

**Connecticut Natural Gas Corporation**  
**Financial Statements**  
**For the Years Ended December 31, 2008 and 2007**

# Connecticut Natural Gas Corporation

## Index

	<b>Page(s)</b>
<b>Financial Statements for the Years Ended December 31, 2008 and 2007</b>	
Report of Independent Auditors	
Statements of Income .....	1
Balance Sheets .....	2 – 3
Statements of Cash Flows .....	4
Statements of Changes in Common Stock Equity .....	5
Notes to Financial Statements .....	6 – 20

**Report of Independent Auditors**

To the Shareholder and Board of Directors  
of Connecticut Natural Gas Corporation:

In our opinion, the accompanying balance sheets and the related statements of income, of cash flows and of changes in common stock equity present fairly, in all material respects, the financial position of Connecticut Natural Gas Corporation (a wholly owned subsidiary of Energy East Corporation) at December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the financial statements, effective January 1, 2008, the Company adopted Emerging Issues Tasks Force Issue 06-10, *Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements*.

*PricewaterhouseCoopers LLP*

PricewaterhouseCoopers LLP  
March 19, 2009

**Connecticut Natural Gas Corporation**  
**Statements of Income**

<b>Year Ended December 31,</b>	<b>2008</b>	<b>2007</b>
<b>(Thousands)</b>		
<b>Operating Revenues</b>		
Sales and services	<b>\$464,480</b>	\$405,862
<b>Operating Expenses</b>		
Natural gas purchased	<b>310,434</b>	254,100
Other operating expenses	<b>57,886</b>	47,838
Maintenance	<b>6,134</b>	6,190
Depreciation and amortization	<b>21,898</b>	22,140
Other taxes	<b>25,826</b>	24,650
<b>Total Operating Expenses</b>	<b>422,178</b>	354,918
<b>Operating Income</b>	<b>42,302</b>	50,944
<b>Other (Income)</b>	<b>(2,484)</b>	(1,089)
<b>Other Deductions</b>	<b>1,179</b>	2,563
<b>Interest Charges, Net</b>	<b>12,842</b>	11,900
<b>Income Before Income Taxes</b>	<b>30,765</b>	37,570
<b>Income Taxes</b>	<b>10,999</b>	14,484
<b>Net Income</b>	<b>19,766</b>	23,086
<b>Preferred Stock Dividends</b>	<b>65</b>	52
<b>Earnings Available for Common Stock</b>	<b>\$19,701</b>	\$23,034

The notes on pages 6 through 20 are an integral part of our financial statements.

**Connecticut Natural Gas Corporation  
Balance Sheets**

<b>December 31,</b>	<b>2008</b>	<b>2007</b>
(Thousands)		
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	<b>\$5,023</b>	\$3,131
Accounts receivable and unbilled revenues, net	<b>95,631</b>	88,805
Affiliated accounts receivable	<b>3,202</b>	2,237
Natural gas in storage, at average cost	<b>106,976</b>	67,276
Deferred income taxes	<b>712</b>	583
Prepayments and other current assets	<b>5,258</b>	11,450
<b>Total Current Assets</b>	<b>216,802</b>	173,482
<b>Utility Plant, at Original Cost</b>		
Natural gas	<b>619,460</b>	603,588
Less accumulated depreciation	<b>199,069</b>	191,125
<b>Net Utility Plant in Service</b>	<b>420,391</b>	412,463
Construction work in progress	<b>95</b>	1,802
<b>Total Utility Plant</b>	<b>420,486</b>	414,265
<b>Other Property and Investments, Net</b>	<b>12,081</b>	15,442
<b>Regulatory and Other Assets</b>		
Regulatory assets		
Unfunded future income taxes	<b>6,691</b>	6,076
Deferred income taxes	<b>6,262</b>	23,675
Deferred purchase gas costs	<b>13,442</b>	19,757
Pension and other postretirement benefits	<b>97,962</b>	39,416
Other	<b>32,418</b>	31,898
Total regulatory assets	<b>156,775</b>	120,822
Other assets		
Goodwill	<b>218,630</b>	218,630
Other	<b>4,668</b>	6,583
Total other assets	<b>223,298</b>	225,213
<b>Total Regulatory and Other Assets</b>	<b>380,073</b>	346,035
<b>Total Assets</b>	<b>\$1,029,442</b>	\$949,224

The notes on pages 6 through 20 are an integral part of our financial statements.

**Connecticut Natural Gas Corporation  
Balance Sheets**

<b>December 31,</b>	<b>2008</b>	<b>2007</b>
(Thousands)		
<b>Liabilities</b>		
<b>Current Liabilities</b>		
Current portion of long-term debt	\$-	\$20,000
Notes payable	67,650	29,300
Accounts payable and accrued liabilities	5,681	9,743
Account payable, purchased gas	51,204	47,738
Accounts payable to affiliates	2,825	3,485
Interest accrued	2,689	3,387
Taxes accrued	10,109	-
Other	11,423	7,532
<b>Total Current Liabilities</b>	<b>151,581</b>	<b>121,185</b>
<b>Regulatory and Other Liabilities</b>		
Regulatory liabilities		
Pension and other postretirement benefits	14,262	17,842
Accrued removal obligation	104,548	100,537
Other	29,889	23,349
Total regulatory liabilities	148,699	141,728
Other liabilities		
Deferred income taxes	71,079	100,767
Pension and other postretirement benefits	88,827	26,980
Asset retirement obligation	7,232	7,167
Other	14,855	14,604
Total other liabilities	181,993	149,518
<b>Total Regulatory and Other Liabilities</b>	<b>330,692</b>	<b>291,246</b>
Long-term debt	130,000	130,000
<b>Total Liabilities</b>	<b>612,273</b>	<b>542,431</b>
<b>Commitments and Contingencies</b>		
<b>Preferred Stock</b>		
Preferred stock	750	750
<b>Common Stock Equity</b>		
Common stock (\$3.125 par value, 20,000,000 shares authorized, 10,634,436 shares outstanding for 2008 and 2007)	33,233	33,233
Capital in excess of par value	335,814	335,469
Retained earnings	48,835	37,421
Accumulated other comprehensive (loss)	(1,463)	(80)
<b>Total Common Stock Equity</b>	<b>416,419</b>	<b>406,043</b>
<b>Total Liabilities and Shareholder's Equity</b>	<b>\$1,029,442</b>	<b>\$949,224</b>

The notes on pages 6 through 20 are an integral part of our financial statements.

**Connecticut Natural Gas Corporation**  
**Statements of Cash Flows**

Year Ended December 31,	2008	2007
<b>(Thousands)</b>		
<b>Operating Activities</b>		
Net income	<b>\$19,766</b>	\$23,086
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	<b>22,911</b>	22,891
Amortization of regulatory and other assets and liabilities	<b>(18,275)</b>	(16,626)
Income taxes and investment tax credits deferred, net	<b>(12,104)</b>	9,013
Pension expense	<b>1,144</b>	2,953
Changes in current operating assets and liabilities		
Accounts receivable and unbilled revenues, net	<b>(7,791)</b>	(18,786)
Materials and supplies	<b>(39,772)</b>	6,856
Prepayments and other current assets	<b>(493)</b>	2,917
Accounts payable and accrued liabilities	<b>(1,258)</b>	6,112
Interest accrued	<b>(698)</b>	(70)
Taxes accrued	<b>16,599</b>	(16,581)
Other current liabilities	<b>2,641</b>	(315)
Pension contributions	-	(3,000)
Other assets	<b>(702)</b>	(5,519)
Changes in other liabilities		
Non-firm margin sharing	<b>20,444</b>	13,738
Other	<b>10,609</b>	2,368
<b>Net Cash Provided by Operating Activities</b>	<b>13,021</b>	29,037
<b>Investing Activities</b>		
Utility plant additions	<b>(25,051)</b>	(29,562)
Investments, net	<b>1,637</b>	80
<b>Net Cash Used in Investing Activities</b>	<b>(23,414)</b>	(29,482)
<b>Financing Activities</b>		
Long-term note issuance	-	20,000
Long-term note repayments	<b>(20,000)</b>	(19,000)
Notes payable	<b>38,350</b>	9,300
Dividends on common and preferred stocks	<b>(6,065)</b>	(15,052)
<b>Net Cash Provided by (Used in) Financing Activities</b>	<b>12,285</b>	(4,752)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>1,892</b>	(5,197)
<b>Cash and Cash Equivalents, Beginning of Year</b>	<b>3,131</b>	8,328
<b>Cash and Cash Equivalents, End of Year</b>	<b>\$5,023</b>	\$3,131

The notes on pages 6 through 20 are an integral part of our financial statements.

**Connecticut Natural Gas Corporation**  
**Statements of Changes in Common Stock Equity**

(Thousands, except per share amounts)	Common Stock Outstanding \$3.125 Par Value		Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive (Loss)	Total
	Shares	Amount				
<b>Balance, January 1, 2007</b>	10,634,436	\$33,233	\$335,286	\$29,387	\$(766)	\$397,140
Net income				23,086		23,086
Other comprehensive income, net of tax					686	686
Comprehensive income						23,772
Dividends – common stock				(15,000)		(15,000)
Dividends – preferred stock				(52)		(52)
Equity contributions from parent			183			183
<b>Balance, December 31, 2007</b>	10,634,436	33,233	335,469	37,421	(80)	406,043
Net income				19,766		19,766
Other comprehensive loss, net of tax					(1,383)	(1,383)
Comprehensive income						18,383
Adjustment to initially apply EITF 06-10				(2,287)		(2,287)
Dividends – common stock				(6,000)		(6,000)
Dividends – preferred stock				(65)		(65)
Equity contributions from parent			345			345
<b>Balance, December 31, 2008</b>	10,634,436	\$33,233	\$335,814	\$48,835	\$(1,463)	\$416,419

The notes on pages 6 through 20 are an integral part of our financial statements.

## Notes to Financial Statements

### Connecticut Natural Gas Corporation

#### Note 1. Significant Accounting Policies

**Background:** Connecticut Natural Gas Corporation (CNG, the company, we, our, us) conducts natural gas transportation and distribution operations in Connecticut serving approximately 155,000 customers in its service territory of approximately 575 square miles with a population of approximately 706,000, principally in the greater Hartford-New Britain area and Greenwich.

CNG is the principal operating utility of CTG Resources, Inc., a wholly-owned subsidiary of Energy East Corporation (Energy East). CNG operates under the authority of the Connecticut Department of Public Utility Control (DPUC) in Connecticut and is also subject to regulation by the Federal Energy Regulatory Commission (FERC).

Effective September 16, 2008, Energy East became a wholly-owned subsidiary of Iberdrola, S.A. (Iberdrola), a corporation organized under the laws of the Kingdom of Spain. The merger provided for a business combination whereby Energy East and its subsidiaries, including CNG, became wholly-owned subsidiaries of Iberdrola. The merger was completed through the acquisition by a subsidiary of Iberdrola, of all the outstanding common stock of Energy East. The effects of the merger required for accounting purposes, including any allocation of goodwill, were not pushed down to CNG. The accompanying financial statements have not been adjusted to reflect Iberdrola's basis in Energy East, or its subsidiaries, including CNG.

**Accounts receivable:** Accounts receivable at December 31 include unbilled revenues of \$33 million for 2008 and \$31 million for 2007, net of an allowance for doubtful accounts at December 31 of \$6 million for 2008 and \$5 million for 2007. Accounts receivable do not bear interest, although late fees may be assessed. Bad debt expense was \$14 million in 2008 and \$7 million in 2007.

Unbilled revenues represent estimates of receivables for energy provided but not yet billed. The estimates are determined based on various assumptions, such as current month energy load requirements, billing rates by customer classification and delivery loss factors. Changes in those assumptions could significantly affect the estimates of unbilled revenues.

The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in our existing accounts receivable, determined based on experience for each service region and operating segment and other economic data. Each month we review our allowance for doubtful accounts and past due accounts over 90 days and/or above a specified amount, and review all other balances on a pooled basis by age and type of receivable. When we believe that a receivable will not be recovered, we charge off the account balance against the allowance. Changes in assumptions about input factors such as economic conditions and customer receivables, which are inherently uncertain and susceptible to change from period to period, could significantly affect the allowance for doubtful accounts estimates.

**Asset retirement obligations:** We record the fair value of the liability for an asset retirement obligation (ARO) and/or a conditional ARO in the period in which it is incurred and capitalize the cost by increasing the carrying amount of the related long-lived asset. We adjust the liability to its present value periodically over time, and depreciate the capitalized cost over the useful life of the related asset. Upon settlement we will either settle the obligation at its recorded amount or incur a gain or a loss. We defer any timing differences between rate recovery and depreciation expense as either a regulatory asset or a regulatory liability.

## Notes to Financial Statements

### Connecticut Natural Gas Corporation

The term conditional ARO refers to an entity's legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. If an entity has sufficient information to reasonably estimate the fair value of the liability for a conditional ARO, it must recognize that liability at the time the liability is incurred.

Our ARO including our estimated conditional asset retirement obligation at December 31 was \$7 million for 2008 and 2007. The ARO consists primarily of obligations related to removal or retirement of: asbestos, polychlorinated biphenyl (PCB) contaminated equipment, gas pipeline and cast iron gas mains. The long-lived assets associated with our AROs are generation property, gas storage property, distribution property and other property.

We meet the requirements of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation* (Statement 71), and recognize a regulatory liability, for financial reporting purposes only, for the difference between removal costs collected in rates and actual costs incurred. We classify those amounts as accrued removal obligations.

**Statements of cash flows:** We consider all highly liquid investments with a maturity date of three months or less when acquired to be cash equivalents and those investments are included in cash and cash equivalents.

<b>Supplemental Disclosure of Cash Flows Information</b>	<b>2008</b>	<b>2007</b>
(Thousands)		
Cash paid during the year ended December 31:		
Interest, net of amounts capitalized	<b>\$11,799</b>	\$11,302
Income taxes, net of benefits received	<b>\$8,743</b>	\$20,698

**Depreciation and amortization:** We determine depreciation expense using the straight-line method, based on the average service lives of groups of depreciable property, which include estimated cost of removal. The weighted-average service lives of certain classifications of property are: production property – 29 years, storage – 32 years, distribution property – 50 years, and other property – 26 years. Our depreciation accruals were equivalent to 3.7% of average depreciable property for 2008 and 3.8% for 2007.

We charge repairs and minor replacements to operating expense, and capitalize renewals and betterments, including certain indirect costs. We charge the original cost of utility plant retired or otherwise disposed of to accumulated depreciation.

**EITF 06-10:** Effective January 1, 2008, we began applying the consensus in Emerging Issues Task Force (EITF) Issue No. 06-10, "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements" (EITF 06-10), which the FASB ratified in late March 2007. EITF 06-10 requires an employer to recognize a liability for a postretirement benefit related to a collateral assignment split-dollar life insurance arrangement. In a collateral assignment split-dollar life insurance arrangement, the employee, versus the employer, owns and controls the insurance policy. EITF 06-10 also requires an employer to recognize and measure an asset based on the nature and substance of the collateral assignment split-dollar life insurance arrangement. Entities should recognize the effects of applying the consensus through either (1) a change in accounting principle through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption or (2) a change in accounting principle through retrospective application to all prior periods. We elected to recognize the effects of applying the consensus as a change in accounting principle through a cumulative-effect adjustment that resulted in a decrease in retained earnings of \$2.3 million. Our application of EITF 06-10 did not affect results of operation or cash flows.

## Notes to Financial Statements

### Connecticut Natural Gas Corporation

**FSP FAS 132(R)-1:** In December 2008 the FASB issued FASB Staff Position (FSP) FAS 132(R)-1, "Employers' Disclosures about Postretirement Benefit Plan Assets," which amends FASB Statement No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits* (Statement 132(R)), to improve disclosures about postretirement benefit plan assets. FSP FAS 132(R)-1 applies to employers that are subject to the disclosure requirements of Statement 132(R). The FSP requires the disclosures about plan assets to be provided for fiscal years ending after December 15, 2009. We expect that our initial application of FSP FAS 132(R)-1 for the fiscal year ending December 31, 2009, will have no effect on our financial position, results of operation and cash flows.

**Goodwill:** We record the excess of the cost over the fair value of net assets of purchased businesses as goodwill. We evaluate the carrying value of goodwill for impairment at least annually and on an interim basis if there are indications that goodwill might be impaired. We may recognize an impairment if the fair value of goodwill is less than its carrying value. (See Note 2.)

#### **Other (Income) and Other Deductions:**

<b>Year Ended December 31,</b>	<b>2008</b>	<b>2007</b>
<b>(Thousands)</b>		
Interest and dividend income	<b>\$(1,084)</b>	\$(1,018)
Carrying cost	<b>(927)</b>	(71)
Miscellaneous	<b>(473)</b>	-
<b>Total other (income)</b>	<b>\$(2,484)</b>	\$(1,089)
Civic donations	<b>\$327</b>	\$149
Losses on energy risk contracts	<b>620</b>	2,402
Miscellaneous	<b>232</b>	12
<b>Total other deductions</b>	<b>\$1,179</b>	\$2,563

**Regulatory assets and liabilities:** We currently meet the criteria of Statement 71 for our regulated natural gas operations in Connecticut; however, we cannot predict what effect the competitive market or future actions of regulatory entities would have on our ability to continue to do so. If we no longer met the criteria of Statement 71 for all or a separable part of our regulated operations, we may have to record certain regulatory assets and regulatory liabilities as an expense or as revenue, or include them in accumulated other comprehensive income.

Pursuant to Statement 71, we capitalize, as regulatory assets, incurred and accrued costs that are probable of recovery in future natural gas rates. Substantially all regulatory assets for which funds have been expended are either included in rate base or are accruing carrying costs. We also record, as regulatory liabilities, obligations to refund previously collected revenue or to spend revenue collected from customers on future costs.

Unfunded future income taxes and deferred income taxes are amortized as the related temporary differences reverse. Other regulatory assets and other regulatory liabilities are amortized over various periods in accordance with our current rate plans. Amortization of total regulatory liabilities, net of amortization of total regulatory assets, was \$19 million as of December 31, 2008 and \$17 million as of December 31, 2007.

## Notes to Financial Statements

### Connecticut Natural Gas Corporation

At December 31, 2008 and 2007, Other regulatory assets and liabilities consisted of:

	2008	2007
(Thousands)		
<b>Other regulatory assets</b>		
Postretirement cost	\$9,810	\$10,781
Low-income program	13,244	12,620
Other	9,364	8,497
<b>Total other regulatory assets</b>	<b>\$32,418</b>	<b>\$31,898</b>
<b>Other regulatory liabilities</b>		
Non-firm margin sharing	\$14,163	\$7,106
Asset retirement obligation	4,880	4,406
Pension	3,858	1,929
Other	6,988	9,908
<b>Total other regulatory liabilities</b>	<b>\$29,889</b>	<b>\$23,349</b>

**Regulatory proceedings:** In June 2008 CNG filed its monthly financial report with the DPUC showing that it exceeded its allowed return on equity by more than 100 basis points for the sixth consecutive monthly period. As a result, the DPUC initiated an overearnings investigation. On August 6, 2008, the DPUC issued a decision ordering CNG to implement an interim rate credit of \$15 million effective August 6, 2008. The interim rate credit is subject to a surcharge. The company has appealed the DPUC's imposition of the rate credit. In addition to the rate credit, the DPUC ordered CNG to file a rate case.

On January 16, 2009, CNG filed an application for a delivery rate increase of \$16.2 million or approximately 4.4% over the revenues produced from its existing rate schedules. The company anticipates a ruling on its requested increase by July 2009.

**Related party transactions:** Utility Shared Services Corporation and Energy East Management Corporation provide various administrative and management services to Energy East's operating utilities, including CNG, pursuant to service agreements. The cost of those services is allocated in accordance with methodologies set forth in the service agreements. The cost allocation methodologies vary depending on the type of service provided. Management believes such allocations are reasonable. The cost for services provided to CNG by Utility Shared Services Corporation and Energy East Management Corporation was approximately \$11 million in 2008 and \$9 million in 2007.

**Revenue recognition:** We recognize revenues upon delivery of gas and gas-related products and services to our customers. Regulated gas operations revenues are based on rates authorized by the DPUC. We are required to provide natural gas service to residential customers within our defined service territory and are precluded by Connecticut state law from discontinuing service to hardship residential customers during a winter moratorium period (November – April).

**Risk management:** The financial instruments we hold or issue are not for trading or speculative purposes.

We have a purchased gas adjustment clause that allow us to recover through rates any changes in the market price of purchased natural gas, substantially eliminating our exposure to natural gas price risk.

To provide financial protection from declining natural gas sales revenues due to warmer than normal winter temperatures, CNG entered into a weather derivative contract for the winter period

## Notes to Financial Statements

### Connecticut Natural Gas Corporation

November 1, 2008 through April 30, 2009. The structure of the derivative contract allows for CNG to receive or requires CNG to make payments in May 2009 based on the actual Heating Degree Day variance from the purchased put option strike level and/or the written call option strike level. If the actual Heating Degree Days for the November 1, 2008 through April 30, 2009 time period are less than the put option strike level (i.e. warmer than normal temperatures), CNG will receive payment. If the actual Heating Degree Days for the November 1, 2008 through April 30, 2009 time period are more than the call option strike level (i.e. colder than normal temperatures), CNG will make payment. The value of the derivative is carried as a derivative asset on the financial books of record with changes in the value of the derivative asset recorded to the income statement as Other Income/Other Deductions. As of December 31, 2008, derivative assets and liabilities each totaled \$0.3 million.

**Statement 157:** In September 2006 the FASB issued Statement No. 157, *Fair Value Measurements*, which we adopted effective January 1, 2008, for financial assets and financial liabilities. Changes that result from the application of Statement 157 relate to the definition of fair value, the methods used to measure fair value, and expanded disclosures about fair value measurements. Statement 157 applies under other accounting pronouncements that require or permit fair value measurements in which the FASB previously concluded that fair value is the relevant measurement attribute, but does not require any new fair value measurements. Our adoption of Statement 157 and related FSPs had no effect on our financial position, results of operation or cash flows.

The FASB issued FSP FAS 157-2 in February 2008. FSP FAS 157-2 delays the effective date of Statement 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in an entity's financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. Nonfinancial assets and nonfinancial liabilities include all assets and liabilities other than those that meet the definition of a financial asset or financial liability as defined in paragraph 6 of FASB Statement No. 159. FSP FAS 157-2 also requires additional disclosures concerning application of the provisions of Statement 157. FSP FAS 157-2 was effective upon issuance.

**Statement 161:** In March 2008 the FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133*, which requires enhanced disclosures about an entity's derivative instruments and hedging activities to enable investors to better understand their effects on the entity's financial position, financial performance and cash flows. It is intended to improve transparency about the location and amounts of derivative instruments in the financial statements and how the entity accounts for derivative instruments and related hedged items. Requirements include: disclosure of fair values of derivative instruments and their gains and losses in a tabular format, disclosure of derivative features that are credit risk-related, and cross-referencing within the notes to enable financial statement users to locate important information about derivative instruments. Statement 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Disclosures for earlier periods presented for comparative purposes are encouraged but not required at initial adoption. In years after initial adoption, comparative disclosures are required only for periods subsequent to initial adoption. Our adoption of Statement 161 effective January 1, 2009, did not affect our financial position, results of operation or cash flows.

**Taxes:** We compute our income tax provision on a separate return method. The determination and allocation of our income tax provision and its components are outlined and agreed to in our tax sharing agreement with Energy East.

## Notes to Financial Statements

### Connecticut Natural Gas Corporation

Deferred income taxes reflect the effect of temporary differences between the amount of assets and liabilities recognized for financial reporting purposes and the amount recognized for tax purposes. We amortize investment tax credits (ITCs) over the estimated lives of the related assets.

We account for sales tax collected from customers and remitted to taxing authorities on a net basis.

We classify all interest and penalties related to uncertain tax positions as income tax expense.

**Use of Estimates and Assumptions:** The preparation of our financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Significant estimates and assumptions are used for, but not limited to: (1) allowance for doubtful accounts; (2) asset impairments, including goodwill; (3) depreciable lives of assets; (4) income tax valuation allowances; (5) uncertain tax positions; (6) reserves for professional, workers' compensation, and comprehensive general insurance liability risks; (7) contingency and litigation reserves; and (8) environmental remediation liability. Future events and their effects cannot be predicted with certainty; accordingly, our accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of our financial statements will change as new events occur, as more experience is acquired, as additional information is obtained, and as our operating environment changes. We evaluate and update our assumptions and estimates on an ongoing basis and may employ outside experts to assist in our evaluation, as considered necessary. Actual results could differ from those estimates.

#### Note 2. Goodwill

We do not amortize goodwill, but test it for impairment at least annually. Impairment testing includes various assumptions, primarily the discount rate, which is based on an estimate of our marginal, weighted-average cost of capital, and forecasted cash flows. We test the reasonableness of the conclusions of our impairment testing using a range of discount rates and a range of assumptions for long-term cash flows. We had no impairment of goodwill in 2008 and 2007, and no impairment was indicated within any of the ranges of assumptions analyzed.

The carrying amount of goodwill was \$219 million at December 31, 2008 and 2007. Goodwill has not been adjusted to reflect the purchase of Energy East by Iberdrola and its subsidiaries, including CNG.

#### Note 3. Income Taxes

<b>Year Ended December 31,</b>	<b>2008</b>	<b>2007</b>
<b>(Thousands)</b>		
Current		
Federal	<b>\$19,405</b>	\$5,410
State	<b>3,697</b>	61
Current taxes charged to expense	<b>23,102</b>	5,471
Deferred		
Federal	<b>(9,115)</b>	7,363
State	<b>(2,767)</b>	1,871
Deferred taxes charged to expense	<b>(11,882)</b>	9,234
Investment tax credits	<b>(221)</b>	(221)
<b>Total</b>	<b>\$10,999</b>	\$14,484

## Notes to Financial Statements

### Connecticut Natural Gas Corporation

The significant increase in current income tax expense in 2008 as compared to 2007 is driven primarily by the impact of the differences in the 2007 filed tax return compared to the booked current tax expense offset by the impact of the 50% bonus depreciation on federal taxable income in 2008. The significant decrease in deferred income tax expense in 2008 as compared to 2007 is due primarily to the differences in the 2007 filed tax return compared to the booked deferred tax expense offset by the recording of a deferred tax liability related to the impact of 50% bonus depreciation on federal deferred income taxes.

Our tax expense differed from the expense at the statutory rate of 35% due to the following:

<b>Year Ended December 31,</b>	<b>2008</b>	<b>2007</b>
<b>(Thousands)</b>		
Tax expense at statutory rate	<b>\$10,768</b>	\$13,149
Depreciation and amortization not normalized	<b>790</b>	962
Investment tax credits	<b>(221)</b>	(221)
Removal costs	<b>(588)</b>	(759)
Medicare subsidy	<b>(136)</b>	(129)
Out of period adjustments	<b>(690)</b>	41
State taxes, net of federal benefit	<b>605</b>	1,256
Other, net	<b>471</b>	185
<b>Total</b>	<b>\$10,999</b>	14,484

Income taxes were \$0.2 million more than what it would have been at the federal statutory rate of 35% in 2008 and \$1.3 million more in 2007. The effective tax rate was 36% in 2008 and 39% in 2007. The decrease in the effective tax rate in 2008 is due primarily to the impacts of recurring flow-through items, differences in the 2007 filed tax return compared to the 2007 booked tax expense, primarily due to book depreciation, inventory adjustments and state tax credits and the favorable resolution of federal tax audits.

Our deferred tax assets and liabilities consisted of:

<b>December 31,</b>	<b>2008</b>	<b>2007</b>
<b>(Thousands)</b>		
<b>Current Deferred Income Tax Assets (Liabilities)</b>		
Derivative (liabilities)	<b>\$(2)</b>	\$(208)
Other	<b>714</b>	791
<b>Total Current Deferred Income Tax Assets</b>	<b>\$712</b>	\$583
<b>Noncurrent Deferred Income Tax Liabilities (Assets)</b>		
Property related	<b>\$65,983</b>	\$64,135
Unfunded future income taxes	<b>2,668</b>	2,423
Accumulated deferred investment tax credits	<b>501</b>	906
Pension	<b>2,967</b>	3,695
Statement 106 postretirement benefits	<b>(5,075)</b>	(3,072)
Deferred natural gas costs	<b>(4,062)</b>	5,117
Nonfirm margin sharing	<b>(5,647)</b>	(2,833)
Other	<b>7,482</b>	6,721
<b>Total Noncurrent Deferred Income Tax Liabilities</b>	<b>64,817</b>	77,092
Less amounts classified as regulatory assets		
Deferred income taxes	<b>(6,262)</b>	(23,675)
<b>Noncurrent Deferred Income Tax Liabilities</b>	<b>\$71,079</b>	\$100,767
Deferred tax assets	<b>\$8,016</b>	\$3,863
Deferred tax liabilities	<b>72,121</b>	80,373
<b>Net Accumulated Deferred Income Tax Liabilities</b>	<b>\$64,105</b>	\$76,510

## Notes to Financial Statements

### Connecticut Natural Gas Corporation

We have no federal tax credit or loss carryforwards and no valuation allowances. There were no total gross unrecognized tax benefits during the year ended December 31, 2008.

We have been audited through 2005 for federal income taxes. The statute of limitations in Connecticut has expired for all years through 2004. Our federal returns for 2006 and 2007 are currently under review. We anticipate that the reviews will be completed by June 30, 2010. We cannot predict the ultimate outcome of the reviews.

#### Note 4. Long-term Debt

At December 31, 2008 and 2007, our long-term debt was:

	Interest Rates	Maturity	Amount (Thousands)	
			2008	2007
<b>Medium Term Note</b>				
Medium Term Note Series A	6.85% - 9.10%	2012 - 2017	<b>\$55,000</b>	\$55,000
Medium Term Note Series B	8.12% - 8.49%	2014 - 2024	<b>10,000</b>	30,000
Medium Term Note Series C	5.63% - 6.66%	2035 - 2037	<b>65,000</b>	65,000
Total medium-term note			<b>130,000</b>	150,000
Less debt due within one year, included in current liabilities			-	20,000
<b>Total</b>			<b>\$130,000</b>	\$130,000

We have no intercompany collateralizations and have no guarantees to affiliates or subsidiaries. None of CNG's debt obligations are guaranteed or secured by its parent or affiliates.

At December 31, 2008, other long-term debt, including sinking fund obligations (in thousands) that will become due during the next five years is:

2009	2010	2011	2012	2013
-	-	-	\$5,000	\$20,000

#### Note 5. Bank Loans and Other Borrowings

We participate in a joint borrowing with the other operating utilities under Energy East in a revolving credit facility providing individual maximum borrowings of up to \$70 million. We pay a facility fee of 6 basis points annually on our current revolver sublimit.

We draw on our credit facilities to finance working capital needs, to temporarily finance certain refunding and for other corporate purposes. We had \$68 million of short term debt outstanding at December 31, 2008 and \$29 million at December 31, 2007. The weighted-average interest rate on short-term debt was 0.7% at December 31, 2008, and 4.8% at December 31, 2007. At March 13, 2009, we had \$2 million of such debt outstanding.

In our revolving credit facility, we covenant not to permit, without the consent of the lender, our ratio of total indebtedness to total capitalization to exceed 0.65 to 1.00 at any time. The facility contains various other covenants, including a restriction on the amount of secured indebtedness Energy East may maintain. Continued unremedied failure to comply with those covenants for 5 days after written notice of such failure from the lender constitutes an event of default and would result in acceleration of maturity. At December 31, 2008, our ratio of total indebtedness to total capitalization pursuant to the revolving credit facility was 0.32 to 1.00. We were not in default as of December 31, 2008.

## Notes to Financial Statements

### Connecticut Natural Gas Corporation

We also have an intercompany borrowing agreement with Energy East which provides financing of up to \$100 million. Under the terms of this agreement, which expires in October 2009, we pay the same rate as under Energy East's credit facility. As of March 13, 2009 we had no amount outstanding under this agreement. Energy East obtains funding for its own short-term needs and for the temporary needs of its subsidiaries through a separate credit facility providing maximum borrowings of up to \$300 million. This credit facility expires in 2012 and requires a fee on undrawn borrowings of 10 basis points. As of December 31, 2008, Energy East had borrowed \$179 million of the \$300 million available under this facility.

In its revolving credit facility, Energy East covenants not to permit, without the consent of the lender, its ratio of consolidated indebtedness to consolidated total capitalization to exceed 0.65 to 1.00 at any time. The facility contains various other covenants, including a restriction on the amount of secured indebtedness Energy East may maintain. Continued unremedied failure to comply with those covenants for 15 days after written notice of such failure from the lender constitutes an event of default and would result in acceleration of maturity. Energy East's ratio of consolidated indebtedness to consolidated total capitalization pursuant to the revolving credit facility was 0.59 to 1.00 at December 31, 2008. Energy East was not in default as of December 31, 2008.

#### **Note 6. Preferred Stock Redeemable Solely at the Option of the Company**

At December 31, 2008 and 2007, our cumulative preferred stock was:

Series	Par Value Per Share	Redemption Price Per Share	Shares Authorized And Outstanding	Amount (Thousands)	
				2008	2007
6.00%	\$100	\$110.00	4,104	\$411	\$411
8.00% Noncallable	3.125	-	108,706	339	339
<b>Total</b>				<b>\$750</b>	<b>\$750</b>

At December 31, 2008 we had 775,609 shares of \$3.125 par value preferred stock and 9,994,989 shares of \$100 par value preferred stock authorized but unissued.

#### **Note 7. Commitments and Contingencies**

**Capital spending:** We have no material commitments in connection with our capital spending program in 2009. Capital spending is expected to be paid for principally with funds generated from debt financing and equity infusion. We plan to invest approximately \$130 million in our energy delivery infrastructure during the next five years. The program is subject to periodic review and revision. Our capital spending will be principally for necessary improvements to existing facilities, the extension of energy delivery service, compliance with environmental requirements and governmental mandates and an Infrastructure Replacement Program.

**CNG Billing Issue:** In early February 2008 the DPUC opened an investigation regarding CNG's billing of certain customers during January 2008. Four of CNG's meter readers had intermittently and inappropriately approximated gas consumption for an estimated 3,000 customers during November and December 2007. These approximations were half of the actual usage by the customers. This led to lower bills to the customers during November and December than actual usage would have produced. When the actual readings were made in January 2008, the unbilled usage was included in customer's bills, resulting in higher bills than January usage would have produced. Connecticut's Attorney General has stated that CNG violated Connecticut law by erroneously billing customers in January 2008 for the full amount of the underbilling, \$1.3 million, rather than prorating the amount over a number of months as Connecticut law requires. The Department issued a final decision on September 24, 2008 which allowed CNG to recover the

## Notes to Financial Statements

### Connecticut Natural Gas Corporation

underbilled amounts over a period of no less than 12 months and ordered CNG to make a charitable contribution to Operation Fuel in the amount of \$150,000. CNG recorded the \$150,000 as other deductions.

The Office of Consumer Counsel (OCC) has appealed the decision to the Connecticut Superior court. The OCC believes that this section of the statute further limits the timeframe within which a utility can collect underbilled amounts from a customer. While the appeal was still pending, CNG filed a Motion to dismiss the Appeal based on the fact that the underlying case was not contested and no rights of appeal exist. The appeal is pending and CNG cannot predict the timing of the resolution of the motion. We believe that it is probable that we will collect the \$1.3 million underbilling from customers and the company has recognized a receivable.

***Kenard Little v. CNG, et. al.*** On December 5, 2003, a firefighter was allegedly injured while fighting a gas-fed fire which resulted from a snow plow hitting a gas meter and regulator while plowing an alley way. The Plaintiff has been allowed to amend his complaint to add a count for corporate recklessness against CNG which could subject it to punitive damages, not covered by insurance. The Plaintiff filed an offer of judgment for \$3 million. While CNG is defending the matter, it does not expect to be subject to punitive damages and cannot predict the timing of its outcome.

#### **Note 8. Fair Value of Financial Instruments and Fair Value Measurements**

The carrying amounts and estimated fair values of our financial instruments are shown in the following table.

December 31,	2008		2007	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
(Thousands)				
Various medium term notes	\$130,000	\$124,972	\$150,000	\$158,227

The carrying amounts for cash and cash equivalents, accounts receivable, and notes payable approximate their estimated fair values.

We value our medium term notes, by assigning a market-based yield for each security and then deriving the price from the yield. Market-based yields are determined by observing secondary market trading levels for debt of similar maturity, rating, tax and structural characteristics.

#### **Assets and Liabilities Measured at Fair Value on a Recurring Basis**

Description	Total	Fair Value Measurements at December 31, 2008, Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(Thousands)				
<b>Assets</b>				
Noncurrent investments available for sale	\$12,081	\$12,081	-	-
Derivatives	316	-	-	\$316
Total	\$12,397	\$12,081	-	\$316
<b>Liabilities</b>				
Derivatives	\$310	-	-	\$310
Total	\$310	-	-	\$310

## Notes to Financial Statements

### Connecticut Natural Gas Corporation

Valuation techniques: We measure our fair value of our noncurrent investments available for sale using quoted market prices in active markets for identical assets and includes the measurements in Level 1. The investments consist of a money market fund.

Fleet fuel derivatives are placed in the level 3 category in the fair value hierarchy due to the fact that a proprietary calculation (unobservable to the market) is used to arrive at the valuation.

In accordance with the provisions of FASB Statement No. 133, the fair value of fleet fuel derivative contracts is determined by comparing the initial cost of the derivative contracts to the exchange-based settlement price as described in New York Mercantile Exchange Rulebook Chapter 6 Section 6.51(a) adjusted by a calculated rolling 3-year locational basis derived from actual company purchases of fleet fuel within a particular fleet fueling location.

#### Note 9. Accumulated Other Comprehensive Income (Loss)

	Balance January 1, 2007	2007 Change	Balance December 31, 2007	2008 Change	Balance December 31, 2008
<b>(Thousands)</b>					
Net unrealized gains (losses) on investments net of income tax (expense) benefit of \$(276) for 2007 and \$790 for 2008	\$346	\$416	\$762	\$(1,192)	\$(430)
Amortization of pension cost for nonqualified plans, net of income tax (expense) of \$(132) for 2007 and \$(19) for 2008	(1,075)	199	(876)	29	(847)
Unrealized gains (losses) on derivatives qualified as hedges, net of income tax (expense) benefit of \$(25) for 2007 and \$155 for 2008		39		(234)	
Reclassification adjustment for losses included in net income, net of income tax (benefit) of \$(21) for 2007 and \$(9) for 2008		32		14	
Net unrealized (losses) gains on derivatives qualified as hedges <sup>(1)</sup>	(37)	71	34	(220)	(186)
<b>Accumulated Other Comprehensive (Loss) Income</b>	<b>\$(766)</b>	<b>\$686</b>	<b>\$(80)</b>	<b>\$(1,383)</b>	<b>\$(1,463)</b>

<sup>(1)</sup> See Risk management in Note 1.

## Notes to Financial Statements

### Connecticut Natural Gas Corporation

#### Note 10. Retirement Benefits

We have funded noncontributory defined benefit pension plans that cover substantially all of our employees. The plans provide defined benefits based on years of service and final average salary. We also have a postretirement health care benefit plan covering substantially all of our employees. The health care plan is contributory with participants' contributions adjusted annually.

Obligations and funded status:	Pension Benefits		Postretirement Benefits	
	2008	2007	2008	2007
<b>(Thousands)</b>				
<b>Change in benefit obligation</b>				
Benefit obligation at January 1	\$172,687	\$176,577	\$31,859	\$32,616
Service cost	3,053	3,227	336	369
Interest cost	10,295	9,917	1,873	1,833
Plan participants' contributions	-	-	982	613
Plan amendments	2	1	32	-
Actuarial (gain)	(289)	(9,283)	(951)	(1,005)
Benefits paid	(7,995)	(7,752)	(3,395)	(2,787)
Federal Subsidy on benefits paid	-	-	217	220
Benefit obligation at December 31	\$177,753	\$172,687	\$30,953	\$31,859
<b>Change in plan assets</b>				
Fair value of plan assets at January 1	\$165,792	\$157,589	\$11,775	\$9,769
Actual return on plan assets	(46,629)	12,955	(728)	745
Contributions	-	3,000	-	3,400
Plan participants contributions	-	-	981	613
Benefits paid	(7,995)	(7,752)	(3,317)	(2,752)
Fair value of plan assets at December 31	\$111,168	\$165,792	\$8,711	\$11,775
Funded status at December 31	\$(66,585)	\$(6,895)	\$(22,242)	\$(20,084)
<b>Amounts recognized on the balance sheet</b>				
<b>December 31,</b>	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Noncurrent Liabilities	\$(66,585)	\$(6,895)	\$(22,242)	\$(20,084)

We have determined that we are allowed to defer as regulatory assets or regulatory liabilities items that would otherwise be recorded in accumulated other comprehensive income pursuant to FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)*. Amounts recognized as regulatory assets or regulatory liabilities consist of:

December 31,	Pension Benefits		Postretirement Benefits	
	2008	2007	2008	2007
<b>(Thousands)</b>				
Net loss (gain)	\$97,194	\$38,470	\$(1,137)	\$(1,586)
Prior service cost (credit)	\$768	\$946	\$(105)	\$(65)

Our accumulated benefit obligation for all defined benefit pension plans at December 31 was \$162 million for 2008 and \$157 million for 2007.

Our postretirement benefits were partially funded at December 31, 2008 and 2007.

The accumulated benefit obligation and projected benefit obligation exceeded the fair value of plan assets of all of the pension plans at December 31, 2008. The fair value of pension plan assets exceeded the accumulated benefit obligation for all plans, and the projected benefit obligation for one of the plans at December 31, 2007. The following table shows the aggregate

## Notes to Financial Statements

### Connecticut Natural Gas Corporation

projected and accumulated benefit obligations and the fair value of plan assets for the underfunded pension plans.

<b>December 31</b>	<b>2008</b>	<b>2007</b>
<b>(Thousands)</b>		
Projected benefit obligation	<b>\$177,753</b>	\$172,687
Accumulated benefit obligation	<b>\$162,039</b>	\$156,748
Fair value of plan assets	<b>\$111,168</b>	\$165,792

#### **Components of net periodic benefit cost and other amounts recognized in regulatory assets and regulatory liabilities:**

<b>Years ended December 31,</b>	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>(Thousands)</b>				
<b>Net periodic benefit cost</b>				
Service cost	<b>\$3,053</b>	\$3,227	<b>\$336</b>	\$369
Interest cost	<b>10,295</b>	9,917	<b>1,873</b>	1,832
Expected return on plan assets	<b>(13,935)</b>	(13,223)	<b>(644)</b>	(727)
Amortization of prior service cost	<b>180</b>	252	<b>72</b>	64
Amortization of net loss (gain)	<b>1,551</b>	2,780	<b>(28)</b>	-
Net periodic benefit cost	<b>\$1,144</b>	\$2,953	<b>\$1,609</b>	\$1,538
<b>Other changes in plan assets and benefit obligations recognized in regulatory assets and regulatory liabilities</b>				
Net loss (gain)	<b>\$60,275</b>	\$(9,013)	<b>\$421</b>	\$(1,022)
Amortization of net (loss) gain	<b>(1,551)</b>	(2,780)	<b>28</b>	-
Prior service cost	<b>2</b>	-	<b>33</b>	-
Amortization of prior service (cost)	<b>(180)</b>	(252)	<b>(72)</b>	(64)
Total recognized in regulatory assets (liabilities)	<b>\$58,546</b>	\$(12,045)	<b>\$410</b>	\$(1,086)
Total recognized in net periodic benefit cost and regulatory assets (liabilities)	<b>\$59,690</b>	\$(9,092)	<b>\$2,019</b>	\$452

We include the net periodic benefit cost in other operating expenses. The net periodic benefit cost for postretirement benefits represents the amount expensed for providing health care benefits to retirees and their eligible dependents. The amount of postretirement benefit cost deferred at December 31 was \$10 million for 2008, and \$12 million for 2007. We expect to recover any deferred postretirement costs by 2012. We are amortizing over 20 years the transition obligation for postretirement benefits that resulted from the adoption of FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*.

#### **Amounts expected to be amortized from regulatory assets or regulatory liabilities into net periodic benefit cost for the fiscal year ended December 31, 2009**

	<b>Pension Benefits</b>	<b>Postretirement Benefits</b>
<b>(Thousands)</b>		
Estimated net loss	\$3,678	-
Estimated prior service cost	\$180	\$72

We expect that no pension benefit plan assets will be returned to us during the fiscal year ended December 31, 2009.

## Notes to Financial Statements

### Connecticut Natural Gas Corporation

#### Weighted-average assumptions used to determine benefit obligations at December 31,

	Pension Benefits		Postretirement Benefits	
	2008	2007	2008	2007
Discount rate	6.10%	6.00%	6.10%	6.00%
Rate of compensation increase	4.00%	4.00%	N/A	N/A

As of December 31, 2008, we increased our discount rate from 6.00% to 6.10%. The discount rate is the rate at which the benefit obligations could presently be effectively settled. We determined the discount rate developing a yield curve derived from a portfolio of high grade noncallable bonds that closely matches the duration of the expected cash flows of our benefit obligations.

#### Weighted-average assumptions used to determine net periodic benefit cost years ended December 31,

	Pension Benefits		Postretirement Benefits	
	2008	2007	2008	2007
Discount rate	6.00%	5.75%	6.00%	5.75%
Expected return on plan assets	8.75%	8.75%	8.00%	8.00%
Rate of compensation increase	4.00%	4.00%	N/A	N/A

We developed our expected long-term rate of return on plan assets assumption based on a review of long-term historical returns for the major asset classes. That analysis considered current capital market conditions and projected conditions. We amortize unrecognized actuarial gains and losses using the standard amortization methodology, under which amounts in excess of 10% of the greater of the projected benefit obligation or market related value are amortized over the plan participants' average remaining service to retirement.

#### Assumed health care cost trend rates to determine benefit obligations at December 31

	2008	2007
Health care cost trend rate assumed for next year	8.0%	8.0%
Rate to which cost trend rate is assumed to decline (the ultimate trend rate)	5.0%	5.0%
Year that the rate reaches the ultimate trend rate	2014	2014

Assumed health care cost trend rates have a significant effect on the amount reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	1% Increase	1% Decrease
(Thousands)		
Effect on total of service and interest cost	\$63	\$(51)
Effect on postretirement benefit obligation	\$731	\$(609)

**Plan assets:** Our weighted-average asset allocations at December 31, 2008 and 2007, by asset category, are:

Asset Category	Pension Benefits			Postretirement Benefits		
	Target Allocation	Actual Allocation		Target Allocation	Actual Allocation	
		2008	2007		2008	2007
Equity securities	56%	48%	60%	10%	8%	23%
Debt securities	30%	34%	26%	70%	72%	56%
Real estate	4%	6%	5%	4%	4%	-
Other	10%	12%	9%	16%	16%	21%
Total	100%	100%	100%	100%	100%	100%

## Notes to Financial Statements

### Connecticut Natural Gas Corporation

Our pension benefits plan assets are held in a master trust with a trustee and our postretirement benefits plan assets are held with two trustees in multiple VEBA and 401(h) arrangements. Those assets are invested among and within various asset classes in order to achieve sufficient diversification in accordance with our risk tolerance. This is achieved for our pension benefits plan assets through the utilization of multiple asset managers and systematic allocation to investment management styles, providing broad exposure to different segments of the fixed income and equity markets; and for our postretirement benefits plan assets through the utilization of multiple institutional mutual and money market funds, providing exposure to different segments of the fixed income, equity and short-term cash markets. We believe that the resulting valuations are a reasonable estimate of fair value as of December 31, 2008. The fair values of an insignificant portion of the pension plan assets are subject to uncertainty, and therefore, may differ from the values that would have been used had a ready market for the investments existed. We do not expect that such differences would have a material effect on the funded status of the plan. Due to the level of risk associated with financial assets, and the level of uncertainty related to the changes in the values of those instruments, it is reasonably possible that changes in values in the near term could affect the fair value amounts reported as of December 31, 2008.

Equity securities did not include any Iberdrola common stock at December 31, 2008.

**Contributions:** In accordance with our funding policy we make annual contributions of not less than the minimum required by applicable regulations. We expect to contribute between \$6 million and \$14 million to our pension benefit plans.

**Estimated future benefit payments:** Our expected benefit payments and expected Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) subsidy receipts, which reflect expected future service, as appropriate, are as follows:

	<b>Pension Benefits</b>	<b>Postretirement Benefits</b>	<b>Medicare Act Subsidy Receipts</b>
(Thousands)			
2009	\$8,466	\$3,632	\$(309)
2010	\$8,912	\$3,939	\$(334)
2011	\$9,391	\$4,281	\$(350)
2012	\$10,009	\$4,529	\$(380)
2013	\$10,472	\$4,748	\$(398)
2014 – 2018	\$59,307	\$26,203	\$(2,237)