended March 31, 2014 and 2013, the Company made contributions of approximately $15.5 million and $17.6 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.

In 1993, LIPA agreed to scheduled payments for PBOP, which the Company recorded as a contractual receivable. As of March 31, 2014 and 2013, the remaining balance is zero and $5.4 million, respectively. 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 the years ended March 31, 2014 and 2013, the Company recognized an expense in the accompanying consolidated statements of income of $0.3 million for matching contributions.

Other Benefits

During the fiscal year ended March 31, 2014, NGUSA improved its methodology for allocating to its subsidiaries the expense and liability for workers compensation, auto, and general insurance claims which have been incurred but not yet reported ("IBNR"). In prior fiscal years, such costs and liabilities were allocated to NGUSA's subsidiaries based on each subsidiary's pro-rata share of known outstanding case reserves. As of and for the year ended March 31, 2014, such IBNR amounts are allocated proportionally based on various factors including revenue, payroll, and number of fleet vehicles, as applicable to the related exposure source. Management believes this improved methodology provides a more accurate and appropriate allocation to each of its subsidiaries. The change in allocation methodology resulted in an increase in income before taxes of approximately $4.8 million in the current fiscal year. At March 31, 2014 and 2013, the Company had accrued IBNR of $5.1 million and $0.2 million respectively.

7. 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. Effective April 2014, the Company entered into an Equity Contribution Agreement with NGUSA which provides 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 is regained. The Company has not made use of this facility since its effective date. The Company had no short-term debt outstanding to third parties as of March 31, 2014 or 2013.

Authority Financing Notes

At March 31, 2014 and 2013, $41.1 million of 1999 Series A Pollution Control Revenue Bonds due October 1, 2028 were outstanding. The interest rate ranged from 0.15% to 1.35% for the year ended March 31, 2014 and 0.25% to 1.60% for the year ended March 31, 2013.

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, 2014 and 2013 respectively. The interest rate on these bonds is reset weekly and ranged from 0.04% to 0.25% during the year ended March 31, 2014 and from 0.10% to 0.27% for the year ended March 31, 2013. 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, 2014 and 2013, the Company was in compliance with this covenant.

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, 2014 and 2013 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.

Industrial Development Revenue Bonds

At March 31, 2014 and 2013, 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.

Advance from Parent

At March 31, 2014 and 2013, a $131.9 million Advance due to the Parent remains outstanding, and matures in June 2015. The interest rate of this advance is 6.15%.

Current Maturities of Long-term Debt

(in thousands of dollars)	
Years Ended March 31,	
2015	$ -
2016	159,768
2017	-
2018	-
2019	-
Thereafter	241,680
Total	$ 401,448

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, 2014 and 2013, 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, 2014 and 2013 member's equity was 59.1% and 57.8% of total capitalization, respectively. Under these provisions, none of the Company's retained earnings at March 31, 2014 or 2013 were restricted as to payment of dividends.

8. INCOME TAXES

Components of Income Tax Expense

	Years Ended March 31,	
	2014	2013
	(in thousands of dollars)	
Current tax expense (benefit):		
Federal	**$ 4,553**	$ (11,764)
State	**1,691**	3,449
Total current tax expense (benefit)	**6,244**	(8,315)
Deferred tax expense:		
Federal	**10,191**	30,291
State	**4,501**	2,682
Total deferred tax expense	**14,692**	32,973
Total income tax expense	**$ 20,936**	$ 24,658

Statutory Rate Reconciliation

The Company's effective tax rates for the years ended March 31, 2014 and 2013 are 45.0% and 41.5%, respectively. The following table presents a reconciliation of income tax expense at the federal statutory tax rate of 35% to the actual tax expense from continuing operations:

	Years Ended March 31,	
	2014	2013
	(in thousands of dollars)	
Computed tax	**$ 16,276**	$ 20,801
Change in computed taxes resulting from:		
State income tax, net of federal benefit	**4,025**	3,985
Other items, net	**635**	(128)
Total	**4,660**	3,857
Federal and state income taxes	**$ 20,936**	$ 24,658

The Company is a member of the NGNA and subsidiaries consolidated federal income tax return. The Company has joint and several liability for any potential assessments against the consolidated group.

In September 2013, the Internal Revenue Service ("IRS") issued final regulations, effective for tax years beginning in 2014, that provide guidance on the appropriate tax treatment of costs incurred to acquire, produce or improve tangible property, as well as routine maintenance and repair costs. Proposed regulations were issued addressing the tax treatment of asset dispositions. The Company has evaluated tax accounting method changes that may be elected or required by the final regulations. The application of these regulations is not expected to have a material impact on the Company's financial position, results of operations or liquidity.

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 surcharge rate increased from 17% to 25.6% of the NY 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, the Company decreased its New York State and MTA deferred tax liability by $0.9 million with an offset to expense to reflect the decrease in tax rate. The application of this legislation is not expected to have a material impact on the Company's financial position, results of operations or liquidity.

Deferred Tax Components

	March 31,	
	2014	2013
	(in thousands of dollars)	
Deferred tax assets:		
Net operating losses	**$ 11,387**	$ -
Future federal benefit on state taxes	**8,728**	6,358
Reserves not currently being deducted	**5,384**	6,313
Pensions, PBOP, and other employee benefits	**2,277**	5,949
Other items	**6,235**	299
Total deferred tax assets [1]	**34,011**	18,919
Deferred tax liabilities:		
Property related differences	**137,470**	111,415
Property taxes	**39,128**	32,755
Other items	**-**	614
Total deferred tax liabilities	**176,598**	144,784
Net deferred income tax liabilities	**142,587**	125,865
Current portion of deferred income tax liabilities	**22,980**	27,674
Deferred income tax liabilities	**$ 119,607**	$ 98,191

(1) There were no valuation allowances for deferred tax assets at March 31, 2014 or 2013.

During the year ended March 31, 2014, the Company changed its accounting policy for presentation of tax balances. The change in policy resulted in a reclassification of balances reported at March 31, 2013, which increased accounts payable to affiliates and prepaid taxes by $4.2 million and $3.9 million, respectively, and reduced other non-current liabilities by $0.3 million.

The following table presents the amounts and expiration dates of operating losses as of March 31, 2014:

Expiration of net operating losses:	Federal
	(in thousands of dollars)
03/31/2033	$ 36,880

Expiration of net operating losses:	New York State	New York City
03/31/2033	$ -	$ 21,830

Unrecognized Tax Benefits

As of March 31, 2014 and 2013, the Company's unrecognized tax benefits totaled $4.2 million and $10.4 million, respectively, of which none would affect the effective tax rate, if recognized.

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

	Years Ended March 31,	
	2014	2013
	(in thousands of dollars)	
Balance as of the beginning of the year	**$ 10,405**	$ 10,138
Gross increases related to prior period	**1,811**	710
Gross decreases related to prior period	**(726)**	(295)
Gross increases related to current period	**489**	109
Gross decreases related to current period	**-**	(257)
Settlements with tax authorities	**(7,748)**	-
Balance as of the end of the year	**$ 4,231**	$ 10,405

As of March 31, 2014 and 2013, the Company has accrued for interest related to unrecognized tax benefits of $1.7 million and zero, respectively. During the years ended March 31, 2014 and 2013, the Company recorded interest expense of $1.8 million and $0.7 million, respectively. The Company recognizes interest related to unrecognized tax benefits in other interest, including affiliate interest and related penalties, if applicable, are recorded to other income, net in the accompanying consolidated statements of income. No tax penalties were recognized during the years ended March 31, 2014 and 2013.

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.

During the years ended March 31, 2014 the IRS has 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 March 31, 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 items with the IRS Office of Appeals. The Company does not anticipate a change in its unrecognized tax positions in the next twelve months as a result of the appeals. However, pursuant to the Company's tax sharing agreement, the audit or appeals may result in a change to allocated tax.

Fiscal years ended March 31, 2010 through March 31, 2014 remain subject to examination by the IRS.

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

Jurisdiction	**Tax Year**
Federal	March 31, 2008 *
New York	December 31, 2003
New York City	December 31, 2003

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

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, short period ended August 24, 2007 and 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 Corporation and subsidiaries for the period starting January 1, 2003 through March 31, 2008. The tax returns for the separately filed years ended March 31, 2009 through March 31, 2014 remain subject to examination by the State of New York.

During the fiscal year, New York City commenced an examination of KeySpan Corporation and subsidiaries for the period January 1, 2003 through December 31, 2005.

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, 2014 are summarized in the table below:

(in thousands of dollars)	
Years Ended March 31,	
2015	$ 49,653
2016	42,246
2017	40,117
2018	49,564
2019	33,586
Thereafter	-
Total	$ 215,166

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.

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 EPA, the 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 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 results of operations, financial position, 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 its 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 on the order of approximately $100 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.

Power Supply Agreement

Effective May 23, 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 $4.0 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 thru May 2013, as a reduction in operating revenues.

Included in unbilled revenues is an allowance for doubtful accounts of $0.7 million related to unbilled carrying charges on employee benefit-related items.

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 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 intercompany money pool. A summary of net outstanding accounts receivable from affiliates and accounts payable to affiliates balances is as follows:

	Accounts Receivable from Affiliates		Accounts Payable to Affiliates	
	March 31,		March 31,	
	2014	2013	**2014**	2013
	(in thousands of dollars)		*(in thousands of dollars)*	
KeySpan Corporation	**$ -**	$ -	**$ 87,180**	$ 30,673
KeySpan Engineering Services	**-**	-	**30,109**	26,560
NGUSA Service Company	**-**	-	**18,539**	31,286
Other	**134**	939	**3,760**	361
Total	**$ 134**	$ 939	**$ 139,588**	$ 88,880

Intercompany Money Pool

The settlement of the Company's various transactions with NGUSA and certain affiliates generally occurs via the intercompany money pool. The Company is a participant in the Unregulated Money Pool and can both borrow and lend funds. Borrowings from the Unregulated Money Pool bear interest in accordance with the terms of the intercompany 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 and payable from affiliate 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 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 its subsidiary, 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 $558.3 million and $477.4 million at March 31, 2014 and 2013, respectively. The average interest rates for the intercompany money pool were 0.7% and 1.4% for the years ended March 31, 2014 and 2013, 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, etc. Lastly, all other costs are allocated based on a general allocator determined using a 3-point formula based on net margin, net property, plant and equipment, and operations and maintenance expense.

Charges from the service companies of NGUSA to the Company for the years ended March 31, 2014 and 2013 were $287.4 million and $222.5 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 on these consolidated financial statements. Were these amounts allocated to the Company, the estimated effect on net income would be $2.5 million and $1.6 million before taxes, and $1.6 million and $1.0 million after taxes, for the years ended March 31, 2014 and 2013, respectively.