

Yankee Gas Services Company

Financial Statements as of and for the
Years Ended December 31, 2016 and 2015,
Together With Independent Auditors' Report

Yankee Gas Services Company
Table of Contents

Independent Auditors' Report	1
Financial Statements as of and for the Years Ended December 31, 2016 and 2015:	
Balance Sheets	2
Statements of Income	3
Statements of Comprehensive Income	3
Statements of Common Stockholder's Equity	4
Statements of Cash Flows	5
Notes to Financial Statements	6

INDEPENDENT AUDITORS' REPORT

Yankee Gas Services Company
The Board of Directors of Yankee Gas Services Company
Berlin, CT

We have audited the accompanying financial statements of Yankee Gas Services Company (the "Company"), which comprise the balance sheets as of December 31, 2016 and 2015, 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, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

March 30, 2017

YANKEE GAS SERVICES COMPANY
BALANCE SHEETS

	As of December 31,	
(Thousands of Dollars)	2016	2015
ASSETS		
Current Assets:		
Cash	\$ 1,807	\$ —
Receivables, Net	47,250	37,522
Accounts Receivable from Affiliated Companies	3,182	3,446
Unbilled Revenues	15,026	9,978
Taxes Receivable	11,812	16,566
Fuel, Materials and Supplies	24,109	33,733
Regulatory Assets	18,585	14,365
Prepayments	8,005	7,405
Total Current Assets	129,776	123,015
Property, Plant and Equipment, Net	1,313,915	1,225,549
Deferred Debits and Other Assets:		
Regulatory Assets	128,913	129,825
Goodwill	287,591	287,591
Other Long-Term Assets	4,579	4,593
Total Deferred Debits and Other Assets	421,083	422,009
Total Assets	\$ 1,864,774	\$ 1,770,573
LIABILITIES AND CAPITALIZATION		
Current Liabilities:		
Notes Payable to Eversource Parent	\$ 17,300	\$ 25,900
Accounts Payable	52,210	37,288
Accounts Payable to Affiliated Companies	13,180	13,256
Accrued Interest	7,859	7,788
Regulatory Liabilities	1,535	1,912
Other Current Liabilities	15,348	14,304
Total Current Liabilities	107,432	100,448
Deferred Credits and Other Liabilities:		
Accumulated Deferred Income Taxes	344,008	303,270
Regulatory Liabilities	43,570	49,899
Accrued Pension, SERP and PBOP	69,463	72,480
Other Long-Term Liabilities	42,479	45,278
Total Deferred Credits and Other Liabilities	499,520	470,927
Capitalization:		
Long-Term Debt	443,858	443,746
Common Stockholder's Equity:		
Common Stock	5	5
Capital Surplus, Paid In	707,168	667,169
Retained Earnings	108,167	89,238
Accumulated Other Comprehensive Loss	(1,376)	(960)
Common Stockholder's Equity	813,964	755,452
Total Capitalization	1,257,822	1,199,198
Total Liabilities and Capitalization	\$ 1,864,774	\$ 1,770,573

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,	
	2016	2015
Operating Revenues	\$ 445,230	\$ 479,485
Operating Expenses:		
Cost of Natural Gas	155,445	184,724
Operations and Maintenance	97,230	103,298
Depreciation	33,891	32,857
Amortization of Regulatory Assets, Net	2,043	616
Energy Efficiency Programs	16,865	18,734
Taxes Other Than Income Taxes	47,166	47,032
Total Operating Expenses	<u>352,640</u>	<u>387,261</u>
Operating Income	92,590	92,224
Interest Expense	24,492	23,774
Other Income, Net	94	10
Income Before Income Tax Expense	68,192	68,460
Income Tax Expense	23,662	22,697
Net Income	<u>\$ 44,530</u>	<u>\$ 45,763</u>

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

STATEMENTS OF COMPREHENSIVE INCOME

(Thousands of Dollars)	For the Years Ended December 31,	
	2016	2015
Net Income	\$ 44,530	\$ 45,763
Other Comprehensive (Loss)/Income, Net of Tax:		
Qualified Cash Flow Hedging Instruments	93	93
Changes in Funded Status of SERP Benefit Plan	(509)	27
Other Comprehensive (Loss)/Income, Net of Tax	<u>(416)</u>	<u>120</u>
Comprehensive Income	<u>\$ 44,114</u>	<u>\$ 45,883</u>

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		Capital Surplus, Paid In	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Stock	Amount				
Balance as of January 1, 2015	1,000	\$ 5	\$ 647,030	\$ 67,474	\$ (1,080)	\$ 713,429
Net Income				45,763		45,763
Dividends on Common Stock				(23,999)		(23,999)
Capital Contributions from Parent			20,000			20,000
Allocation of Benefits - ESOP			139			139
Other Comprehensive Income					120	120
Balance as of December 31, 2015	1,000	5	667,169	89,238	(960)	755,452
Net Income				44,530		44,530
Dividends on Common Stock				(25,600)		(25,600)
Capital Contributions from Parent			40,000			40,000
Other			(1)	(1)		(2)
Other Comprehensive Loss					(416)	(416)
Balance as of December 31, 2016	1,000	\$ 5	\$ 707,168	\$ 108,167	\$ (1,376)	\$ 813,964

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

YANKEE GAS SERVICES COMPANY
STATEMENTS OF CASH FLOWS

For the Years Ended December 31,
2016 2015

(Thousands of Dollars)

	2016	2015
Operating Activities:		
Net Income	\$ 44,530	\$ 45,763
Adjustments to Reconcile Net Income to Net Cash Flows		
Provided by Operating Activities:		
Depreciation	33,891	32,857
Deferred Income Taxes	33,438	22,123
Pension, PBOP and SERP Expense	4,275	6,936
Pension and PBOP Contributions	(9,370)	(24,646)
Amortization of Regulatory Assets, Net	2,043	616
Regulatory (Under)/Over Recoveries, Net	(2,830)	8,023
Bad Debt Expense	5,110	6,849
Other	442	(4,335)
Changes in Current Assets and Liabilities:		
Receivables and Unbilled Revenues, Net	(23,753)	7,021
Fuel, Materials and Supplies	9,624	15,717
Taxes Receivable/Accrued, Net	6,516	(3,368)
Accounts Payable	13,556	(6,189)
Other Current Assets and Liabilities, Net	550	(246)
Net Cash Flows Provided by Operating Activities	<u>118,022</u>	<u>107,121</u>
Investing Activities:		
Investments in Property, Plant and Equipment	(122,011)	(96,566)
Other Investing Activities	—	70
Net Cash Flows Used in Investing Activities	<u>(122,011)</u>	<u>(96,496)</u>
Financing Activities:		
Cash Dividends on Common Stock	(25,600)	(23,999)
Capital Contributions from Parent	40,000	20,000
Issuance of Long-Term Debt	—	75,000
Decrease in Notes Payable to Eversource Parent	(8,600)	(82,300)
Other Financing Activities	(4)	(333)
Net Cash Flows Provided by/(Used in) Financing Activities	<u>5,796</u>	<u>(11,632)</u>
Net Increase/(Decrease) in Cash	1,807	(1,007)
Cash - Beginning of Year	—	1,007
Cash - End of Year	<u>\$ 1,807</u>	<u>\$ —</u>

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

**YANKEE GAS SERVICES COMPANY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. About Yankee Gas Services Company

Yankee Gas Services Company ("Yankee Gas" or the "Company") is a regulated public utility company engaged in the distribution and sale of natural gas to customers in parts of Connecticut. Yankee Gas distributes natural gas to approximately 229,000 customers in 72 cities and towns in Connecticut covering 2,187 square miles. The Company is subject to regulation of the rates it charges its customers, accounting and other matters, by the Connecticut Public Utility Regulatory Authority ("PURA"). Yankee Gas is a wholly-owned subsidiary of Yankee Energy System, Inc., a holding company that is a wholly-owned subsidiary of Eversource Energy ("Eversource"). Yankee Gas is doing business as Eversource Energy.

B. Basis of Presentation

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 the 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 reclassifications of prior year data were made in the accompanying financial statements to conform to the current year presentation.

Yankee Gas is subject to rate regulation that is based on cost recovery and meets the criteria for application of accounting guidance for entities with rate-regulated operations, which considers the effect of regulation on the differences in the timing of the recognition of certain revenues and expenses from those of other businesses and industries. See Note 2, "Regulatory Accounting," for further information.

As of December 31, 2016 and 2015, Yankee Gas' carrying amount of goodwill was \$287.6 million. Yankee Gas performs an assessment for possible impairment of its goodwill at least annually. Yankee Gas completed its annual goodwill impairment test as of October 1, 2016 and determined that no impairment exists. See Note 5, "Goodwill," for further information.

Yankee Gas evaluates events and transactions that occur after the balance sheet date but before financial statements are issued and recognizes 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 discloses, but does 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 financial statements, Yankee Gas evaluated events subsequent to December 31, 2016 through the issuance of the financial statements on March 30, 2017 and did not identify any such events that required recognition or disclosure under this guidance.

C. Accounting Standards

Accounting Standards Issued but Not Yet Effective

In May 2014, the Financial Accounting Standards Board ("FASB") issued an Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers*, which amends existing revenue recognition guidance and is required to be applied retrospectively (either to each reporting period presented or cumulatively at the date of initial application). The Company is evaluating the requirements and potential impacts of ASU 2014-09 and will implement the standard in the first quarter of 2018 cumulatively at the date of initial application. The guidance continues to be interpreted on an industry specific level, including the timing of recognizing revenues from billings to protected customers that may not meet the collectibility threshold for revenue recognition. Therefore, while the effects of implementing the ASU on results of operations are not expected to be material, there may be changes in the timing of revenue recognition on the financial statements of Yankee Gas.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which changes existing lease accounting guidance and is required to be applied in the first quarter of 2019, with earlier application permitted. The ASU is required to be implemented for leases beginning on the date of initial application. For prior periods presented, leases are required to be recognized and measured using a modified retrospective approach. The Company is reviewing the requirements of ASU 2016-02, including balance sheet recognition of leases previously deemed operating leases, and expects to implement the ASU in the first quarter of 2019.

D. Cash

Cash consists of cash on hand. At the end of each reporting period, any overdraft amounts are reclassified from Cash to Accounts Payable on the balance sheets.

E. Provision for Uncollectible Accounts

Yankee Gas presents its receivables at estimated net realizable value by maintaining a provision for uncollectible accounts. This provision is determined based upon a variety of judgments and factors, including the application of an estimated uncollectible percentage to each receivable aging category. The estimate is based upon historical collection and write-off experience and management's assessment of collectability from customers. Management continuously assesses the collectability of receivables and adjusts collectability estimates based on actual experience. Receivable balances are written off against the provision for uncollectible accounts when the customer accounts are terminated and these balances are deemed to be uncollectible.

The PURA allows Yankee Gas to accelerate the recovery of accounts 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, 2016 and 2015, Yankee Gas had an uncollectible hardship accounts receivable reserve of \$10.5 million and \$12.7 million, respectively. These uncollectible customer account balances, which are expected to be recovered in rates, are included in Regulatory Assets on the balance sheets and are reflected in the total provision for uncollectible accounts.

The total provision for uncollectible accounts, which includes uncollectible hardship accounts, is included in Receivables, Net on the balance sheets, and was \$17.0 million and \$19.3 million as of December 31, 2016 and 2015, respectively.

F. Fuel, Materials and Supplies

Fuel, Materials and Supplies include natural gas purchased for delivery to customers and materials and supplies purchased primarily for construction or operation and maintenance purposes. Included in Fuel, Materials and Supplies on the balance sheets as of December 31, 2016 and 2015 were \$21.0 million and \$30.9 million, respectively, of natural gas inventory, and \$3.1 million and \$2.8 million, respectively, of materials and supplies. Inventory is valued at the lower of cost or net realizable value.

G. Fair Value Measurements

Fair value measurement guidance is applied to valuations of the investments used to calculate the funded status of pension and postretirement benefits other than pensions ("PBOP") plans, the nonrecurring fair value measurements of nonfinancial assets such as goodwill and asset retirement obligations ("AROs"), and the estimated fair value of long-term debt.

Fair Value Hierarchy: In measuring fair value, the Company uses observable market data when available in order to minimize the use of unobservable inputs. Inputs used in fair value measurements are categorized into three fair value hierarchy levels for disclosure purposes. The entire fair value measurement is categorized based on the lowest level of input that is significant to the fair value measurement. The Company evaluates the classification of assets and liabilities measured at fair value on a quarterly basis, and the Company's policy is to recognize transfers between levels of the fair value hierarchy as of the end of the reporting period. The three levels of the fair value hierarchy are described below:

Level 1 - Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 - Inputs are quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs are observable.

Level 3 - Quoted market prices are not available. Fair value is derived from valuation techniques in which one or more significant inputs or assumptions are unobservable. Where possible, valuation techniques incorporate observable market inputs that can be validated to external sources such as industry exchanges, including prices of energy and energy-related products.

Determination of Fair Value: The valuation techniques and inputs used in Yankee Gas' fair value measurements are described in Note 4, "Asset Retirement Obligations," and Note 12, "Fair Value of Financial Instruments," to the financial statements.

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. The rates are designed to recover the costs to provide service to its customers, and include a return on investment. Yankee Gas also utilizes PURA-approved tracking mechanisms to recover certain costs on a fully-reconciling basis. These tracking mechanisms require rates to be changed periodically to ensure recovery of actual costs incurred.

A significant portion of Yankee Gas' revenues relate to the recovery of costs incurred for the sale of natural gas purchased on behalf of customers. These natural gas supply costs are recovered from customers in rates through a cost tracking mechanism. Natural gas purchases are recorded in Cost of Natural Gas, and the sale of natural gas associated with these purchases is recorded in Operating Revenues on the statements of income.

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 in Current 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 volumes by first allocating billed sales volumes to the current calendar month based on the daily send-out for each billing cycle. The billed sales volumes are then subtracted from total month send-out, net of delivery losses, to estimate unbilled sales volumes. Unbilled revenues are estimated by first allocating unbilled sales volumes to the respective customer and rate classes, then applying an estimated rate by customer and rate class to those sales volumes. The estimate of unbilled revenues can significantly impact the amount of revenues recorded.

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 plant on the balance sheets. The portion of AFUDC attributable to borrowed funds is recorded as a reduction of Interest Expense, and the AFUDC related to equity funds is recorded as Other Income, Net on the 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. For the year ended December 31, 2016, AFUDC costs included borrowed funds of \$0.3 million and equity funds of \$0.4 million. For the year ended December 31, 2015, AFUDC costs included borrowed funds of \$0.1 million.

Yankee Gas' average AFUDC rate is based on a Federal Energy Regulatory Commission prescribed formula using the cost of a company's short-term financings and capitalization (long-term debt and common equity), as appropriate. The average rate is applied to average eligible construction work in progress amounts to calculate AFUDC. Average AFUDC rates for the years ended December 31, 2016 and 2015 were 2.5 percent and 0.5 percent, respectively.

J. Other Taxes

Gross receipts taxes levied by the state of Connecticut are collected by Yankee Gas from its customers. These gross receipts taxes are shown separately with collections in Operating Revenues and with payments in Taxes Other Than Income Taxes on the statements of income. For the years ended December 31, 2016 and 2015, gross receipts taxes were \$17.5 million and \$18.7 million, respectively. As an agent for the state and local governments, Yankee Gas collects certain sales taxes that are recorded on a net basis with no impact on the statements of income.

K. Supplemental Cash Flow Information

<i>(Millions of Dollars)</i>	<u>As of and for the Years Ended December 31,</u>	
	<u>2016</u>	<u>2015</u>
Cash Paid/(Received) During the Year For:		
Interest, Net of Amounts Capitalized	\$ 24.0	\$ 21.7
Income Taxes	(15.0)	3.8
Non-Cash Investing Activities:		
Plant Additions Included in Accounts Payable (As of)	20.1	18.8

L. Related Parties

Eversource Energy Service Company ("Eversource Service"), Eversource's service company, provides centralized accounting, administrative, engineering, financial, information technology, legal, operational, planning, purchasing, and other services to Yankee Gas. In addition, Yankee Gas incurs costs associated with leases entered into by The Rocky River Realty Company, a related party, which is also a subsidiary of Eversource.

Included in the balance sheets as of December 31, 2016 and 2015 are Accounts Receivable from Affiliated Companies and Accounts Payable to Affiliated Companies related to transactions between Yankee Gas and other subsidiaries that are wholly-owned by Eversource, primarily Eversource Service.

2. REGULATORY ACCOUNTING

Yankee Gas is subject to rate regulation that is based on cost recovery and meets the criteria for application of accounting guidance for rate-regulated operations, which considers the effect of regulation on the timing of the recognition of certain revenues and expenses. Yankee Gas' financial statements reflect the effects of the rate-making process. The rates charged to customers are designed to collect the Company's costs to provide service, including a return on investment.

Management believes it is probable that it will recover its investment in long-lived assets, including regulatory assets. If management were to determine that it could no longer apply the accounting guidance applicable to rate-regulated enterprises to the Company's operations, or if management could not conclude it is probable that costs would be recovered from customers 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 were as follows:

<i>(Millions of Dollars)</i>	<u>As of December 31,</u>	
	<u>2016</u>	<u>2015</u>
Benefit Costs	\$ 63.2	\$ 62.7
Income Taxes, Net	37.3	34.2
Environmental Remediation Costs	27.6	29.4
Hardship Customer Receivables	9.2	10.5
Asset Retirement Obligations	4.1	3.9
Other Regulatory Assets	6.1	3.5
Total Regulatory Assets	147.5	144.2
Less: Current Portion	18.6	14.4
Total Long-Term Regulatory Assets	\$ 128.9	\$ 129.8

Benefit Costs: Yankee Gas participates in Eversource's Pension and PBOP Plans, which are accounted for in accordance with accounting guidance on defined benefit pension and other PBOP plans. The liability recorded by Yankee Gas to recognize the funded status of the retiree benefit plans is offset by a regulatory asset in lieu of a charge to Accumulated Other Comprehensive Income/(Loss), reflecting ultimate recovery from customers through rates. The regulatory asset is amortized as the actuarial gains and losses and prior service cost are amortized to net periodic benefit cost for the pension and PBOP plans. All amounts are remeasured annually. As these regulatory assets do not represent a cash outlay for Yankee Gas, no carrying charge is recovered from customers.

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. The amortization period of these assets varies depending on the nature and/or remaining life of the underlying assets and liabilities. For further information regarding income taxes, see Note 9, "Income Taxes," to the financial statements.

Environmental Remediation Costs: Recoverable costs associated with the remediation of environmental sites are recorded as regulatory assets in accordance with PURA regulation. 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 for customer receivables that qualify under Connecticut's Matching Payment Program and hardship protection plans (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 annual level of recoverable hardship costs. For further information regarding hardship accounts receivable, see Note 1E, "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.

Regulatory Costs in Other Long-Term Assets: Yankee Gas had \$2.7 million of additional regulatory costs as of both December 31, 2016 and 2015 that were included in Other Long-Term Assets on the balance sheets. These amounts represent incurred costs for which recovery has not yet been specifically approved by the PURA. However, based on regulatory policies or past precedent on similar costs, management believes it is probable that these costs will ultimately be approved and recovered from customers in rates.

Regulatory Liabilities: The components of regulatory liabilities were as follows:

<i>(Millions of Dollars)</i>	As of December 31,	
	2016	2015
Cost of Removal	\$ 28.0	\$ 39.1
Regulatory Tracker Mechanisms	15.2	10.8
Other Regulatory Liabilities	1.9	1.9
Total Regulatory Liabilities	45.1	51.8
Less: Current Portion	1.5	1.9
Total Long-Term Regulatory Liabilities	\$ 43.6	\$ 49.9

Cost of Removal: Yankee Gas currently recovers amounts in rates for future costs of removal of plant assets over the lives of the assets. The estimated cost to remove utility assets from service is recognized as a component of depreciation expense, and the cumulative amount collected from customers but not yet expended is recognized as a regulatory liability.

Regulatory Tracker Mechanisms: Yankee Gas' approved rates are designed to recover its costs incurred to provide service to customers. Yankee Gas recovers certain of its costs on a fully-reconciling basis through PURA-approved tracking mechanisms. The difference between the costs incurred (or the rate recovery allowed) and the actual revenues are recorded as regulatory assets (for undercollections) or as regulatory liabilities (for overcollections) to be included in future customer rates each year. Carrying charges are recorded on all material regulatory tracker mechanisms. Yankee Gas recovers, on a fully reconciling basis, the costs associated with the procurement of natural gas for its firm and seasonal customers, system expansion costs and conservation costs through rate reconciling mechanisms.

2015 Regulatory Development:

Settlement Agreement: On April 29, 2015, the PURA approved a settlement agreement entered into among Yankee Gas, the Connecticut Office of Consumer Counsel, and the PURA Staff, which eliminated the requirement to file a base distribution rate case in 2015. Under the terms of the settlement agreement, Yankee Gas provided a \$1.5 million rate credit to firm customers beginning in December 2015 and continued through February 2016, and established an earnings sharing mechanism whereby Yankee Gas and its customers will share equally in any earnings exceeding a 9.5 percent ROE in a twelve month period commencing with the period from April 1, 2015 through March 31, 2016. The settlement agreement also resolved two pending regulatory proceedings before the PURA pertaining to a review of Yankee Gas' overearnings. In 2015, Yankee Gas recorded the \$1.5 million expected refund to customers as a reduction to operating revenues.

3. PROPERTY, PLANT AND EQUIPMENT AND ACCUMULATED DEPRECIATION

Property, plant and equipment is recorded at original cost. Original cost includes materials, labor, construction overhead and AFUDC. The cost of repairs and maintenance is charged to Operations and Maintenance expense as incurred.

The following table summarizes the investments in property, plant and equipment:

<i>(Millions of Dollars)</i>	As of December 31,	
	2016	2015
Property, Plant and Equipment, Gross	\$ 1,709.6	\$ 1,573.0
Less: Accumulated Depreciation	(419.6)	(394.4)
Property, Plant and Equipment, Net	1,290.0	1,178.6
Construction Work in Progress	23.9	46.9
Total Property, Plant and Equipment, Net	\$ 1,313.9	\$ 1,225.5

Depreciation of 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, which are subject to approval by the PURA, include a cost of removal component, which is collected from customers over the lives of the plant assets 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 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 property, plant and equipment aggregate to a composite rate of 2.3 percent in both 2016 and 2015. As of December 31, 2016, the average remaining useful life of Yankee Gas' depreciable assets was 46.5 years.

4. ASSET RETIREMENT OBLIGATIONS

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 removal of hazardous materials and the cutting and capping of natural gas mains, and has performed fair value calculations reflecting expected probabilities for settlement scenarios.

The fair value of an ARO is recorded as a liability in Other Long-Term Liabilities with a corresponding amount included in Property, Plant and Equipment, Net on the balance sheets. The ARO assets are depreciated, and the ARO liabilities are accreted over the estimated life of the obligation and the corresponding credits are recorded as accumulated depreciation and ARO liabilities, respectively. As Yankee Gas is rate-regulated on a cost-of-service basis, it applies regulatory accounting guidance and both the depreciation and accretion costs associated with the AROs are recorded as increases to Regulatory Assets on the balance sheets.

A reconciliation of the beginning and ending carrying amounts of ARO liabilities is as follows:

<i>(Millions of Dollars)</i>	As of December 31,	
	2016	2015
Balance as of Beginning of Year	\$ 3.9	\$ 4.2
Liabilities Incurred During the Year	0.5	—
Accretion	0.2	0.2
Revisions in Estimated Cash Flows	—	(0.5)
Balance as of End of Year	\$ 4.6	\$ 3.9

5. GOODWILL

Yankee Gas recorded \$287.6 million of goodwill related to the acquisition of the parent of Yankee Gas in 2000. This goodwill is not being recovered from its customers.

Goodwill is not subject to amortization, however is subject to a fair value based assessment for impairment at least annually and whenever facts or circumstances indicate that there may be an impairment. A resulting write-down, if any, would be charged to Operating Expenses. Management is required to test the goodwill balance for impairment by considering the fair value of the reporting unit, which requires the use estimates and judgments.

The annual goodwill assessment included an evaluation of credit ratings, financial performance, cost and risk factors, long-term strategy, growth and future projections, as well as macroeconomic, industry and market conditions. Yankee Gas completed its annual goodwill impairment test as of October 1, 2016 and determined that no impairment existed. There were no events subsequent to October 1, 2016 that indicated impairment of goodwill.

Goodwill impairment is deemed to exist if the carrying amount 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's assets and liabilities is less than the carrying amount of the goodwill. If goodwill were deemed to be impaired, it would be written down in the current period to the extent of the impairment.

6. SHORT-TERM DEBT

Credit Agreement and Notes Payable: The Eversource Energy holding company ("Eversource parent") and certain of its subsidiaries, including Yankee Gas, are parties to a five-year \$1.45 billion revolving credit facility. Effective September 26, 2016, the revolving credit facility's termination date was extended for one additional year to September 4, 2021. Under the revolving credit facility, Yankee Gas has a borrowing sublimit of \$200 million. The revolving credit facility serves to backstop Eversource parent's \$1.45 billion commercial paper program. The commercial paper program allows Eversource parent to issue commercial paper as a form of short-term debt. There were no borrowings outstanding on the revolving credit facility as of December 31, 2016 or 2015.

As of December 31, 2016 and 2015, there were intercompany loans from Eversource parent to Yankee Gas of \$17.3 million and \$25.9 million, respectively, recorded as Notes Payable to Eversource Parent and classified in current liabilities on the balance sheets as all borrowings are outstanding for no more than 364 days at one time. The weighted-average interest rate on these borrowings as of December 31, 2016 and 2015 was 0.88 percent and 0.72 percent, respectively.

Under the credit facility, Yankee Gas must comply with certain financial and non-financial covenants, including a debt to total capitalization ratio. As of December 31, 2016 and 2015, Yankee Gas was in compliance with these covenants. If Yankee Gas was not in compliance with these covenants, an event of default would occur requiring all outstanding borrowings by Yankee Gas to be repaid, and additional borrowings would not be permitted under the credit facility.

7. LONG-TERM DEBT

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

(Millions of Dollars)	As of December 31,	
	2016	2015
First Mortgage Bonds:		
8.48% Series B due 2022	\$ 20.0	\$ 20.0
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
4.82% Series L due 2044	100.0	100.0
3.35% Series M due 2025	75.0	75.0
Total First Mortgage Bonds	445.0	445.0
Unamortized Premium	0.4	0.4
Unamortized Debt Issuance Costs	(1.5)	(1.7)
Yankee Gas Long-Term Debt	\$ 443.9	\$ 443.7

Long-Term Debt Issuance Authorization: On December 28, 2016, PURA approved Yankee Gas' request to extend the authorization period for issuance of up to \$125 million in long-term debt from December 31, 2016 to December 31, 2017.

Long-Term Debt Provisions: The utility plant of Yankee Gas is subject to the lien of its' first mortgage bond indenture. Additionally, Yankee Gas has certain long-term debt agreements that contain cross-default provisions. 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.

8. PENSION BENEFITS AND POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

Eversource Service sponsors a defined benefit retirement plan (the "Pension Plan") that covers eligible employees, including, among others, employees of Yankee Gas. The Pension Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended by the Pension Protection Act of 2006. Eversource Service's Employer Identification Number is 06-0810627. Eversource's policy is to fund the Pension Plan annually in an amount at least equal to the amount that will satisfy all federal funding requirements. In addition to the Pension Plan, Eversource maintains non-qualified defined benefit retirement plans ("SERP Plans"), sponsored by Eversource Service, which provide benefits in excess of Internal Revenue Code limitations to eligible participants consisting of current and retired employees.

Eversource Service also sponsored a defined benefit postretirement plan ("PBOP Plan") that provided certain benefits, primarily medical, dental and life insurance to eligible employees that met certain age and service eligibility requirements. In August 2016, Eversource amended its PBOP Plan, which standardized separate benefit structures that existed within the plan and made other benefit changes. The new plan provides life insurance and a health reimbursement arrangement created for the purpose of reimbursing retirees and dependents for health insurance premiums and certain medical expenses. The benefits provided under the PBOP Plan are not vested and Eversource has the right to modify any benefit provision subject to applicable laws at that time. Eversource annually funds postretirement costs through tax deductible contributions to external trusts.

Plan sponsor information is included in the Eversource 2016 Annual Report on Form 10-K filed on February 23, 2017 with the Securities Exchange Commission.

Because Yankee Gas recovers the pension and PBOP benefit costs from customers through rates, regulatory assets are recorded in lieu of recording an adjustment to Accumulated Other Comprehensive Income/(Loss) for the funded status of the Pension and PBOP Plans. Adjustments to the SERP Plan funded status are recorded on an after-tax basis to Accumulated Other Comprehensive Income/(Loss) on the balance sheets. For further information, see Note 2, "Regulatory Accounting," and Note 13, "Accumulated Other Comprehensive Income/(Loss)," to the financial statements.

The difference between the actual return and calculated expected return on plan assets for the Pension and PBOP Plans is reflected as a component of unrecognized actuarial gains or losses, which are recorded in Regulatory Assets or Accumulated Other Comprehensive Income/(Loss). Unrecognized actuarial gains or losses are amortized as a component of pension and PBOP expense over the estimated average future employee service period.

Pension and SERP Plans: Yankee Gas participates in the overall Eversource single-employer Pension Plan and SERP Plans and accounts for the Pension and SERP Plans under the multiple-employer approach, with its share of the funded status of the plans reflected on its balance sheet. Although Eversource maintains marketable securities in a benefit trust, the SERP Plans do not contain any assets. The following table provides information on the portions attributable to Yankee Gas in the Eversource single-employer Pension and SERP Plan benefit obligations, fair values of Pension Plan assets, and funded status:

<i>(Millions of Dollars)</i>	Pension and SERP	
	As of December 31,	
	2016	2015
Benefit Obligation as of End of Year	\$ (183.8)	\$ (180.5)
Fair Value of Pension Plan Assets as of End of Year	122.9	114.6
Funded Status as of December 31 st	\$ (60.9)	\$ (65.9)
Employer Contributions	\$ 9.4	\$ 24.6
Benefits Paid	8.2	7.8
Benefits Paid - Lump Sum	—	4.0
Benefits Paid - SERP	0.1	0.1

The pension and SERP Plans' funded status includes the current portion of the SERP liability, which is included in Other Current Liabilities on the balance sheets.

Yankee Gas' accumulated benefit obligation for the Pension and SERP Plans was \$163.3 million and \$163.2 million as of December 31, 2016 and 2015, respectively.

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

	Pension and SERP	
	As of December 31,	
	2016	2015
Discount Rate	4.01% — 4.33%	4.21% — 4.60%
Compensation/Progression Rate	3.50%	3.50%

Pension and SERP Expense: Eversource charges net periodic pension expense to its subsidiaries based on the actual participant demographic data for each subsidiary's participants. 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.

Effective January 1, 2016, Eversource refined its method of estimating the discount rate for the service and interest cost components of Pension expense from the yield-curve approach to the spot rate methodology, which provides a more precise measurement by matching projected cash flows to the corresponding spot rates on the yield curve. Historically, these components were estimated using the same weighted-average discount rate as for the funded status.

Yankee Gas' components of net periodic benefit expense for the Pension and SERP Plans are shown below. The net periodic benefit expense and the intercompany allocations less the capitalized portion of pension and SERP amounts are included in Operations and Maintenance expense on the statements of income. Capitalized pension amounts relate to employees working on capital projects and are included in Property, Plant and Equipment, Net on the balance sheets. Pension and SERP expense reflected in the statements of cash flows for Yankee Gas does not include the intercompany allocations or the corresponding capitalized portion, as these amounts are cash settled on a short-term basis.

<i>(Millions of Dollars)</i>	Pension and SERP	
	For the Years Ended December 31,	
	2016	2015
Service Cost	\$ 3.7	\$ 4.6
Interest Cost	6.7	8.2
Expected Return on Pension Plan Assets	(9.4)	(9.0)
Actuarial Loss	3.7	5.8
Prior Service Cost	0.1	0.1
Total Net Periodic Benefit Expense	\$ 4.8	\$ 9.7
Intercompany Allocations	\$ 1.8	\$ 2.8
Capitalized Pension Expense	\$ 1.7	\$ 2.3

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

	Pension and SERP	
	For the Years Ended December 31,	
	2016	2015
Discount Rate	3.27% — 4.89%	4.20%
Expected Long-Term Rate of Return	8.25%	8.25%
Compensation/Progression Rate	3.50%	3.50%

PBOP Plan: Yankee Gas participates in the overall Eversource single-employer PBOP Plan and accounts for the PBOP Plan under the multiple-employer approach, with its share of the funded status of the plan reflected on its balance sheets. The following table provides information on the portions attributable to Yankee Gas in the Eversource single-employer PBOP Plan benefit obligations, fair values of plan assets, and funded status:

<i>(Millions of Dollars)</i>	PBOP	
	As of December 31,	
	2016	2015
Benefit Obligation as of End of Year	\$ (25.0)	\$ (22.8)
Fair Value of Plan Assets as of End of Year	16.3	16.1
Funded Status as of December 31 st	\$ (8.7)	\$ (6.7)
Benefits Paid	\$ 1.5	\$ 1.2

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

	PBOP	
	As of December 31,	
	2016	2015
Discount Rate	4.21%	4.62%
Health Care Cost Trend Rate	N/A	6.25%

Effective with the plan amendment that standardized plan designs and made benefit changes in August 2016, the health care cost trend rate is no longer applicable.

PBOP Expense: Eversource charges net periodic postretirement benefits expense to its subsidiaries based on the actual participant demographic data for each subsidiary's participants. 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.

Effective January 1, 2016, Eversource refined its method of estimating the discount rate for the service and interest cost components of PBOP expense from the yield-curve methodology to the spot rate methodology, which provides a more precise measurement by matching projected cash flows to the corresponding spot rates on the yield curve. Historically these components were estimated using the same weighted-average discount rate as for the funded status.

The August 2016 PBOP Plan amendment resulted in a remeasurement of the benefit obligation and annual expense using assumptions at that point in time, including updated discount rates and asset values.

Yankee Gas' components of net periodic benefit expense for the PBOP Plan are shown below. The net periodic benefit expense and the intercompany allocations less the capitalized portion of PBOP are included in Operations and Maintenance expense on the statements of income. Capitalized PBOP amounts relate to employees working on capital projects and are included in Property, Plant and Equipment, Net on the balance sheets. PBOP expense reflected in the statements of cash flows for Yankee Gas does not include the intercompany allocations or the corresponding capitalized portion, as these amounts are cash settled on a short-term basis.

<i>(Millions of Dollars)</i>	PBOP	
	For the Years Ended December 31,	
	2016	2015
Service Cost	\$ 0.5	\$ 0.6
Interest Cost	0.8	1.0
Expected Return on Plan Assets	(1.3)	(1.6)
Actuarial Loss	0.2	0.2
Prior Service Cost	0.1	—
Total Net Periodic Benefit Expense	\$ 0.3	\$ 0.2
Intercompany Allocations	\$ —	\$ 0.2
Capitalized PBOP Expense	\$ 0.1	\$ 0.1

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

	PBOP	
	For the Years Ended December 31,	
	2016	2015
Discount Rate	2.88% — 4.09%	4.22%
Expected Long-Term Rate of Return	8.25%	8.25%

The health care cost trend rate assumption used to calculate the PBOP expense amount was 6.25 percent and 6.5 percent for the years ended December 31, 2016 and 2015, respectively. Effective January 1, 2017, the health care trend rate no longer has an impact on the PBOP expense due to the benefit design changes effective with the plan amendment.

Contributions: Based on the current status of the Pension Plan and federal pension funding requirements, Eversource currently expects to make contributions of approximately \$175 million in 2017, of which approximately \$12.7 million will be contributed by Yankee Gas. Eversource expects to make \$7.6 million in contributions to the PBOP Plan in 2017.

9. INCOME TAXES

The components of income tax expense were as follows:

<i>(Millions of Dollars)</i>	For the Years Ended December 31,	
	2016	2015
Current Income Taxes:		
Federal	\$ (13.5)	\$ (2.9)
State	4.1	3.8
Total Current	(9.4)	0.9
Deferred Income Taxes, Net:		
Federal	36.9	21.1
State	(3.5)	1.0
Total Deferred	33.4	22.1
Investment Tax Credits, Net	(0.3)	(0.3)
Income Tax Expense	\$ 23.7	\$ 22.7

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

<i>(Millions of Dollars, except percentages)</i>	For the Years Ended December 31,	
	2016	2015
Income Before Income Tax Expense	\$ 68.2	\$ 68.5
Statutory Federal Income Tax Expense at 35%	23.9	24.0
Tax Effect of Differences:		
Depreciation	(0.1)	0.2
Investment Tax Credit Amortization	(0.3)	(0.3)
State Income Taxes, Net of Federal Impact	(2.0)	1.4
Excess Stock Benefit	(0.2)	—
Other, Net	2.4	(2.6)
Income Tax Expense	\$ 23.7	\$ 22.7
Effective Tax Rate	34.7%	33.2%

Yankee Gas files a consolidated federal income tax return with Eversource and also files state income tax returns. Yankee Gas is party to a tax allocation agreement with Eversource 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 that 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 included in determining customers' rates. 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 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.

Deferred tax assets and liabilities are recognized for the future tax effects of temporary differences between the carrying amounts and the tax basis of assets and liabilities. The tax effect of temporary differences is accounted for in accordance with the rate-making treatment of the PURA and relevant accounting authoritative literature. The tax effects of temporary differences that give rise to the net accumulated deferred income tax obligations were as follows:

<i>(Millions of Dollars)</i>	As of December 31,	
	2016	2015
Deferred Tax Assets:		
Allowance for Uncollectible Accounts	\$ 7.0	\$ 7.7
Regulatory Deferrals - Liabilities	12.4	16.9
Employee Benefits	30.1	31.8
Tax Effect - Tax Regulatory Liabilities	0.4	0.5
Other	4.9	6.1
Total Deferred Tax Assets	\$ 54.8	\$ 63.0
Deferred Tax Liabilities:		
Accelerated Depreciation and Other Plant-Related Differences	\$ 342.8	\$ 313.8
Property Tax Accruals	6.5	5.8
Regulatory Amounts:		
Regulatory Deferrals - Assets	44.7	42.9
Tax Effect - Tax Regulatory Assets	14.9	13.6
Other	(10.1)	(9.8)
Total Deferred Tax Liabilities	\$ 398.8	\$ 366.3

Carryforwards: The following tables provide the amounts and expiration dates of state tax credit and loss carryforwards:

<i>(Millions of Dollars)</i>	As of December 31, 2016		As of December 31, 2015	
	Total	Expiration Range	Total	Expiration Range
State Tax Credit	\$ 15.5	2016 - 2021	\$ 11.5	2015 - 2020
State Charitable Contribution	—	N/A	0.1	2015 - 2018

Unrecognized Tax Benefits: A reconciliation of the activity in unrecognized tax benefits, all of which would impact the effective tax rate, if recognized, is as follows:

(Millions of Dollars)

Balance as of January 1, 2015	\$	17.2
Gross Increases - Current Year		3.7
Gross Increases - Prior Year		0.1
Lapse of Statute of Limitations		(1.6)
Balance as of December 31, 2015		19.4
Gross Increases - Current Year		4.5
Lapse of Statute of Limitations		(2.7)
Balance as of December 31, 2016	\$	21.2

Interest and Penalties: Interest on uncertain tax positions is recorded and generally classified as a component of Other Interest Expense on the statements of income. However, when resolution of uncertainties results in Yankee Gas receiving interest income, any related interest benefit is recorded in Other Income, Net on the statements of income. No penalties have been recorded. The amount of interest expense/(income) on uncertain tax positions recognized and the related accrued interest payable are as follows:

(Millions of Dollars)	For the Years Ended December 31,		(Millions of Dollars)	As of December 31,	
	2016	2015		2016	2015
Other Interest Income	\$	—	Accrued Interest Expense	\$	0.1
	\$	—		\$	0.1

Tax Positions: During 2016 and 2015, Yankee Gas did not resolve any of its uncertain tax positions.

Open Tax Years: The following table summarizes Yankee Gas' tax years that remain subject to examination by major tax jurisdictions as of December 31, 2016:

Description	Tax Years
Federal (Eversource consolidated)	2016
Connecticut	2013 - 2016

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. Yankee Gas does not currently estimate potential resolutions of differences of a non-timing nature.

2015 Federal Legislation: On December 18, 2015, the "Protecting Americans from Tax Hikes" Act became law, which extended the accelerated deduction of depreciation to businesses from 2015 through 2019. This extended stimulus provided Yankee Gas with cash flow benefits in 2016 of approximately \$13 million due to a refund of taxes paid in 2015 and lower tax payments in 2016 of approximately \$20 million.

2015 Connecticut Legislation: In 2015, the state of Connecticut enacted several changes to its corporate tax laws. Among the changes, commencing as of January 1, 2015, is the reduction in the amount of tax credits that corporations can utilize against its tax liability in a year and a continuation of the corporate income tax surcharge through 2018, which effectively increases the state corporate tax rate to 9 percent for the years 2016 and 2017 and 8.25 percent for 2018. Also, effective January 1, 2016, all Connecticut companies have a mandatory unitary tax filing requirement.

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. The environmental sites are comprised of former manufactured gas plant ("MGP") sites that were operated several decades ago and manufactured gas from coal and other processes, which resulted in certain by-products remaining in the environment that may pose a potential risk to human health and the environment, for which Yankee Gas may have potential liability.

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 liabilities are estimated on an undiscounted basis and do not assume that the 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.

These reserve 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 of Yankee Gas' responsibility for remediation or the extent of remediation required, recently enacted laws and regulations or changes in cost estimates due to certain economic factors. 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.

The amounts recorded as environmental reserves are included in Other Current Liabilities and Other Long-Term Liabilities on the balance sheets and 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 reserves also take into account recurring costs of managing hazardous substances and pollutants, mandated expenditures to remediate contaminated sites and any other infrequent and non-recurring clean-up costs. A reconciliation of the activity in the environmental reserves is as follows:

<i>(Millions of Dollars)</i>	As of December 31,	
	2016	2015
Balance as of Beginning of Year	\$ 26.2	\$ 24.5
Additions	1.0	2.0
Payments/Reductions	(0.8)	(0.3)
Balance as of End of Year	<u>\$ 26.4</u>	<u>\$ 26.2</u>

The Company has 14 environmental sites as of December 31, 2016. As of December 31, 2016, for three of the 14 environmental sites that are included in the Company's reserve for environmental costs, the information known and the nature of the remediation options allow for the Company to estimate the range of losses for environmental costs. As of December 31, 2016, \$12.3 million had been accrued as a liability for these sites, which represents the low end of the range of the liabilities for environmental costs. Management believes that additional losses of up to approximately \$11 million may be incurred in executing current remediation plans for these sites.

As of December 31, 2016, for eight environmental sites that are 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, 2016, \$11.4 million has been accrued as a liability for these sites. As of December 31, 2016, for the remaining three of the 14 environmental sites that are included in the Company's reserve for environmental costs, the \$2.7 million accrual represents management's best estimate of the probable liability and no additional loss is anticipated at this time.

Environmental Rate Recovery: Yankee Gas has a rate recovery mechanism for MGP related environmental costs, therefore, changes in environmental reserves do not impact Net Income. For further information, see Note 2, "Regulatory Accounting," to the financial statements.

B. Long-Term Contractual Arrangements

The estimated future annual costs of Yankee Gas' significant long-term contractual arrangements as of December 31, 2016 are as follows:

<i>(Millions of Dollars)</i>	2017	2018	2019	2020	2021	Thereafter	Total
Natural Gas Procurement	\$ 126.3	\$ 117.3	\$ 89.9	\$ 77.0	\$ 73.8	\$ 513.9	\$ 998.2

In the normal course of business, Yankee Gas has long-term contracts for the purchase, transportation and storage of natural gas as part of its portfolio of supplies. These contracts extend through 2031. The total cost incurred under these agreements was \$152.1 million in 2016 and \$182.1 million in 2015.

C. Litigation and Legal Proceedings

Yankee Gas is 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. The Company records and discloses losses when these losses are probable and reasonably estimable, and discloses matters when losses are probable but not estimable or when losses are reasonably possible. Legal costs related to the defense of loss contingencies are expensed as incurred.

11. LEASES

Yankee Gas has entered into operating lease agreements for the use of data processing and office equipment, vehicles, service centers, and office space. In addition, Yankee Gas incurs costs associated with leases entered into by Eversource Service and The Rocky River Realty Company, which are included below in operating lease rental expense and future minimum rental payments. 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.

Operating lease rental payments charged to expense were \$1.1 million and \$1.0 million for the years ended December 31, 2016 and 2015, respectively.

Future minimum rental payments, excluding executory costs, such as property taxes, state use taxes, insurance, and maintenance, under long-term noncancelable operating leases, as of December 31, 2016 are as follows:

(Millions of Dollars)

2017	\$	0.2
2018		0.1
2019		0.1
2020		0.1
2021		0.1
Thereafter		0.2
Future Minimum Lease Payments	\$	<u>0.8</u>

12. FAIR VALUE OF FINANCIAL INSTRUMENTS

Long-Term Debt: The fair value of Yankee Gas' 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 amount of Yankee Gas' long-term debt was \$443.9 million and \$443.7 million as of December 31, 2016 and 2015, respectively. The estimated fair values of these financial instruments were \$473.4 million and \$473.5 million as of December 31, 2016 and 2015, respectively. These fair values were classified as Level 2 in the fair value hierarchy. See Note 1G, "Summary of Significant Accounting Policies - Fair Value Measurements," for the fair value measurement policy and the fair value hierarchy.

13. ACCUMULATED OTHER COMPREHENSIVE INCOME/(LOSS)

The changes in accumulated other comprehensive income/(loss) by component, net of tax effect, was as follows:

(Millions of Dollars)	As of December 31, 2016			As of December 31, 2015		
	Qualified Cash Flow Hedging Instruments	SERP Plan	Total	Qualified Cash Flow Hedging Instruments	SERP Plan	Total
Balance as of Beginning of Year	\$ (0.7)	\$ (0.3)	\$ (1.0)	\$ (0.8)	\$ (0.3)	\$ (1.1)
OCI Before Reclassifications	—	(0.6)	(0.6)	—	—	—
Amounts Reclassified from AOCL	0.1	0.1	0.2	0.1	—	0.1
Net OCI	0.1	(0.5)	(0.4)	0.1	—	0.1
Balance as of End of Year	\$ (0.6)	\$ (0.8)	\$ (1.4)	\$ (0.7)	\$ (0.3)	\$ (1.0)

Qualified cash flow hedging instruments represent interest rate swap agreements on debt issuances that were settled in prior years. The settlement amount was recorded in Accumulated Other Comprehensive Loss ("AOCL") and is being amortized into Net Income over the term of the underlying debt instrument.

Other Comprehensive Income ("OCI") amounts before reclassifications relate to actuarial gains and losses that arose during the year on the SERP Plan and were recognized in AOCL. The unamortized actuarial gains and losses on the SERP Plan are amortized from AOCL into Operations and Maintenance expense over the average future employee service period, and are reflected in amounts reclassified from AOCL.

As of December 31, 2016, it was estimated that a pre-tax amount of \$0.2 million will be reclassified from AOCL as a decrease to Net Income over the next 12 months as a result of the amortization of interest rate swap agreements, which have been settled and a pre-tax amount of \$0.2 million will be reclassified from AOCL as a decrease to Net Income over the next 12 months as a result of the amortization of SERP costs.

14. COMMON STOCK

Yankee Gas had 1,000 shares of common stock authorized, issued and outstanding at a \$5 per share par value as of December 31, 2016 and 2015.