# Combined Yankee Energy System, Inc. and Subsidiaries and Yankee Gas Services Company

Financial Statements as of and for the
Years Ended December 31, 2012 and 2011,
Together With Independent Auditors' Reports

Combined
Yankee Energy System, Inc. and Subsidiaries
and
Yankee Gas Services Company

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# Deloitte.

**Deloitte & Touche LLP**
City Place 1, 32nd Floor
185 Asylum Street
Hartford, CT 06103-3402
USA

Tel: +1 860 725 3000
Fax: +1 860 725 3500
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholder of
Yankee Energy System, Inc. and subsidiaries
Hartford, CT

We have audited the accompanying consolidated financial statements of Yankee Energy System, Inc. and subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, common stockholder's equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

**Management's Responsibility for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of these 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.

**Auditors' Responsibility**

Our responsibility is to express an opinion on these 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 the auditor's 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, the auditor considers 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 Yankee Energy System, Inc. and subsidiaries as of December 31, 2012 and 2011, 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.

Deloitte & Touche LLP

March 27, 2013

YANKEE ENERGY SYSTEM, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

| (Thousands of Dollars) | As of December 31, 2012 | 2011 |
|---|---|---|
| ASSETS | | |
| Current Assets: | | |
| Cash | $ 2,841 | $ 230 |
| Receivables, Net | 38,787 | 33,691 |
| Unbilled Revenues | 18,220 | 16,715 |
| Fuel, Materials and Supplies | 50,898 | 58,629 |
| Regulatory Assets | 11,461 | 22,168 |
| Prepayments and Other Current Assets | 3,198 | 5,665 |
| Total Current Assets | 125,405 | 137,098 |
| Property, Plant and Equipment, Net | 1,014,500 | 943,285 |
| Deferred Debits and Other Assets: | | |
| Regulatory Assets | 149,616 | 138,953 |
| Goodwill | 287,591 | 287,591 |
| Other Long-Term Assets | 5,202 | 5,172 |
| Total Deferred Debits and Other Assets | 442,409 | 431,716 |
| Total Assets | $ 1,582,314 | $ 1,512,099 |

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

YANKEE ENERGY SYSTEM, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

| (Thousands of Dollars) | As of December 31, 2012 | 2011 |
|---|---|---|
| LIABILITIES AND CAPITALIZATION | | |
| Current Liabilities: | | |
| Notes Payable | $ - | $ 30,000 |
| Notes Payable to Affiliated Companies | 72,200 | 11,200 |
| Long-Term Debt - Current Portion | - | 4,286 |
| Accounts Payable | 34,611 | 27,627 |
| Accounts Payable to Affiliated Companies | 6,165 | 6,519 |
| Accrued Taxes | 11,571 | 9,444 |
| Accrued Interest | 7,689 | 7,390 |
| Regulatory Liabilities | 10,143 | 8,961 |
| Other Current Liabilities | 15,654 | 19,675 |
| Total Current Liabilities | 158,033 | 125,102 |
| Deferred Credits and Other Liabilities: | | |
| Accumulated Deferred Income Taxes | 209,751 | 190,833 |
| Regulatory Liabilities | 52,026 | 55,762 |
| Accrued Pension, SERP and PBOP | 105,068 | 89,592 |
| Other Long-Term Liabilities | 37,885 | 36,534 |
| Total Deferred Credits and Other Liabilities | 404,730 | 372,721 |
| Capitalization: | | |
| Long-Term Debt | 345,805 | 345,920 |
| Common Stockholder's Equity: | | |
| Common Stock | - | - |
| Capital Surplus, Paid In | 628,227 | 627,949 |
| Retained Earnings | 47,000 | 41,792 |
| Accumulated Other Comprehensive Loss | (1,481) | (1,385) |
| Common Stockholder's Equity | 673,746 | 668,356 |
| Total Capitalization | 1,019,551 | 1,014,276 |
| Total Liabilities and Capitalization | $ 1,582,314 | $ 1,512,099 |

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

YANKEE ENERGY SYSTEM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

| (Thousands of Dollars) | For the Years Ended December 31, 2012 | 2011 |
|---|---|---|
| Operating Revenues | $ 385,009 | $ 430,799 |
| Operating Expenses: | | |
| Cost of Natural Gas | 145,861 | 191,286 |
| Operations and Maintenance | 103,049 | 105,043 |
| Depreciation | 29,303 | 27,511 |
| Amortization of Regulatory Assets, Net | 1,531 | 181 |
| Energy Efficiency Programs | 12,569 | 6,396 |
| Taxes Other Than Income Taxes | 31,054 | 30,911 |
| Total Operating Expenses | 323,367 | 361,328 |
| Operating Income | 61,642 | 69,471 |
| Interest Expense: | | |
| Interest on Long-Term Debt | 19,926 | 19,891 |
| Other Interest Expense | 1,632 | 1,076 |
| Interest Expense | 21,558 | 20,967 |
| Other Income, Net | 111 | 1,290 |
| Income Before Income Tax Expense | 40,195 | 49,794 |
| Income Tax Expense | 13,907 | 18,243 |
| Net Income | $ 26,288 | $ 31,551 |

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| | | |
|---|---|---|
| Net Income | $ 26,288 | $ 31,551 |
| Other Comprehensive Loss, Net of Tax: | | |
| Changes in Funded Status of SERP Benefit Plan | (189) | (318) |
| Other | 93 | 93 |
| Other Comprehensive Loss, Net of Tax | (96) | (225) |
| Comprehensive Income | $ 26,192 | $ 31,326 |

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

YANKEE ENERGY SYSTEM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDER'S EQUITY

| (Thousands of Dollars, Except Stock Information) | Common Stock | | Capital Surplus, Paid In | Retained Earnings | Accumulated Other Comprehensive Loss | Total |
|---|---|---|---|---|---|---|
| | Stock | Amount | | | | |
| Balance as of January 1, 2011 | 1,000 | $ - | $619,196 | $48,401 | $ (1,160) | $666,437 |
| Net Income | | | | 31,551 | | 31,551 |
| Dividends on Common Stock | | | | (38,160) | | (38,160) |
| Capital Contributions from Parent | | | 8,503 | | | 8,503 |
| Allocation of Benefits - ESOP | | | 250 | | | 250 |
| Other Comprehensive Loss | | | | | (225) | (225) |
| Balance as of December 31, 2011 | 1,000 | - | 627,949 | 41,792 | (1,385) | 668,356 |
| Net Income | | | | 26,288 | | 26,288 |
| Dividends on Common Stock | | | | (21,080) | | (21,080) |
| Allocation of Benefits - ESOP | | | 278 | | | 278 |
| Other Comprehensive Loss | | | | | (96) | (96) |
| Balance as of December 31, 2012 | 1,000 | $ - | $628,227 | $47,000 | $ (1,481) | $673,746 |

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

YANKEE ENERGY SYSTEM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

| (Thousands of Dollars) | For the Years Ended December 31, 2012 | 2011 |
|---|---|---|
| Operating Activities: | | |
| Net Income | $ 26,288 | $ 31,551 |
| Adjustments to Reconcile Net Income to Net Cash Flows | | |
| Provided by Operating Activities: | | |
| Bad Debt Expense | 3,182 | 3,037 |
| Depreciation | 29,303 | 27,511 |
| Deferred Income Taxes | 14,425 | 9,818 |
| Pension, PBOP, and SERP Expense, Net of Pension and PBOP Contributions | 4,338 | 7,169 |
| Amortization of Regulatory Assets, Net | 1,531 | 181 |
| Regulatory Overrecoveries, Net | 11,259 | 3,790 |
| Other | (10,960) | (5,192) |
| Changes in Current Assets and Liabilities: | | |
| Receivables and Unbilled Revenues, Net | (12,261) | 8,946 |
| Fuel, Materials and Supplies | 7,731 | 75 |
| Taxes Receivable/Accrued, Net | 5,839 | 11,376 |
| Accounts Payable | 5,312 | (4,788) |
| Other Current Assets and Liabilities, Net | 2,430 | (450) |
| Net Cash Flows Provided by Operating Activities | 88,417 | 93,024 |
| Investing Activities: | | |
| Investments in Property, Plant and Equipment | (91,354) | (98,188) |
| Other Investing Activities | - | (1,046) |
| Net Cash Flows Used in Investing Activities | (91,354) | (99,234) |
| Financing Activities: | | |
| Cash Dividends on Common Stock | (21,080) | (38,160) |
| Retirement of Long-Term Debt | (4,286) | (4,286) |
| Capital Contributions from Parent | - | 8,503 |
| Increase in Notes Payable to Affiliated Companies | 61,000 | 9,900 |
| (Decrease)/Increase in Short-Term Debt | (30,000) | 30,000 |
| Other Financing Activities | (86) | (64) |
| Net Cash Flows Provided by Financing Activities | 5,548 | 5,893 |
| Net Increase/(Decrease) in Cash | 2,611 | (317) |
| Cash - Beginning of Year | 230 | 547 |
| Cash - End of Year | $ 2,841 | $ 230 |

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

Deloitte.

**Deloitte & Touche LLP**
City Place 1, 32nd Floor
185 Asylum Street
Hartford, CT 06103-3402
USA

Tel: +1 860 725 3000
Fax: +1 860 725 3500
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholder of
Yankee Gas Services Company
Hartford, CT

We have audited the accompanying financial statements of Yankee Gas Services Company (the "Company"), which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of income, comprehensive income, common stockholder's equity, and cash flows for the years then ended, and the related notes to the financial statements.

**Management's Responsibility for the Financial Statements**

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

**Auditors' Responsibility**

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's 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, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Yankee Gas Services Company as of December 31, 2012 and 2011, 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.

Deloitte & Touche LLP

March 27, 2013

YANKEE GAS SERVICES COMPANY
BALANCE SHEETS

| (Thousands of Dollars) | As of December 31, 2012 | 2011 |
|---|---|---|
| ASSETS | | |
| Current Assets: | | |
| Cash | $ 2,710 | $ - |
| Receivables, Net | 38,076 | 32,980 |
| Unbilled Revenues | 18,220 | 16,715 |
| Fuel, Materials and Supplies | 50,898 | 58,629 |
| Regulatory Assets | 11,461 | 22,168 |
| Prepayments and Other Current Assets | 3,193 | 5,765 |
| Total Current Assets | 124,558 | 136,257 |
| Property, Plant and Equipment, Net | 1,014,500 | 943,285 |
| Deferred Debits and Other Assets: | | |
| Regulatory Assets | 149,616 | 138,953 |
| Goodwill | 287,591 | 287,591 |
| Other Long-Term Assets | 5,203 | 5,172 |
| Total Deferred Debits and Other Assets | 442,410 | 431,716 |
| Total Assets | $ 1,581,468 | $ 1,511,258 |

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

YANKEE GAS SERVICES COMPANY
BALANCE SHEETS

| (Thousands of Dollars) | As of December 31, 2012 | 2011 |
|---|---|---|
| LIABILITIES AND CAPITALIZATION | | |
| Current Liabilities: | | |
| Notes Payable | $ - | $ 30,000 |
| Notes Payable to Affiliated Companies | 70,600 | 12,500 |
| Long-Term Debt - Current Portion | - | 4,286 |
| Accounts Payable | 34,611 | 27,627 |
| Accounts Payable to Affiliated Companies | 6,158 | 6,520 |
| Accrued Taxes | 11,632 | 9,431 |
| Accrued Interest | 7,689 | 7,390 |
| Regulatory Liabilities | 10,143 | 8,961 |
| Other Current Liabilities | 16,551 | 20,615 |
| Total Current Liabilities | 157,384 | 127,330 |
| Deferred Credits and Other Liabilities: | | |
| Accumulated Deferred Income Taxes | 209,749 | 190,735 |
| Regulatory Liabilities | 52,026 | 55,762 |
| Accrued Pension, SERP and PBOP | 105,068 | 89,592 |
| Other Long-Term Liabilities | 37,885 | 36,535 |
| Total Deferred Credits and Other Liabilities | 404,728 | 372,624 |
| Capitalization: | | |
| Long-Term Debt | 345,805 | 345,920 |
| Common Stockholder's Equity: | | |
| Common Stock | 5 | 5 |
| Capital Surplus, Paid In | 616,239 | 615,961 |
| Retained Earnings | 58,788 | 50,803 |
| Accumulated Other Comprehensive Loss | (1,481) | (1,385) |
| Common Stockholder's Equity | 673,551 | 665,384 |
| Total Capitalization | 1,019,356 | 1,011,304 |
| Total Liabilities and Capitalization | $ 1,581,468 | $ 1,511,258 |

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

YANKEE GAS SERVICES COMPANY
STATEMENTS OF INCOME

| (Thousands of Dollars) | For the Years Ended December 31, 2012 | 2011 |
|---|---|---|
| Operating Revenues | $ 385,009 | $ 430,799 |
| Operating Expenses: | | |
| Cost of Natural Gas | 145,861 | 191,286 |
| Operations and Maintenance | 103,006 | 104,953 |
| Depreciation | 29,303 | 27,511 |
| Amortization of Regulatory Assets, Net | 1,531 | 181 |
| Energy Efficiency Programs | 12,569 | 6,396 |
| Taxes Other Than Income Taxes | 31,054 | 30,912 |
| Total Operating Expenses | 323,324 | 361,239 |
| Operating Income | 61,685 | 69,560 |
| Interest Expense: | | |
| Interest on Long-Term Debt | 19,926 | 19,891 |
| Other Interest Expense | 1,616 | 1,075 |
| Interest Expense | 21,542 | 20,966 |
| Other Income, Net | 109 | 1,283 |
| Income Before Income Tax Expense | 40,252 | 49,877 |
| Income Tax Expense | 13,988 | 18,205 |
| Net Income | $ 26,264 | $ 31,672 |

STATEMENTS OF COMPREHENSIVE INCOME

| | | |
|---|---|---|
| Net Income | $ 26,264 | $ 31,672 |
| Other Comprehensive Loss, Net of Tax: | | |
| Changes in Funded Status of SERP Benefit Plan | (189) | (318) |
| Other | 93 | 93 |
| Other Comprehensive Loss, Net of Tax | (96) | (225) |
| Comprehensive Income | $ 26,168 | $ 31,447 |

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

YANKEE GAS SERVICES COMPANY
STATEMENTS OF COMMON STOCKHOLDER'S EQUITY

| (Thousands of Dollars, Except Stock Information) | Common Stock Stock | Common Stock Amount | Capital Surplus, Paid In | Retained Earnings | Accumulated Other Comprehensive Loss | Total |
|---|---|---|---|---|---|---|
| Balance as of January 1, 2011 | 1,000 | $ 5 | $601,212 | $ 57,291 | $ (1,160) | $ 657,348 |
| Net Income | | | | 31,672 | | 31,672 |
| Dividends on Common Stock | | | | (38,160) | | (38,160) |
| Capital Contributions from Parent | | | 14,500 | | | 14,500 |
| Allocation of Benefits - ESOP | | | 249 | | | 249 |
| Other Comprehensive Loss | | | | | (225) | (225) |
| Balance as of December 31, 2011 | 1,000 | 5 | 615,961 | 50,803 | (1,385) | 665,384 |
| Net Income | | | | 26,264 | | 26,264 |
| Dividends on Common Stock | | | | (18,279) | | (18,279) |
| Allocation of Benefits - ESOP | | | 278 | | | 278 |
| Other Comprehensive Loss | | | | | (96) | (96) |
| Balance as of December 31, 2012 | 1,000 | $ 5 | $616,239 | $ 58,788 | $ (1,481) | $ 673,551 |

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

YANKEE GAS SERVICES COMPANY
STATEMENTS OF CASH FLOWS

| (Thousands of Dollars) | For the Years Ended December 31, 2012 | 2011 |
|---|---|---|
| Operating Activities: | | |
| Net Income | $ 26,264 | $ 31,672 |
| Adjustments to Reconcile Net Income to Net Cash Flows | | |
| Provided by Operating Activities: | | |
| Bad Debt Expense | 3,182 | 3,037 |
| Depreciation | 29,303 | 27,511 |
| Deferred Income Taxes | 14,478 | 9,922 |
| Pension, PBOP, and SERP Expense, Net of Pension and PBOP Contributions | 4,338 | 7,169 |
| Amortization of Regulatory Assets, Net | 1,531 | 181 |
| Regulatory Overrecoveries, Net | 11,259 | 3,790 |
| Other | (10,960) | (5,048) |
| Changes in Current Assets and Liabilities: | | |
| Receivables and Unbilled Revenues, Net | (12,257) | 8,934 |
| Fuel, Materials and Supplies | 7,731 | 75 |
| Taxes Receivable/Accrued, Net | 6,014 | 11,356 |
| Accounts Payable | 5,303 | (4,786) |
| Other Current Assets and Liabilities, Net | 2,430 | (448) |
| Net Cash Flows Provided by Operating Activities | 88,616 | 93,365 |
| Investing Activities: | | |
| Investments in Property, Plant and Equipment | (91,354) | (98,188) |
| Other Investing Activities | - | (1,076) |
| Net Cash Flows Used in Investing Activities | (91,354) | (99,264) |
| Financing Activities: | | |
| Cash Dividends on Common Stock | (18,279) | (38,160) |
| Retirement of Long-Term Debt | (4,286) | (4,286) |
| Capital Contributions from Parent | - | 14,500 |
| Increase in Notes Payable to Affiliated Companies | 58,100 | 3,600 |
| (Decrease)/Increase in Short-Term Debt | (30,000) | 30,000 |
| Other Financing Activities | (87) | (64) |
| Net Cash Flows Provided by Financing Activities | 5,448 | 5,590 |
| Net Increase/(Decrease) in Cash | 2,710 | (309) |
| Cash - Beginning of Year | - | 309 |
| Cash - End of Year | $ 2,710 | $ - |

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

**YANKEE ENERGY SYSTEM, INC. AND SUBSIDIARIES**
**YANKEE GAS SERVICES COMPANY**
**COMBINED NOTES TO FINANCIAL STATEMENTS**
**FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### A. About Yankee Energy System, Inc. and Yankee Gas Services Company
Yankee Energy System, Inc. (Yankee or the Company) is a holding company and is a wholly owned subsidiary of Northeast Utilities (NU). Yankee's principal operating subsidiary, Yankee Gas Services Company (Yankee Gas), owns and operates the largest natural gas distribution system in Connecticut and provides service to approximately 212,000 customers. Yankee Gas is a regulated public utility company and is subject to regulation of rates, accounting and other matters by the Connecticut Public Utility Regulatory Authority (PURA).

### B. Merger with NSTAR
On April 10, 2012, NU completed its merger with NSTAR (Merger). Pursuant to the terms and conditions of the Agreement and Plan of Merger, as amended, NSTAR was merged with and into a wholly owned subsidiary of NU, which was subsequently renamed NSTAR LLC.

### C. Presentation
The consolidated financial statements of Yankee include the accounts of all of Yankee's subsidiaries, including Yankee Gas, which does not have any subsidiaries. Intercompany transactions have been eliminated in consolidation. The consolidated financial statements of Yankee and the financial statements of Yankee Gas are herein referred to as the "financial statements."

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Certain changes in classification and corresponding reclassifications of prior year data were made in the accompanying balance sheets and statements of income for Yankee and Yankee Gas for comparative purposes to conform to the current year presentation. The statements of income reflect the reclassification of energy efficiency expenses primarily from Other Operating Expenses, as originally reported, to Energy Efficiency Programs. In addition, Other Operating Expenses and Maintenance, as originally reported, were combined and are reported in aggregate as Operations and Maintenance. The reclassifications on the statements of income were as follows:

| *(Millions of Dollars)* | Energy Efficiency Expense For the Year Ended December 31, 2011 |
|---|---|
| Yankee | $ 6.4 |
| Yankee Gas | 6.4 |

Yankee and Yankee Gas evaluate events and transactions that occur after the balance sheet date but before financial statements are issued and recognize in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed as of the balance sheet date and disclose, but do not recognize, in the financial statements subsequent events that provide evidence about the conditions that arose after the balance sheet date but before the financial statements are issued. In preparing the accompanying financial statements, Yankee and Yankee Gas have evaluated events subsequent to December 31, 2012 through the issuance of the financial statements on March 27, 2013. See Note 9, “Income Taxes” for further information.

### D. Recently Adopted Accounting Standards
In the first quarter of 2012, Yankee Gas adopted the Financial Accounting Standards Board’s (FASB) final Accounting Standards Update (ASU) on testing goodwill for impairment. The ASU provides the election to perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value; if so, quantitative testing is required. The ASU does not change existing guidance relating to when an entity should test goodwill for impairment or the methodology to be utilized in performing quantitative testing. Yankee Gas did not utilize the election provided by this ASU in its current year evaluation of goodwill.

In the first quarter of 2012, Yankee Gas adopted the FASB’s final ASU on the presentation of comprehensive income. The ASU does not change existing guidance on which items should be presented in other comprehensive income but requires other comprehensive income to be presented as part of a single continuous statement of comprehensive income or in a statement of other comprehensive income immediately following the statement of net income. The ASU did not affect the calculation of net income or comprehensive income. The ASU did not have an impact on Yankee Gas’ financial position, results of operations or cash flows.

**E. Cash**

Cash includes cash on hand and short-term cash investments that are highly liquid in nature and have original maturities of three months or less. At the end of each reporting period, any overdraft amounts are reclassified from Cash to Accounts Payable on the accompanying balance sheets.

**F. Provision for Uncollectible Accounts**

Yankee and Yankee Gas present their receivables at net realizable value by maintaining a provision for uncollectible accounts receivables. These provisions are determined based upon a variety of factors, including applying an estimated uncollectible account percentage to each receivable aging category, based upon historical collection and write-off experience and management's assessment of collectibility from individual customers. Management assesses the collectibility of receivables, and if circumstances change, collectibility estimates are adjusted accordingly. Receivable balances are written-off against the provision for uncollectible accounts when the accounts are terminated and these balances are deemed to be uncollectible.

The PURA allows Yankee Gas to accelerate the recovery of uncollectible receivable balances attributable to qualified customers under financial or medical duress (uncollectible hardship accounts receivable) outstanding for greater than 90 days. As of December 31, 2012 and 2011, Yankee Gas had uncollectible hardship accounts receivable reserves in the amount of $6.4 million and $6.8 million, respectively, with the corresponding bad debt expense recorded as Regulatory Assets as these amounts are probable of recovery in future rates. These amounts are reflected in the total provision for uncollectible accounts in the table below.

The provision for uncollectible accounts, which is included in Receivables, Net on the accompanying balance sheets, was as follows:

| | As of December 31, | |
|---|---|---|
| *(Millions of Dollars)* | **2012** | **2011** (1) |
| Yankee | $ 12.9 | $ 15.0 |
| Yankee Gas | 11.1 | 12.6 |

(1) Yankee and Yankee Gas balances as of December 31, 2011 have been reclassified to include the uncollectible hardship reserve in the total provision for uncollectible accounts.

*Loans Receivable, Net:* Yankee Energy Financial Services Company (Yankee Financial) had a loan conversion program under which commercial customers of Yankee Gas were provided the opportunity to finance their purchase of various energy efficient natural gas cooling and heating equipment through loans. As of December 31, 2012, the balance of loans receivable, net of a provision for uncollectible accounts of $1.9 million, was $0.1 million. As of December 31, 2011, the balance of loans receivable, net of a provision for uncollectible accounts of $2.3 million, was $0.2 million. These amounts are included in Receivables, Net on the accompanying balance sheets.

**G. Fuel, Materials and Supplies**

Yankee Gas' Fuel, Materials and Supplies include natural gas purchased for delivery to customers and materials purchased primarily for construction or operation and maintenance purposes. As of December 31, 2012 and 2011, $47.4 million and $55.7 million, respectively, of Fuel, Materials and Supplies related to natural gas inventory that is valued at the weighted average cost of natural gas. The remaining balance relates to materials and supplies that are valued at the lower of average cost or market.

**H. Revenues**

Yankee Gas' revenues are based on rates approved by the PURA. In general, rates can only be changed through formal proceedings with the PURA. Yankee Gas also utilizes PURA-approved tracking mechanisms to recover certain costs as incurred. The tracking mechanisms allow for rates to be changed periodically, with overcollections refunded to customers or undercollections collected from customers in future periods.

Because customers are billed throughout the month based on pre-determined cycles rather than on a calendar month basis, an estimate of natural gas delivered to customers for which the customers have not yet been billed is calculated as of the balance sheet date. Unbilled revenues are included in Operating Revenues on the statements of income and are assets on the balance sheets. Actual amounts billed to customers when meter readings become available may vary from the estimated amount.

Yankee Gas estimates unbilled sales monthly using the daily load cycle method. The daily load cycle method allocates billed sales to the current calendar month based on the daily load for each billing cycle. The billed sales are subtracted from total month load, net of delivery losses, to estimate unbilled sales. Unbilled revenues are estimated by first allocating unbilled sales to the respective customer classes, then applying an estimated rate by customer class to those sales.

**I. Allowance for Funds Used During Construction**

Allowance for funds used during construction (AFUDC) represents the cost of borrowed and equity funds used to finance construction and is included in the cost of Yankee Gas' plant. The portion of AFUDC attributable to borrowed funds is recorded as a reduction of Other Interest Expense and the AFUDC related to equity funds is recorded as Other Income, Net on the accompanying statements of income. AFUDC costs are recovered from customers over the service life of the related plant in the form of increased revenue collected as a result of higher depreciation expense.

| Yankee Gas<br>*(Millions of Dollars, except percentages)* | For the Years Ended December 31,<br>2012 | <br>2011 |
|---|---|---|
| AFUDC: | | |
| Borrowed Funds | $ 0.5 | $ 0.8 |
| Equity Funds | - | 1.3 |
| Total | $ 0.5 | $ 2.1 |
| Average AFUDC Rate | 2.8 % | 6.9 % |

Yankee Gas' average AFUDC rate is based on a Federal Energy Regulatory Commission prescribed formula that produces an average rate using the cost of a company's short-term financings as well as a company's capitalization (long-term debt and common equity). The average rate is applied to average eligible construction work in progress amounts to calculate AFUDC.

### J. Other Taxes

Certain excise taxes levied by Connecticut or local governments are collected by Yankee Gas from its customers. These excise taxes are shown on a gross basis with collections in revenues and payments in expenses. For the years ended December 31, 2012 and 2011, gross receipts taxes, franchise taxes and other excise taxes of $14.3 million and $16.2 million, respectively, were included in Operating Revenues and Taxes Other Than Income Taxes on the accompanying statements of income. Certain sales taxes are also collected by Yankee Gas from its customers as agent for Connecticut and local governments and are recorded on a net basis with no impact on the accompanying statements of income.

### K. Supplemental Cash Flow Information

| | For the Years Ended December 31, | | | |
|---|---|---|---|---|
| | Yankee | | Yankee Gas | |
| *(Millions of Dollars)* | 2012 | 2011 | 2012 | 2011 |
| Cash Paid/(Received) During the Year For: | | | | |
| Interest, Net of Amounts Capitalized | $ 21.2 | $ 21.0 | $ 21.2 | $ 21.0 |
| Income Taxes | (5.2) | (2.3) | (5.3) | (2.4) |
| Non-Cash Investing Activities: | | | | |
| Plant Additions Included in Accounts Payable (As of) | 11.5 | 10.3 | 11.5 | 10.3 |

Short-term borrowings have original maturities of three months or less. Accordingly, borrowings and repayments are shown net on the statements of cash flows.

### L. Related Parties

Northeast Utilities Service Company (NUSCO), a NU subsidiary, provides centralized accounting, administrative, engineering, financial, information technology, legal, operational, planning, purchasing, and other services to Yankee and Yankee Gas. In addition, Yankee and Yankee Gas incur costs associated with leases entered into by The Rocky River Realty Company (RRR), a related party.

Included in the balance sheets as of December 31, 2012 and 2011 are Accounts Receivable from Affiliated Companies of $0.4 million and $0.6 million, respectively, included in Prepayments and Other Current Assets at both Yankee and Yankee Gas, and Accounts Payable to Affiliated Companies of $6.2 million and $6.5 million, respectively, at both Yankee and Yankee Gas, relating to transactions between Yankee and Yankee Gas and other subsidiaries that are wholly owned by NU, primarily NUSCO. The transactions between Yankee and Yankee Gas have been eliminated in consolidation on the Yankee financial statements.

## 2. REGULATORY ACCOUNTING

Yankee Gas continues to be rate-regulated by the PURA on a cost-of-service basis; therefore, the accounting policies of Yankee Gas conform to GAAP applicable to rate-regulated enterprises and historically reflect the effects of the rate-making process.

Management believes it is probable that Yankee Gas will recover its investment in long-lived assets, including regulatory assets. If management determined that it could no longer apply the accounting guidance applicable to rate-regulated enterprises to Yankee Gas' operations, or that management could not conclude it is probable that costs would be recovered or reflected in future rates, the costs would be charged to net income in the period in which the determination is made.

*Regulatory Assets:* The components of regulatory assets are as follows:

| **Yankee Gas** | **As of December 31,** | |
|---|---|---|
| *(Millions of Dollars)* | **2012** | **2011** |
| Benefit Costs | $ 90.1 | $ 82.7 |
| Income Taxes, Net | 30.3 | 27.7 |
| Environmental Remediation Costs | 26.7 | 28.8 |
| Hardship Customer Receivables | 4.7 | 6.8 |
| Asset Retirement Obligations | 4.4 | 2.9 |
| Other Regulatory Assets | 4.9 | 12.3 |
| Total Regulatory Assets | $ 161.1 | $ 161.2 |
| Less: Current Portion | $ 11.5 | $ 22.2 |
| Total Long-Term Regulatory Assets | $ 149.6 | $ 139.0 |

*Regulatory Costs Not Yet Approved:* Additionally, Yankee Gas had $3.5 million and $3.4 million of regulatory costs as of December 31, 2012 and 2011, respectively, which were included in Other Long-Term Assets on the accompanying balance sheets. These amounts represent incurred costs that have not yet been approved for recovery by the PURA. Management believes these costs are probable of recovery in future cost-of-service regulated rates.

*Yankee Gas Rate Case:* On June 29, 2011, the PURA issued a final decision in the Yankee Gas rate proceeding that it amended on September 28, 2011. The final decision approved a regulatory ROE of 8.83 percent, based on a capital structure of 52.2 percent common equity and 47.8 percent debt, approved Yankee Gas' WWL Project, and also allowed for an increase for bare steel and cast iron pipe annual replacement funding, as requested by Yankee Gas.

*Benefit Costs:* Yankee Gas participates in NU's Pension Plan and postretirement benefits other than pension (PBOP) Plans, which are accounted for in accordance with accounting guidance on defined benefit pension and other postretirement plans. Under this accounting guidance, the funded status of pension and other postretirement plans is recorded with an offset to Accumulated Other Comprehensive Loss and is remeasured annually. However, because Yankee Gas recovers these costs from customers through rates, regulatory assets are recorded as an offset for the liability that is recognized for the funded status of the pension and PBOP plans. The deferred benefit costs are not in rate base. Pension and PBOP costs are amortized into expense over the average future employee service period. As part of Yankee Gas' rate case decision, effective July 19, 2011, changes in the Supplemental Executive Retirement Plan (SERP) funded status are recorded to Accumulated Other Comprehensive Loss.

*Income Taxes, Net:* The tax effect of temporary book-tax differences (differences between the periods in which transactions affect income in the financial statements and the periods in which they affect the determination of taxable income, including those differences relating to uncertain tax positions) is accounted for in accordance with the rate-making treatment of the PURA and accounting guidance for income taxes. Differences in income taxes between the accounting guidance and the rate-making treatment of the PURA are recorded as regulatory assets. As these assets are offset by deferred income tax liabilities, no carrying charge is collected. These assets are excluded from rate base. For further information regarding income taxes, see Note 9, "Income Taxes," to the financial statements.

*Environmental Remediation Costs:* Yankee Gas has recorded regulatory assets related to environmental remediation costs. The PURA approved an allowed level of remediation cost recoveries of approximately $2.7 million annually effective July 19, 2011. The PURA has stated that to the extent that environmental remediation expenses are prudently incurred, they should be allowed as proper operating expenses; therefore, management continues to believe that recording the regulatory asset is appropriate as such costs are probable of recovery. These costs earn a return. For further information, see Note 10A, "Commitments and Contingencies - Environmental Matters," to the financial statements.

*Hardship Customer Receivables:* Yankee Gas has recorded regulatory assets for the reserve of customer receivables that qualify as Hardship Forgiveness and Matching Payment Program (hardship accounts receivable), which represent uncollectible amounts attributable to qualified customers under financial or medical duress outstanding for greater than 90 days. These deferred costs are included in rate base. The PURA approved an allowed level of recoverable hardship costs of approximately $7.6 million annually effective July 19, 2011. For further information regarding hardship accounts receivable, see Note 1F, "Summary of Significant Accounting Policies - Provision for Uncollectible Accounts," to the financial statements.

*Asset Retirement Obligations:* The costs associated with the depreciation of Yankee Gas' ARO assets and accretion of the ARO liabilities are recorded as regulatory assets in accordance with regulatory accounting guidance. Yankee Gas' ARO assets, regulatory assets and liabilities offset and are excluded from rate base. These costs are being recovered over the life of the underlying property, plant and equipment.

*Other Regulatory Assets:* As of December 31, 2012 and 2011, other regulatory assets included $0.8 million and $1 million, respectively, of regulatory assets related to losses on reacquired debt, $3 million and $3.5 million, respectively, related to the 2010 Patient Protection and Affordable Care Act (2010 Healthcare Act), and $1.1 million and $1.3 million, respectively, of various items that are also probable of recovery.

*Regulatory Liabilities:* The components of regulatory liabilities are as follows:

| **Yankee Gas** *(Millions of Dollars)* | **As of December 31, 2012** | **2011** |
|---|---|---|
| Cost of Removal | $ 46.5 | $ 48.0 |
| Pension Liability | 7.5 | 10.0 |
| Overrecovered Natural Gas Costs | 6.7 | 4.3 |
| Other Regulatory Liabilities | 1.4 | 2.5 |
| Total Regulatory Liabilities | $ 62.1 | $ 64.8 |
| Less: Current Portion | $ 10.1 | $ 9.0 |
| Total Long-Term Regulatory Liabilities | $ 52.0 | $ 55.8 |

*Cost of Removal:* Through its rate settlement with the PURA, effective July 2007, Yankee Gas has restored recovery of a net negative salvage rate in its depreciation provision to cover future costs of removal of plant assets over the lives of the assets. These amounts are classified as Regulatory Liabilities on the accompanying balance sheets.

*Pension Liability:* When Yankee Gas was acquired by NU in 2000, the pension liability was adjusted to fair value with an offset to the adjustment recorded as a regulatory liability, as approved by the PURA. This amount will offset the deferred benefit costs regulatory asset that will be recovered. The pension liability was approved for amortization over an approximate 13-year period beginning in 2002.

*Overrecovered Natural Gas Costs:* The Purchased Gas Adjustment (PGA) clause is a PURA-approved tracking mechanism that allows Yankee Gas to recover the costs of the procurement of natural gas for its firm and seasonal customers. Differences between actual natural gas costs and collection amounts are deferred and then recovered or returned to customers in future periods. Carrying charges on outstanding balances are calculated using Yankee Gas' weighted average cost of capital in accordance with the directives of the PURA.

## 3. PROPERTY, PLANT AND EQUIPMENT AND ACCUMULATED DEPRECIATION

Utility property, plant and equipment is recorded at original cost. Original cost includes materials, labor, construction overhead and AFUDC for regulated property. The cost of repairs and maintenance, including planned major maintenance activities, is charged to Operating Expenses as incurred.

The following table summarizes Yankee Gas' investments in utility property, plant and equipment:

| **Yankee Gas** *(Millions of Dollars)* | **As of December 31, 2012** | **2011** |
|---|---|---|
| Total Property, Plant and Equipment, Gross | $ 1,335.6 | $ 1,247.6 |
| Less: Accumulated Depreciation | (341.0) | (322.5) |
| Property, Plant and Equipment, Net | 994.6 | 925.1 |
| Construction Work in Progress | 19.9 | 18.2 |
| Total Property, Plant and Equipment, Net | $ 1,014.5 | $ 943.3 |

Depreciation of utility assets is calculated on a straight-line basis using composite rates based on the estimated remaining useful lives of the various classes of property. The composite rates are subject to approval by the PURA. The composite rates include a cost of removal component, which is collected from customers during the life of the property and is recognized as a regulatory liability. Depreciation rates are applied to property from the time it is placed in service. Upon retirement from service, the cost of the utility asset is charged to the accumulated provision for depreciation. The actual incurred removal costs are applied against the related regulatory liability. The depreciation rates for the various classes of utility property, plant and equipment aggregate to a composite rate of 2.3 percent in 2012 and 2.4 percent in 2011. As of December 31, 2012, the average depreciable life of Yankee Gas' property, plant and equipment was 46.2 years.

## 4. ASSET RETIREMENT OBLIGATIONS

In accordance with accounting guidance for conditional AROs, Yankee Gas recognizes a liability for the fair value of an ARO on the obligation date if the liability's fair value can be reasonably estimated and is conditional on a future event. Settlement dates and future costs are reasonably estimated when sufficient information becomes available. Management has identified AROs related to the cutting and capping of natural gas mains and has identified certain assets containing asbestos. A fair value calculation, reflecting expected probabilities for settlement scenarios, has been performed.

The fair value of the ARO is recorded as a liability in Other Long-Term Liabilities with an offset included in Property, Plant and Equipment, Net on the accompanying balance sheets. As Yankee Gas is rate-regulated on a cost-of-service basis, it applies regulatory accounting guidance and the cost associated with Yankee Gas' AROs are included in Regulatory Assets as of December 31, 2012 and 2011. The ARO assets are depreciated, and the ARO liabilities are accreted over the estimated life of the obligation with corresponding credits recorded as accumulated depreciation and ARO liabilities, respectively. Both the depreciation and accretion were recorded as increases to Regulatory Assets on the accompanying balance sheets as of December 31, 2012 and 2011. For further information, see Note 2, "Regulatory Accounting," to the financial statements.

A reconciliation of the beginning and ending carrying amounts of the Yankee Gas ARO liabilities are as follows:

| **Yankee Gas** | **For the Years Ended December 31,** | |
|---|---|---|
| *(Millions of Dollars)* | **2012** | **2011** |
| Balance as of Beginning of Year | $ (3.0) | $ (2.8) |
| Liabilities Incurred During the Year | (1.2) | - |
| Accretion | (0.2) | (0.2) |
| Revisions in Estimated Cash Flows | (0.2) | - |
| Balance as of End of Year | $ (4.6) | $ (3.0) |

## 5. GOODWILL

Goodwill and intangible assets deemed to have indefinite useful lives are reviewed for impairment at least annually by applying a fair value-based test. Yankee Gas uses October 1st as the annual goodwill impairment testing date. However, if an event occurs or circumstances change that would indicate that goodwill might be impaired, the goodwill would be tested between the annual testing dates. Goodwill impairment is deemed to exist if the net book value of a reporting unit exceeds its estimated fair value and if the implied fair value of goodwill based on the estimated fair value of the reporting unit is less than the carrying amount.

As of December 31, 2012 and 2011, Yankee Gas maintained $287.6 million of goodwill that is not being recovered from its customers. Yankee Gas completed its impairment analysis of the goodwill balance as of October 1, 2012 and determined that no impairment exists. In completing this analysis, the fair value of Yankee Gas was estimated using a discounted cash flow methodology and analyses of comparable companies and transactions.

## 6. SHORT-TERM DEBT

Yankee Gas is not required to obtain approval from any state or federal authority to incur short-term debt.

*Credit Agreement and Commercial Paper Program:* On July 25, 2012, NU and certain of its subsidiaries, including Yankee Gas, jointly entered into a five-year $1.15 billion revolving credit facility. The new facility replaced the CL&P, PSNH, WMECO, and Yankee Gas joint three-year $400 million revolving credit facility, as well as other NU subsidiaries' revolving credit facilities. The new facility expires on July 25, 2017. Management expects the new facility to be used primarily to backstop the $1.15 billion commercial paper program at NU, which commenced July 25, 2012. The commercial paper program allows NU parent to issue commercial paper as a form of short-term debt. Under the terms of the agreement, NU parent may provide intercompany loans to its subsidiaries, including Yankee and Yankee Gas.

As of December 31, 2012, NU had short-term borrowings outstanding under its commercial paper program in an amount of $72.2 million that were intercompany loans from NU to Yankee, of which $70.6 million relates to Yankee Gas, and were included in Notes Payable to Affiliated Companies and classified in current liabilities on the accompanying balance sheets. The weighted-average interest rate on these borrowings as of December 31, 2012 was 0.46 percent, which is generally based on money market rates.

As of December 31, 2011, Yankee Gas had $30 million in short-term borrowings outstanding under the joint $400 million revolving credit facility with a weighted average interest rate of 2.07 percent.

Yankee Gas must comply with certain financial and non-financial covenants, including a consolidated debt to total capitalization ratio. Yankee Gas was in compliance with these covenants as of December 31, 2012 and 2011. If Yankee Gas was not in compliance with these covenants, an event of default would occur requiring all outstanding borrowings by such borrower to be repaid and additional borrowings by such borrower would not be permitted under the respective credit facility.

*Working Capital:* Yankee Gas and Yankee use their available capital resources to fund their respective construction expenditures, meet debt requirements, pay costs and dividends and fund other corporate obligations, such as pension contributions. Yankee Gas and Yankee operate in an environment where recovery of its natural gas distribution construction expenditures takes place over an extended period of time. This impacts the timing of the revenue stream designed to fully recover the total investment plus a return on the equity portion of the cost and related financing costs. These factors have resulted in both Yankee Gas' and Yankee current liabilities exceeding current assets by approximately $33 million as of December 31, 2012.

Yankee Gas and Yankee will reduce their short-term borrowings with cash received from operating cash flows or with the issuance of new long-term debt, as deemed appropriate given capital requirements and maintenance of their credit rating and profile. Management expects the future operating cash flows of Yankee Gas and Yankee along with the access to financial markets, will be sufficient to meet any future operating requirements and capital investment forecasted opportunities.

*Money Pool:* As of December 31, 2011, Yankee Gas and Yankee were members of the Money Pool. Short-term borrowing needs of the member companies were met with available funds of other member companies, including funds borrowed by NU parent. Investing and borrowing subsidiaries received or paid interest based on the average daily federal funds rate. The borrowings from the Money Pool are recorded in Notes Payable to Affiliated Companies on the accompanying balance sheets. As of December 31, 2011, Money Pool amounts were as follows:

| | As of and for the Year Ended December 31, 2011 | |
|---|---|---|
| *(Millions of Dollars, except percentages)* | **Yankee** (1) | **Yankee Gas** |
| Borrowings From | $ 11.2 | $ 12.5 |
| Weighted-Average Interest Rates | 0.09 % | 0.09 % |

(1) Yankee's borrowings from the Money Pool are reported on a consolidated basis and include the activity of Yankee Gas. As indicated above, Yankee cannot borrow from the Money Pool as a separate entity.

## 7. LONG-TERM DEBT

Details of Yankee Gas' long-term debt outstanding are as follows:

| | As of December 31, | |
|---|---|---|
| *(Millions of Dollars)* | **2012** | **2011** |
| 7.19% Series E due 2012 | $ - | $ 4.3 |
| 8.48% Series B due 2022 | 20.0 | 20.0 |
| 4.80% Series G due 2014 | 75.0 | 75.0 |
| 5.26% Series H due 2019 | 50.0 | 50.0 |
| 5.35% Series I due 2035 | 50.0 | 50.0 |
| 6.90% Series J due 2018 | 100.0 | 100.0 |
| 4.87% Series K due 2020 | 50.0 | 50.0 |
| Total First Mortgage Bonds | 345.0 | 349.3 |
| Less Amounts due Within One Year | - | (4.3) |
| Unamortized Premium | 0.8 | 0.9 |
| Yankee Gas Long-Term Debt | $ 345.8 | $ 345.9 |

Long-term debt maturities on debt outstanding as of December 31, 2012 for the years 2013 through 2017 are $75 million in 2014 for the 4.80 percent Series G bonds, with the remainder due thereafter.

The unamortized premium represents an adjustment to record Yankee Gas' long-term debt at its fair value as of the date of the merger with NU in 2000.

The utility plant of Yankee Gas is subject to the lien of Yankee Gas's first mortgage bond indenture.

Yankee Gas' long-term debt agreements provide that NU and certain of its subsidiaries must comply with certain covenants as are customarily included in such agreements, including a debt to total capitalization ratio. Yankee Gas was in compliance with these covenants as of December 31, 2012 and 2011.

Yankee Gas has certain long-term debt agreements that contain cross-default provisions applicable to all of Yankee Gas' outstanding first mortgage bond series. The cross-default provisions on Yankee Gas' Series B Bonds would be triggered if Yankee Gas were to default on a payment due on indebtedness in excess of $2 million. The cross-default provisions on all other series of Yankee Gas' first mortgage bonds would be triggered if Yankee Gas were to default in a payment due on indebtedness in excess of $10 million. No other debt issuances contain cross-default provisions as of December 31, 2012.

## 8. PENSION BENEFITS AND POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

NUSCO sponsors a defined benefit retirement plan that covers most employees, including Yankee Gas employees, hired before 2006 (or as negotiated, for bargaining unit employees), referred to as the NUSCO Pension Plan. The plan is subject to the provisions of ERISA, as amended by the PPA of 2006. NUSCO also maintains a SERP, which provides benefits in excess of Internal Revenue Code limitations to eligible current and retired participants that would have otherwise been provided under the Pension Plan.

NUSCO sponsors defined benefit postretirement plans that provide certain retiree health care benefits, primarily medical and dental, and life insurance benefits to retiring employees that meet certain age and service eligibility requirements. Under certain circumstances, eligible retirees are required to contribute to the costs of postretirement benefits. The benefits provided under the NUSCO PBOP Plans are not vested and the Company has the right to modify any benefit provision subject to applicable laws at that time.

The funded status of the Pension, SERP and PBOP Plans is calculated based on the difference between the benefit obligation and the fair value of plan assets. The funded status of the Pension, SERP and PBOP Plans is recorded on the balance sheets as a liability with an offset to Accumulated Other Comprehensive Loss. Pension and PBOP costs for Yankee Gas are recorded as Regulatory Assets as these amounts are recovered from customers. SERP costs for Yankee Gas are recorded on an after-tax basis to Accumulated Other Comprehensive Loss. For further information, see Note 2, "Regulatory Accounting," and Note 13, "Accumulated Other Comprehensive Loss," to the financial statements. The SERP Plan does not have plan assets.

For the NUSCO Pension and PBOP Plans, the expected return on plan assets is calculated by applying the assumed rate of return to a four-year rolling average of plan asset fair values, which reduces year-to-year volatility. Investment gains or losses for this purpose are the difference between the calculated expected return and the actual return. As investment gains and losses are reflected in the average plan asset fair values, they are subject to amortization with other unrecognized actuarial gains or losses. Unrecognized actuarial gains or losses are amortized as a component of Pension and PBOP expense over the estimated average future employee service period.

The NUSCO Plans are accounted for under the multiple-employer basis. Accordingly, the funded status of the NUSCO Plans is allocated to NU's subsidiaries, including Yankee Gas.

*Pension and SERP Plans:* The following tables represent the plan benefit obligations, fair values of plan assets, and funded status of the NUSCO Pension and SERP Plan and the portions attributable to Yankee Gas:

| | Pension and SERP | | | |
|---|---|---|---|---|
| | As of December 31, 2012 | | As of December 31, 2011 | |
| *(Millions of Dollars)* | NUSCO Plans | Yankee Gas | NUSCO Plans | Yankee Gas |
| **Change in Benefit Obligation** | | | | |
| Benefit Obligation as of Beginning of Year | $ (3,098.9) | $ (158.4) | $ (2,820.9) | $ (141.9) |
| Service Cost | (60.7) | (3.9) | (55.4) | (3.5) |
| Interest Cost | (152.3) | (7.8) | (153.3) | (7.8) |
| Actuarial Loss | (364.2) | (19.6) | (206.1) | (11.5) |
| Benefits Paid - Excluding Lump Sum Payments | 138.8 | 6.9 | 134.4 | 6.2 |
| Benefits Paid - SERP | 3.0 | 0.1 | 2.4 | 0.1 |
| SERP Curtailment | (1.8) | - | - | - |
| **Benefit Obligation as of End of Year** | $ (3,536.1) | $ (182.7) | $ (3,098.9) | $ (158.4) |
| **Change in Pension Plan Assets** | | | | |
| Fair Value of Plan Assets as of Beginning of Year | $ 2,005.9 | $ 80.5 | $ 1,977.6 | $ 85.8 |
| Employer Contributions | 197.4 | 4.7 | 143.6 | - |
| Actual Return on Plan Assets | 277.8 | 10.5 | 19.1 | 0.9 |
| Benefits Paid - Excluding Lump Sum Payments | (138.8) | (6.9) | (134.4) | (6.2) |
| **Fair Value of Plan Assets as of End of Year** | $ 2,342.3 | $ 88.8 | $ 2,005.9 | $ 80.5 |
| Funded Status as of December 31st | $ (1,193.8) | $ (93.9) | $ (1,093.0) | $ (77.9) |

Pension and SERP benefits funded status includes the current portion of the SERP liability, which is included in Other Current Liabilities on the accompanying balance sheets.

The accumulated benefit obligation for the Pension Plans as of December 31, 2012 and 2011 is as follows:

| | Pension and SERP | |
|---|---|---|
| | As of December 31, | |
| *(Millions of Dollars)* | 2012 | 2011 |
| NUSCO Plans | $ 3,218.5 | $ 2,810.6 |
| Yankee Gas | 162.1 | 140.6 |

The following actuarial assumptions were used in calculating the Pension and SERP Plans' year end funded status:

| | Pension and SERP As of December 31, 2012 | 2011 |
|---|---|---|
| **NUSCO Pension and SERP Plans** | | |
| Discount Rate | 4.24 % | 5.03 % |
| Compensation/Progression Rate | 3.50 % | 3.50 % |

*Pension and SERP Expense:* For the NUSCO Plans, NU allocates net periodic pension expense to its subsidiaries based on the actual participant demographic data for each subsidiary's participants. Benefit payments to participants and contributions are also tracked for each subsidiary. The actual investment return in the trust each year is allocated to each of the subsidiaries annually in proportion to the investment return expected to be earned during the year. The components of net periodic benefit expense, the portion of pension amounts capitalized related to employees working on capital projects, and intercompany allocations not included in the net periodic benefit expense amounts for the Pension and SERP Plans were as follows:

| | Pension and SERP | | | |
|---|---|---|---|---|
| | NUSCO Plans | | Yankee Gas | |
| | For the Years Ended December 31, | | | |
| *(Millions of Dollars)* | 2012 | 2011 | 2012 | 2011 |
| Service Cost | $ 60.7 | $ 55.4 | $ 3.9 | $ 3.5 |
| Interest Cost | 152.3 | 153.3 | 7.8 | 7.8 |
| Expected Return on Plan Assets | (171.7) | (170.8) | (6.7) | (7.1) |
| Actuarial Loss | 125.0 | 84.2 | 7.5 | 5.8 |
| Prior Service Cost | 8.3 | 9.7 | 0.2 | 0.2 |
| Total Net Periodic Benefit Expense | $ 174.6 | $ 131.8 | $ 12.7 | $ 10.2 |
| Curtailments | $ 1.9 | $ - | $ - | $ - |
| Related Intercompany Allocations | N/A | N/A | $ 4.4 | $ 3.5 |
| Capitalized Pension Expense | $ 43.3 | $ 29.7 | $ 3.4 | $ 2.7 |

The following actuarial assumptions were used to calculate Pension and SERP expense amounts:

| | Pension and SERP For the Years Ended December 31, 2012 | 2011 |
|---|---|---|
| **NUSCO Pension and SERP Plans** | | |
| Discount Rate | 5.03 % | 5.57 % |
| Expected Long-Term Rate of Return | 8.25 % | 8.25 % |
| Compensation/Progression Rate | 3.50 % | 3.50 % |

The following is a summary of the changes in plan assets and benefit obligations recognized in Regulatory Assets and other comprehensive income (OCI) as well as amounts in Regulatory Assets and OCI reclassified as net periodic benefit expense during the years presented:

| | Amounts Reclassified To/From | | | |
|---|---|---|---|---|
| | Regulatory Assets | | OCI | |
| *(Millions of Dollars)* | For the Years Ended December 31, | | | |
| **NUSCO Pension and SERP Plans** | 2012 | 2011 | 2012 | 2011 |
| Actuarial Losses Arising During the Year | $ 241.1 | $ 334.8 | $ 17.0 | $ 23.0 |
| Actuarial Losses Reclassified as Net Periodic Benefit Expense | (117.5) | (79.4) | (7.4) | (4.8) |
| Prior Service Cost Reclassified as Net Periodic Benefit Expense | (8.1) | (9.4) | (0.3) | (0.3) |

The following is a summary of the remaining Regulatory Assets and Accumulated Other Comprehensive Loss amounts that have not been recognized as components of net periodic benefit expense as of December 31, 2012 and 2011, and the amounts that are expected to be recognized as components in 2013:

| | Regulatory Assets as of December 31, | | Expected 2013 | AOCI as of December 31, | | Expected 2013 |
|---|---|---|---|---|---|---|
| *(Millions of Dollars)*<br>**NUSCO Pension and SERP Plans** | 2012 | 2011 | Expense | 2012 | 2011 | Expense |
| Actuarial Loss | $ 1,249.7 | $ 1,126.1 | $ 144.3 | $ 80.2 | $ 70.2 | $ 9.3 |
| Prior Service Cost | 21.2 | 29.3 | 4.1 | 1.2 | 1.4 | 0.2 |

*PBOP Plans:* Yankee Gas annually funds postretirement costs through tax deductible contributions to external trusts.

The following tables represent information on the benefit obligations, fair values of plan assets, and funded status of the NUSCO PBOP Plans and the portions attributable to Yankee Gas:

| | PBOP | | | |
|---|---|---|---|---|
| | As of December 31, 2012 | | As of December 31, 2011 | |
| *(Millions of Dollars)* | NUSCO Plans | Yankee Gas | NUSCO Plans | Yankee Gas |
| **Change in Benefit Obligation** | | | | |
| Benefit Obligation as of Beginning of Year | $ (520.9) | $ (24.3) | $ (489.9) | $ (22.2) |
| Service Cost | (9.3) | (0.6) | (9.2) | (0.6) |
| Interest Cost | (24.0) | (1.1) | (25.7) | (1.2) |
| Actuarial Loss | (2.4) | (1.0) | (30.1) | (1.8) |
| Federal Subsidy on Benefits Paid | (3.9) | (0.2) | (4.1) | (0.3) |
| Benefits Paid | 37.7 | 1.7 | 38.1 | 1.8 |
| **Benefit Obligation as of End of Year** | $ (522.8) | $ (25.5) | $ (520.9) | $ (24.3) |
| **Change in Plan Assets** | | | | |
| Fair Value of Plan Assets as of Beginning of Year | $ 285.4 | 12.5 | $ 278.5 | $ 13.2 |
| Actual Return on Plan Assets | 37.3 | 1.8 | (2.5) | (0.3) |
| Employer Contributions | 50.0 | 1.7 | 47.5 | 1.4 |
| Benefits Paid | (37.7) | (1.7) | (38.1) | (1.8) |
| **Fair Value of Plan Assets as of End of Year** | $ 335.0 | $ 14.3 | $ 285.4 | $ 12.5 |
| Funded Status as of December 31st | $ (187.8) | $ (11.2) | $ (235.5) | $ (11.8) |

The following actuarial assumptions were used in calculating the PBOP Plans' year end funded status:

| | PBOP | |
|---|---|---|
| | As of December 31, | |
| | 2012 | 2011 |
| **NUSCO PBOP Plans** | | |
| Discount Rate | 4.04 % | 4.84 % |
| Health Care Cost Trend Rate | 7.00 % | 7.00 % |

*PBOP Expense:* For the NUSCO Plans, NU allocates net periodic postretirement benefits expense to its subsidiaries based on the actual participant demographic data for each subsidiary's participants. Benefit payments to participants and contributions are also tracked for each subsidiary. The actual investment return in the trust is allocated to each of the subsidiaries annually in proportion to the investment return expected to be earned during the year.

The components of net periodic postretirement benefit expense and intercompany allocations not included in the net periodic benefit expense amounts for the PBOP Plans were as follows:

| | PBOP | | | |
|---|---|---|---|---|
| | For the Years Ended December 31, | | | |
| | 2012 | | 2011 | |
| *(Millions of Dollars)* | NUSCO Plans | Yankee Gas | NUSCO Plans | Yankee Gas |
| Service Cost | $ 9.3 | $ 0.6 | $ 9.2 | $ 0.6 |
| Interest Cost | 24.0 | 1.1 | 25.7 | 1.2 |
| Expected Return Plan Assets | (22.6) | (1.2) | (21.6) | (1.2) |
| Actuarial Loss | 20.5 | 1.0 | 19.0 | 0.7 |
| Prior Service Credit | (0.3) | (0.1) | (0.3) | (0.1) |
| Transition Obligation (1) | 11.6 | - | 11.6 | - |
| Total Net Periodic Benefit Expense | $ 42.5 | $ 1.4 | $ 43.6 | $ 1.2 |
| Related Intercompany Allocations | N/A | $ 0.9 | N/A | $ 0.9 |

(1) The transition obligation will be fully amortized in 2013.

The following actuarial assumptions were used to calculate PBOP expense amounts:

| | PBOP | |
|---|---|---|
| | For the Years Ended December 31, | |
| **NUSCO PBOP Plans** | **2012** | **2011** |
| Discount Rate | 4.84 % | 5.28 % |
| Expected Long-Term Rate of Return | 8.25 % | 8.25 % |

The following is a summary of the changes in plan assets and benefit obligations recognized in Regulatory Assets and OCI as well as amounts in Regulatory Assets and OCI reclassified as net periodic benefit (expense)/income during the years presented:

| | Amounts Reclassified To/From | | | |
|---|---|---|---|---|
| | Regulatory Assets | | OCI | |
| *(Millions of Dollars)* | For the Years Ended December 31, | | | |
| **NUSCO PBOP Plans** | **2012** | **2011** | **2012** | **2011** |
| Actuarial (Gains)/Losses Arising During the Year | $ (10.9) | $ 50.2 | $ (1.1) | $ 4.0 |
| Actuarial Losses Reclassified as Net Periodic Benefit Expense | (19.5) | (18.1) | (1.1) | (0.9) |
| Prior Service Credit Reclassified as Net Periodic Benefit Income | 0.3 | 0.3 | - | - |
| Transition Obligation Reclassified as Net Periodic Benefit Expense | (11.3) | (11.3) | (0.2) | (0.2) |

The following is a summary of the remaining Regulatory Assets and Accumulated Other Comprehensive Loss amounts that have not been recognized as components of net periodic benefit expense as of December 31, 2012 and 2011, and the amounts that are expected to be recognized as components in 2013:

| *(Millions of Dollars)* | Regulatory Assets as of December 31, | | Expected 2013 | AOCI as of December 31, | | Expected 2013 |
|---|---|---|---|---|---|---|
| **NUSCO PBOP Plans** | **2012** | **2011** | **Expense** | **2012** | **2011** | **Expense** |
| Actuarial Loss | $ 166.0 | $ 196.3 | $ 18.9 | $ 9.9 | $ 12.1 | $ 1.0 |
| Prior Service Credit | (2.1) | (2.4) | (0.3) | - | - | - |
| Transition Obligation | - | 11.4 | - | - | 0.2 | - |

For the NUSCO PBOP Plans, the health care cost trend assumption is 7 percent, subsequently decreasing 50 basis points per year to an ultimate rate of 5 percent in 2017.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. The effect of changing the assumed health care cost trend rate by one percentage point for the year ended December 31, 2012 would have the following effects:

| *(Millions of Dollars)*<br>**NUSCO PBOP Plans** | One Percentage Point Increase | One Percentage Point Decrease |
|---|---|---|
| Effect on Postretirement Benefit Obligation | $ 15.9 | $ (13.1) |
| Effect on Total Service and Interest Cost Components | 1.2 | (1.0) |

*Estimated Future Benefit Payments:* The following benefit payments, which reflect expected future service, are expected to be paid by the Pension, SERP and PBOP Plans:

| *(Millions of Dollars)* | Pension and SERP | PBOP |
|---|---|---|
| 2013 | $ 152.8 | $ 33.9 |
| 2014 | 160.3 | 34.4 |
| 2015 | 167.6 | 34.7 |
| 2016 | 175.3 | 34.9 |
| 2017 | 183.2 | 35.0 |
| 2018-2022 | 1,021.4 | 173.5 |

*Contributions:* NU's policy is to annually fund the NUSCO Pension Plan in an amount at least equal to an amount that will satisfy federal requirements. NU contributed $197.4 million to the NUSCO Pension Plan in 2012, $4.7 million of which was contributed by Yankee Gas. Based on the current status of the NUSCO Pension Plan, NU anticipates making a contribution of approximately $203 million in 2013, of which $107 million is required to meet minimum federal funding requirements.

For the PBOP Plans, it is NU's policy to annually fund the NUSCO PBOP Plans in an amount equal to the PBOP Plans' postretirement benefit cost, excluding curtailment and termination benefits. NU contributed $50 million to the NUSCO PBOP Plans in 2012, $1.7 million of which was contributed by Yankee Gas. NU expects to make $25.7 million in contributions in 2013.

*Fair Value of Pension and PBOP Plan Assets:* Pension and PBOP funds are held in external trusts. Trust assets, including accumulated earnings, must be used exclusively for Pension and PBOP payments. NU's investment strategy for its Pension and PBOP

Plans is to maximize the long-term rates of return on these plans' assets within an acceptable level of risk. The investment strategy for each asset category includes a diversification of asset types, fund strategies and fund managers and establishes target asset allocations that are routinely reviewed and periodically rebalanced. In 2012 and 2011, PBOP assets were comprised of specific assets within the defined benefit pension plan trust (401(h) assets) as well as assets held in the PBOP Plans. The investment policy and strategy of the 401(h) assets is consistent with those of the defined benefit pension plans, which are detailed below. NU's expected long-term rates of return on Pension and PBOP Plan assets are based on these target asset allocation assumptions and related expected long-term rates of return. In developing its expected long-term rate of return assumptions for the Pension and PBOP Plans, NU evaluated input from actuaries and consultants, as well as long-term inflation assumptions and historical returns. For the year ended December 31, 2012, management has assumed long-term rates of return of 8.25 percent on NUSCO Pension and PBOP Plan assets. These long-term rates of return are based on the assumed rates of return for the target asset allocation as follows:

| | As of December 31, 2012 and 2011 NUSCO Pension and PBOP Plans | |
|---|---|---|
| | Target Asset Allocation | Assumed Rate of Return |
| Equity Securities: | | |
| United States | 24% | 9% |
| International | 13% | 9% |
| Emerging Markets | 3% | 10% |
| Private Equity | 12% | 13% |
| Debt Securities: | | |
| Fixed Income | 20% | 5% |
| High Yield Fixed Income | 3.5% | 7.5% |
| Emerging Markets Debt | 3.5% | 7.5% |
| Real Estate and Other Assets | 8% | 7.5% |
| Hedge Funds | 13% | 7% |

The following table presents, by asset category, the Pension and PBOP Plan assets held in the NUSCO Plans recorded at fair value on a recurring basis by the level in which they are classified within the fair value hierarchy:

| | NUSCO Pension Plan Fair Value Measurements as of December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| *(Millions of Dollars)* | 2012 | | | | 2011 | | | |
| **Asset Category:** | **Level 1** | **Level 2** | **Level 3** | **Total** | **Level 1** | **Level 2** | **Level 3** | **Total** |
| Equity Securities: | | | | | | | | |
| United States [1] | $ 239.9 | $ 56.4 | $ 270.6 | $ 566.9 | $ 218.7 | $ 14.8 | $ 259.4 | $ 492.9 |
| International [1] | 42.0 | 264.3 | - | 306.3 | 20.0 | 221.9 | - | 241.9 |
| Emerging Markets [1] | - | 79.4 | - | 79.4 | - | 66.6 | - | 66.6 |
| Private Equity | 26.7 | - | 267.9 | 294.6 | 11.3 | - | 255.1 | 266.4 |
| Fixed Income [2] | - | 336.7 | 315.1 | 651.8 | 17.8 | 268.7 | 276.2 | 562.7 |
| Real Estate and Other Assets | - | 78.9 | 108.2 | 187.1 | 24.8 | 57.8 | 71.8 | 154.4 |
| Hedge Funds | - | - | 296.2 | 296.2 | - | - | 240.0 | 240.0 |
| Total Master Trust Assets | $ 308.6 | $ 815.7 | $ 1,258.0 | $ 2,382.3 | $ 292.6 | $ 629.8 | $ 1,102.5 | $ 2,024.9 |
| Less: 401(h) PBOP Assets [3] | | | | (40.0) | | | | (19.0) |
| Total Pension Assets | | | | $ 2,342.3 | | | | $ 2,005.9 |

| | NUSCO PBOP Plans Fair Value Measurements as of December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| *(Millions of Dollars)* | 2012 | | | | 2011 | | | |
| **Asset Category:** | **Level 1** | **Level 2** | **Level 3** | **Total** | **Level 1** | **Level 2** | **Level 3** | **Total** |
| Cash and Cash Equivalents | $ 6.3 | $ - | $ - | $ 6.3 | $ 5.9 | $ - | $ - | $ 5.9 |
| Equity Securities: | | | | | | | | |
| United States [1] | 116.3 | - | 12.4 | 128.7 | 116.9 | - | 10.7 | 127.6 |
| International [1] | 35.2 | - | - | 35.2 | 29.6 | - | - | 29.6 |
| Emerging Markets [1] | 7.7 | - | - | 7.7 | 4.6 | - | - | 4.6 |
| Fixed Income [2] | - | 46.8 | 32.1 | 78.9 | - | 44.3 | 26.0 | 70.3 |
| Hedge Funds | - | - | 16.9 | 16.9 | - | - | 16.1 | 16.1 |
| Private Equity | - | - | 11.3 | 11.3 | - | - | 5.1 | 5.1 |
| Real Estate and Other Assets | - | 4.7 | 5.3 | 10.0 | - | 4.7 | 2.5 | 7.2 |
| Total | $ 165.5 | $ 51.5 | $ 78.0 | $ 295.0 | $ 157.0 | $ 49.0 | $ 60.4 | $ 266.4 |
| Add: 401(h) PBOP Assets [3] | | | | 40.0 | | | | 19.0 |
| Total PBOP Assets | | | | $ 335.0 | | | | $ 285.4 |

(1) United States, International and Emerging Markets equity securities classified as Level 2 include investments in commingled funds and unrealized gains/(losses) on holdings in equity index swaps. Level 3 investments include hedge funds that are overlayed with equity index swaps and futures contracts and funds invested in equities that have redemption restrictions.
(2) Fixed Income investments classified as Level 3 investments include fixed income funds that invest in a variety of opportunistic fixed income strategies, and hedge funds that are overlayed with fixed income futures.
(3) The assets of the Pension Plans include a 401(h) account that has been allocated to provide health and welfare postretirement benefits under the PBOP Plans.

Yankee Gas participates in the NUSCO Pension Plan and NUSCO PBOP Plans and is allocated a portion of the total plan assets. As of December 31, 2012 and 2011, the NUSCO Pension Plan has total assets of $2,342.3 million and $2,005.9 million, respectively. Yankee Gas' portion of these total plan assets was 4 percent as of both December 31, 2012 and 2011. The NUSCO PBOP Plans had total plan assets of $335 million and $285.4 million as of December 31, 2012 and 2011, respectively. Yankee Gas' share of these assets was approximately 4 percent as of both December 31, 2012 and 2011.

The Company values assets based on observable inputs when available. Equity securities, exchange traded funds and futures contracts classified as Level 1 in the fair value hierarchy are priced based on the closing price on the primary exchange as of the balance sheet date. Commingled funds included in Level 2 equity securities are recorded at the net asset value provided by the asset manager, which is based on the market prices of the underlying equity securities. Swaps are valued using pricing models that incorporate interest rates and equity and fixed income index closing prices to determine a net present value of the cash flows. Fixed income securities, such as government issued securities, corporate bonds and high yield bond funds, are included in Level 2 and are valued using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. The pricing models utilize observable inputs such as recent trades for the same or similar instruments, yield curves, discount margins and bond structures. Hedge funds and investments in opportunistic fixed income funds are recorded at net asset value based on the values of the underlying assets. The assets in the hedge funds and opportunistic fixed income funds are valued using observable inputs and are classified as Level 3 within the fair value hierarchy due to redemption restrictions. Private Equity investments and Real Estate and Other Assets are valued using the net asset value provided by the partnerships, which are based on discounted cash flows of the underlying investments, real estate appraisals or public market comparables of the underlying investments. These investments are classified as Level 3 due to redemption restrictions.

*Fair Value Measurements Using Significant Unobservable Inputs (Level 3):* The following tables present changes for the Level 3 category of Pension and PBOP Plan assets for the years ended December 31, 2012 and 2011:

| | NUSCO Pension Plan | | | | | |
|---|---|---|---|---|---|---|
| *(Millions of Dollars)* | United States Equity | Private Equity | Fixed Income | Real Estate and Other Assets | Hedge Funds | Total |
| Balance as of January 1, 2011 | $ 266.0 | $ 229.5 | $ 247.6 | $ 43.7 | $ 247.1 | $ 1,033.9 |
| Actual Return/(Loss) on Plan Assets: | | | | | | |
| Relating to Assets Still Held as of Year End | (6.6) | 20.0 | (1.5) | 1.6 | (7.1) | 6.4 |
| Relating to Assets Distributed During the Year | - | 19.5 | (2.8) | 0.3 | - | 17.0 |
| Purchases, Sales and Settlements | - | (13.9) | 32.9 | 26.2 | - | 45.2 |
| Balance as of December 31, 2011 | $ 259.4 | $ 255.1 | $ 276.2 | $ 71.8 | $ 240.0 | $ 1,102.5 |
| Actual Return/(Loss) on Plan Assets: | | | | | | |
| Relating to Assets Still Held as of Year End | 11.2 | 17.0 | 42.1 | 3.3 | 16.2 | 89.8 |
| Relating to Assets Distributed During the Year | - | 15.0 | 0.7 | 0.1 | - | 15.8 |
| Purchases, Sales and Settlements | - | (19.2) | (3.9) | 33.0 | 40.0 | 49.9 |
| Balance as of December 31, 2012 | $ 270.6 | $ 267.9 | $ 315.1 | $ 108.2 | $ 296.2 | $ 1,258.0 |

| | NUSCO PBOP Plans | | | | | |
|---|---|---|---|---|---|---|
| *(Millions of Dollars)* | United States Equity | Private Equity | Fixed Income | Real Estate and Other Assets | Hedge Funds | Total |
| Balance as of January 1, 2011 | $ 10.1 | $ 0.3 | $ 23.4 | $ - | $ 16.4 | $ 50.2 |
| Actual Return/(Loss) on Plan Assets: | | | | | | |
| Relating to Assets Still Held as of Year End | 0.6 | 0.6 | 0.2 | (0.1) | (0.3) | 1.0 |
| Purchases, Sales and Settlements | - | 4.2 | 2.4 | 2.6 | - | 9.2 |
| Balance as of December 31, 2011 | $ 10.7 | $ 5.1 | $ 26.0 | $ 2.5 | $ 16.1 | $ 60.4 |
| Actual Return on Plan Assets: | | | | | | |
| Relating to Assets Still Held as of Year End | 1.7 | 1.6 | 4.0 | - | 0.8 | 8.1 |
| Purchases, Sales and Settlements | - | 4.6 | 2.1 | 2.8 | - | 9.5 |
| Balance as of December 31, 2012 | $ 12.4 | $ 11.3 | $ 32.1 | $ 5.3 | $ 16.9 | $ 78.0 |

## 9. INCOME TAXES

The tax effect of temporary differences is accounted for in accordance with the rate-making treatment of the PURA and relevant accounting authoritative literature. Details of income tax expense and the components of the federal and state income tax provisions are as follows:

| | For the Years Ended December 31, | | | |
|---|---|---|---|---|
| | Yankee | | Yankee Gas | |
| *(Millions of Dollars)* | 2012 | 2011 | 2012 | 2011 |
| Current Income Taxes: | | | | |
| Federal | $ (3.3) | $ 4.7 | $ (3.3) | $ 4.6 |
| State | 3.2 | 4.1 | 3.2 | 4.1 |
| Total Current | (0.1) | 8.8 | (0.1) | 8.7 |
| Deferred Income Taxes, Net: | | | | |
| Federal | 17.0 | 11.4 | 17.1 | 11.5 |
| State | (2.6) | (1.6) | (2.6) | (1.6) |
| Total Deferred | 14.4 | 9.8 | 14.5 | 9.9 |
| Investment Tax Credits, Net | (0.4) | (0.4) | (0.4) | (0.4) |
| Income Tax Expense | $ 13.9 | $ 18.2 | $ 14.0 | $ 18.2 |

A reconciliation between income tax expense and the expected tax expense at the statutory rate is as follows:

| | For the Years Ended December 31, | | | |
|---|---|---|---|---|
| | Yankee | | Yankee Gas | |
| *(Millions of Dollars, except percentages)* | 2012 | 2011 | 2012 | 2011 |
| Income Before Income Tax Expense | $ 40.2 | $ 49.8 | $ 40.3 | $ 49.9 |
| Statutory Federal Income Tax Expense at 35% | 14.1 | 17.4 | 14.1 | 17.5 |
| Tax Effect of Differences: | | | | |
| Depreciation | (0.1) | (0.6) | (0.1) | (0.6) |
| Investment Tax Credit Amortization | (0.4) | (0.4) | (0.4) | (0.4) |
| State Income Taxes, Net of Federal Impact | (1.8) | (0.6) | (1.8) | (0.6) |
| Adjustments For Prior Years Taxes/Reserves | 2.1 | 2.0 | 2.2 | 2.0 |
| Other, Net | - | 0.4 | - | 0.3 |
| Income Tax Expense | $ 13.9 | $ 18.2 | $ 14.0 | $ 18.2 |
| Effective Tax Rate | 34.6% | 36.5 % | 34.7 % | 36.5 % |

Yankee and Yankee Gas file a consolidated federal income tax return with NU and unitary, combined and separate state income tax returns. Yankee and Yankee Gas are also parties to a tax allocation agreement with NU under which taxable subsidiaries do not pay any more taxes than they would have otherwise paid had they filed a separate company tax return, and subsidiaries generating tax losses, if any, are paid for their losses when utilized.

The PURA requires the tax effect of certain property, plant and equipment related temporary differences that directly impact Yankee Gas' customers receive "flow-through" treatment. Using flow-through treatment, the deferred tax expense is not recorded on the statements of income, rather, the tax effect of the temporary difference impacts the amount for income tax expense currently included in customers' rates and may also affect the Company's net income. Flow-through treatment can result in effective income tax rates that are different than statutory income tax rates and therefore are part of the income tax rate reconciliation for Yankee and Yankee Gas. Recording deferred taxes on flow-through items is required by relevant accounting guidance and the offset to the deferred tax amounts is a regulatory asset or liability.

The tax effects of temporary differences that give rise to the net accumulated deferred tax obligations are as follows:

| | As of December 31, | | | |
|---|---|---|---|---|
| | Yankee | | Yankee Gas | |
| *(Millions of Dollars)* | 2012 | 2011 | 2012 | 2011 |
| Deferred Tax Assets: | | | | |
| Allowance for Uncollectible Accounts | $ 5.5 | $ 6.1 | $ 4.6 | $ 5.2 |
| Regulatory Deferrals | 23.3 | 25.2 | 23.3 | 25.2 |
| Employee Benefits | 45.8 | 39.1 | 45.8 | 39.2 |
| Tax Effect - Tax Regulatory Assets | 0.9 | 1.0 | 0.9 | 1.0 |
| Federal Net Operating Loss Carryforwards | 16.6 | 17.0 | 16.6 | 17.0 |
| Other | 16.2 | 13.4 | 16.1 | 13.3 |
| Total Deferred Tax Assets | $ 108.3 | $ 101.8 | $ 107.3 | $ 100.9 |
| Deferred Tax Liabilities: | | | | |
| Accelerated Depreciation and Other Plant-Related Differences | $ 254.1 | $ 232.7 | $ 254.1 | $ 232.7 |
| Property Tax Accruals | 8.5 | 7.2 | 8.5 | 7.2 |
| Regulatory Deferrals | 50.6 | 52.8 | 50.6 | 52.8 |
| Tax Effect - Tax Regulatory Assets | 13.0 | 12.1 | 13.0 | 12.1 |
| Other | (5.6) | (7.7) | (5.7) | (7.7) |
| Total Deferred Tax Liabilities | $ 320.6 | $ 297.1 | $ 320.5 | $ 297.1 |

As of December 31, 2012, Yankee and Yankee Gas had a $47.4 million federal net operating loss carryforward that begins expiring in 2031 and state tax credits of $10.5 million that begin expiring in 2014.

As of December 31, 2011, Yankee and Yankee Gas had a $48.5 million federal net operating loss carryforward that expires on December 31, 2031 and state tax credits of $9.0 million that begin expiring in 2014.

*Unrecognized Tax Benefits:* A reconciliation of the activity in unrecognized tax benefits from January 1, 2011 to December 31, 2012, all of which would impact the effective tax rate, if recognized, is as follows:

| *(Millions of Dollars)* | Yankee | Yankee Gas |
|---|---|---|
| Balance as of January 1, 2011 | $ 8.9 | $ 8.9 |
| Gross Increases - Current Year | 3.2 | 3.2 |
| Balance as of December 31, 2011 | 12.1 | 12.1 |
| Gross Increases - Current Year | 3.5 | 3.5 |
| Gross Decreases - Prior Year | (0.8) | (0.8) |
| Balance as of December 31, 2012 | $ 14.8 | $ 14.8 |

*Interest and Penalties*: Interest on uncertain tax positions is recorded and generally classified as a component of Other Interest Expense. However, when resolution of uncertainties results in Yankee or Yankee Gas receiving interest income, any related interest benefit is recorded in Other Income, Net on the accompanying statements of income. No penalties have been recorded. If penalties are recorded in the future, then the estimated penalties would be classified as a component of Other Income, Net on the accompanying statements of income. The components of interest on uncertain tax positions by company in 2012 and 2011 are as follows:

| | For the Years Ended December 31, | |
|---|---|---|
| **Other Interest Expense** | 2012 | 2011 |
| *(Millions of Dollars)* | | |
| Yankee | $ 0.4 | $ 0.4 |
| Yankee Gas | 0.4 | 0.4 |

| | As of December 31, | |
|---|---|---|
| **Accrued Interest Expense** | 2012 | 2011 |
| *(Millions of Dollars)* | | |
| Yankee | $ 1.4 | $ 1.0 |
| Yankee Gas | 1.4 | 1.0 |

*Tax Positions:* Yankee and Yankee Gas are currently working to resolve the treatment of certain costs in the remaining open periods in the state of Connecticut.

*Tax Years:* The following table summarizes Yankee and Yankee Gas' tax years that remain subject to examination by major tax jurisdictions as of December 31, 2012:

| **Description** | **Tax Years** |
|---|---|
| Federal (NU consolidated) | 2012 |
| Connecticut | 2005-2012 |

While tax audits are currently ongoing, it is reasonably possible that one or more of these open tax years could be resolved within the next twelve months. For both Yankee and Yankee Gas, management estimates that potential resolutions of differences of a non-timing nature could result in a zero to $4.5 million decrease in unrecognized tax benefits. These estimated changes could have an impact on both Yankee's and Yankee Gas' 2012 earnings of zero to $2.9 million.

In March 2013, Yankee Gas and other affiliated companies received a determination from the Connecticut Department of Revenue Services Appellate Division that closed Connecticut tax years 2005 through 2008 and resulted in a non-cash adjustment to Yankee Gas' tax credit carryforwards of $4.5 million and the recording of an after-tax benefit of $0.7 million.

*2013 Federal Legislation:* On January 2, 2013, President Obama signed into law the "American Taxpayer Relief Act of 2012," which extends certain tax rules allowing the accelerated deduction of depreciation from the "American Recovery and Reinvestment Act of 2009" to businesses through 2013. This extended stimulus is expected to provide cash flow benefits of approximately $15 million to $20 million in 2013 and 2014. Management is still evaluating the other provisions of this legislation, which are not expected to have a significant impact on its future financial position, results of operations, or cash flows.

## 10. COMMITMENTS AND CONTINGENCIES

### A. Environmental Matters

*General:* Yankee Gas is subject to environmental laws and regulations intended to mitigate or remove the effect of past operations and improve or maintain the quality of the environment. These laws and regulations require the removal or the remedy of the effect on the environment of the disposal or release of certain specified hazardous substances at current and former operating sites. Yankee Gas has an active environmental auditing and training program and believes that it is substantially in compliance with all enacted laws and regulations.

Environmental reserves are accrued when assessments indicate it is probable that a liability has been incurred and an amount can be reasonably estimated. The approach used estimates the liability based on the most likely action plan from a variety of available remediation options, including no action required or several different remedies ranging from establishing institutional controls to full site remediation and monitoring.

These estimates are subjective in nature as they take into consideration several different remediation options at each specific site. The reliability and precision of these estimates can be affected by several factors, including new information concerning either the level of contamination at the site, the extent Yankee Gas' responsibility or the extent of remediation required, recently enacted laws and regulations or a change in cost estimates due to certain economic factors.

The amounts recorded as environmental liabilities included in Other Current Liabilities and Other Long-Term Liabilities on the accompanying balance sheets represent management's best estimate of the liability for environmental costs, and take into consideration site assessment, remediation and long-term monitoring costs. The environmental liability also takes into account recurring costs of managing hazardous substances and pollutants, mandated expenditures to remediate previously contaminated sites and any other infrequent and non-recurring clean-up costs. A reconciliation of the activity in the environmental reserves is as follows:

| **Yankee Gas** | **For the Years Ended December 31,** | |
|---|---|---|
| *(Millions of Dollars)* | **2012** | **2011** |
| Balance as of Beginning of Year | $ 19.1 | $ 22.0 |
| Additions | 1.7 | 0.9 |
| Payments | (4.8) | (3.8) |
| Balance as of End of Year | $ 16.0 | $ 19.1 |

These liabilities are estimated on an undiscounted basis and do not assume that any amounts are recoverable from insurance companies or other third parties. The environmental reserves include sites at different stages of discovery and remediation and do not include any unasserted claims.

It is possible that new information or future developments could require a reassessment of the potential exposure to related environmental matters. As this information becomes available, management will continue to assess the potential exposure and adjust the reserves accordingly.

All of the 14 sites in the environmental reserve relate to former manufactured gas plant sites that were operated several decades ago and manufactured gas from coal and other processes which resulted in certain by-products in the environment that may pose a risk to human health and the environment.

As of December 31, 2012, for 2 environmental sites that are included in the Company's reserve for environmental costs, the information known and nature of the remediation options at those sites allow for the Company to estimate the range of losses for environmental costs. As of December 31, 2012, $1.3 million had been accrued as a liability for these sites, which represent management's best estimates of the liabilities for environmental costs. These amounts are the best estimates with estimated ranges of additional losses from zero million to $1.2 million.

As of December 31, 2012, for the remaining environmental sites included in the Company's reserve for environmental costs, management cannot reasonably estimate the exposure to loss in excess of the reserve, or range of loss, as these sites are under investigation and/or there is significant uncertainty as to what remedial actions, if any, the Company may be required to undertake. As of December 31, 2012, $14.7 million had been accrued as a liability for these sites.

*CERCLA Matters:* The federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) and its amendments or state equivalents impose joint and several strict liabilities, regardless of fault, upon generators of hazardous substances resulting in removal and remediation costs and environmental damages. Liabilities under these laws can be material and in some instances may be imposed without regard to fault or for past acts that may have been lawful at the time they occurred. Yankee Gas currently does not have any superfund sites under CERCLA for which it has been notified that it is a potentially responsible party.

*Environmental Rate Recovery:* Yankee Gas has a rate recovery mechanism for environmental costs and has recorded regulatory assets related to environmental remediation costs. The PURA approved an allowed level of remediation cost recoveries of approximately $2.7 million annually effective on July 19, 2011. The PURA has stated that to the extent that environmental remediation expenses are prudently incurred, they should be allowed as proper operating expenses; therefore, management continues to believe that recording the regulatory asset is appropriate as such costs are probable of recovery. As of December 31, 2012 and 2011, $26.7 million and $28.8 million, respectively, have been recorded as Regulatory Assets on the accompanying balance sheets.

**B. Long-Term Contractual Arrangements**

*Estimated Future Annual Costs*: The estimated future annual costs of Yankee Gas' significant long-term contractual arrangements as of December 31, 2012 are as follows:

| **Yankee Gas**<br>*(Millions of Dollars)* | **2013** | **2014** | **2015** | **2016** | **2017** | **Thereafter** | **Total** |
|---|---|---|---|---|---|---|---|
| Natural Gas Procurement Contracts | $ 77.7 | $ 68.8 | $ 38.5 | $ 33.1 | $ 27.9 | $ 53.2 | $ 299.2 |

*Natural Gas Procurement Contracts:* Yankee Gas has entered into long-term contracts for the purchase of natural gas in the normal course of business as part of its portfolio of supplies. These contracts extend through 2022. The total cost of Yankee Gas' procurement portfolio, including these contracts, amounted to $149.4 million in 2012 and $191.7 million in 2011.

**C. Other Litigation and Legal Proceedings**

Yankee and Yankee Gas are involved in legal, tax and regulatory proceedings regarding matters arising in the ordinary course of business, which involve management's assessment to determine the probability of whether a loss will occur and, if probable, its best estimate of probable loss. Yankee and Yankee Gas record and disclose losses when these losses are probable and reasonably estimable, disclose matters when losses are probable but not estimable or reasonably possible, and expense legal costs related to the defense of loss contingencies as incurred.

## 11. LEASES

Yankee and Yankee Gas have entered into operating lease agreements for the use of office equipment, vehicles and office space. In addition, Yankee and Yankee Gas incur costs associated with certain leases entered into by NUSCO and RRR. These costs are included below in operating lease payments charged to expense and amounts capitalized as well as future operating lease payments from 2013 through 2017 and thereafter. The provisions of these lease agreements generally contain renewal options. Certain lease agreements contain payments impacted by the commercial paper rate plus a credit spread or the consumer price index.

For the years ended December 31, 2012 and 2011, $1.2 million of operating lease rental payments were charged to expense for both Yankee and Yankee Gas.

Future minimum rental payments to third parties, RRR, a related party, excluding executory costs such as property taxes, state use taxes, insurance, and maintenance, under long-term noncancelable operating leases, as of December 31, 2012 are as follows:

| *(Millions of Dollars)* | **Yankee and Yankee Gas to Third Parties** | **Yankee and Yankee Gas to RRR** | **Total** |
|---|---|---|---|
| 2013 | $ 0.8 | $ 0.1 | $ 0.9 |
| 2014 | 0.6 | 0.1 | 0.7 |
| 2015 | 0.4 | 0.1 | 0.5 |
| 2016 | 0.3 | 0.1 | 0.4 |
| 2017 | 0.2 | 0.1 | 0.3 |
| Thereafter | 0.7 | - | 0.7 |
| Future Minimum Lease Payments | $ 3.0 | $ 0.5 | $ 3.5 |

## 12. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each of the following financial instruments:

*Long-Term Debt:* The fair value of Yankee Gas' fixed-rate long-term debt securities is based upon pricing models that incorporate quoted market prices for those issues or similar issues adjusted for market conditions, credit ratings and treasury benchmark yields.

The carrying amounts of Yankee Gas' long-term debt, including the current portion, are $345.8 million and $349.3 million as of December 31, 2012 and 2011, respectively. The estimated fair values of these financial instruments are $398.5 million and $396.7 million as of December 31, 2012 and 2011, respectively. These fair values are classified as Level 2 in the fair value hierarchy. For further information regarding long-term debt, see Note 7, "Long-Term Debt," to the financial statements.

*Other Financial Instruments:* The carrying value of other financial instruments included in current assets and current liabilities approximates their fair value due to the short-term nature of these instruments.

## 13. ACCUMULATED OTHER COMPREHENSIVE LOSS

The Yankee Gas accumulated balance for other comprehensive loss, net of tax, is as follows:

| **Yankee Gas** | **As of December 31,** | |
|---|---|---|
| *(Millions of Dollars)* | **2012** | **2011** |
| Qualified Cash Flow Hedging Instruments | $ (1.0) | $ (1.1) |
| SERP Benefit Plan | (0.5) | (0.3) |
| Total | $ (1.5) | $ (1.4) |

Qualified cash flow hedging instruments impacting Net Income relate to the amortization of existing interest rate swap agreements and are reported net of $0.1 million in income tax effects for both December 31, 2012 and 2011. The Accumulated Other Comprehensive Loss impact of the SERP benefit plan is recorded net of $0.3 million and $0.2 million in income tax effects for December 31, 2012 and 2011, respectively.

It is estimated that a charge of $0.1 million will be reclassified from Accumulated Other Comprehensive Loss as a decrease to earnings over the next 12 months as a result of amortization of the interest rate swap agreements which have been settled and $0.2 million will be amortized from Accumulated Other Comprehensive Loss over the next twelve months related to the SERP adjustment.

## 14. COMMON STOCK

The following table sets forth the Yankee and Yankee Gas common stock authorized, issued, outstanding and related par values as of December 31, 2012 and 2011:

| | | **Stock** | | |
|---|---|---|---|---|
| | | **Authorized** | **Issued** | **Outstanding** |
| | **Par Value** | **2012 and 2011** | **2012 and 2011** | **2012 and 2011** |
| Yankee | $ - | 20,000 | 1,000 | 1,000 |
| Yankee Gas | $ 5 | 1,000 | 1,000 | 1,000 |