Public Service Company of North Carolina, Incorporated

Consolidated Financial Statements

Quarter Ended March 31, 2019

Public Service Company of North Carolina, Incorporated

GLOSSARY OF TERMS

The following abbreviations or acronyms used in this document are defined below:

Abbreviation or Acronym	Definition
2017 Tax Reform Act	An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018 (previously known as The Tax Cuts and Jobs Act) enacted on December 22, 2017
AOCI	Accumulated Other Comprehensive Income (Loss)
ARO	Asset Retirement Obligation
bcf	billion cubic feet
Cardinal	Cardinal Pipeline Company, L.L.C.
CUT	Customer Usage Tracker (decoupling mechanism)
DESS	Dominion Energy Southeast Services, Inc. (formerly known as SCANA Services, Inc.)
Dominion Energy	The legal entity, Dominion Energy, Inc., one or more of its consolidated subsidiaries (other than SCANA and PSNC) or operating segments, or the entirety of Dominion Energy, Inc. and its consolidated subsidiaries
FASB	Financial Accounting Standards Board
GAAP	U.S. generally accepted accounting principles
IMT	Integrity Management Tracker
LNG	Liquefied Natural Gas
Merger Agreement	Agreement and Plan of Merger entered on January 2, 2018 between Dominion Energy and SCANA
North Carolina Commission	North Carolina Utilities Commission
NYMEX	New York Mercantile Exchange
Pine Needle	Pine Needle LNG Company, L.L.C.
PGA	Purchased Gas Adjustment
PSNC	Public Service Company of North Carolina, Incorporated, doing business as Dominion Energy North Carolina
Rider D	Rate mechanism which allows PSNC to recover from customers all prudently incurred gas costs and certain uncollectible expenses as well as losses on negotiated gas and transportation sales
SCANA	The legal entity, SCANA Corporation, one or more of its consolidated subsidiaries (other than PSNC) or the entirety of SCANA Corporation and its consolidated subsidiaries
SCANA Combination	Dominion Energy's acquisition of SCANA completed on January 1, 2019 pursuant to the terms of the Merger Agreement
SCANA Merger Approval Order	Final order issued by the North Carolina Commission on November 19, 2018 setting forth its approval of the SCANA Combination

Public Service Company of North Carolina, Incorporated and Subsidiaries
Consolidated Balance Sheets
(Unaudited)

(thousands)	March 31, 2019	December 31, 2018
Assets		
Gas Utility Plant	$ 2,640,489	$ 2,544,876
Accumulated Depreciation	(537,252)	(527,702)
Goodwill, net of write-down of $229,590	209,824	209,824
Gas Utility Plant, Net	2,313,061	2,226,998
Investments	16,641	17,363
Current Assets:		
Cash and cash equivalents	1,055	1,290
Receivables, net of allowance for uncollectible accounts of $934 and $712	114,874	118,331
Receivables-affiliated companies	6,198	7,813
Inventories (at average cost):		
Stored gas	19,265	36,226
Materials and supplies	11,809	11,296
Regulatory assets	15,878	31,650
Prepayments and other	3,012	2,867
Total Current Assets	172,091	209,473
Deferred Debits and Other Assets:		
Regulatory assets	108,412	116,215
Other	1,302	266
Total Deferred Debits and Other Assets	109,714	116,481
Total Assets	$ 2,611,507	$ 2,570,315

See Notes to Consolidated Financial Statements.

(thousands)	March 31, 2019	December 31, 2018
Capitalization and Liabilities		
Common Stock - no par value, 1,000 shares outstanding	$ 636,080	$ 636,080
Retained Earnings	276,372	225,474
Accumulated Other Comprehensive Loss	(1,338)	(865)
Total Common Equity	911,114	860,689
Long-Term Debt, net	598,510	698,476
Total Capitalization	1,509,624	1,559,165
Current Liabilities:		
Short-term borrowings	—	97,748
Current portion of long-term debt	100,000	—
Accounts payable	47,097	61,261
Accounts payable-affiliated companies	149,231	93,598
Customer deposits and customer prepayments	11,052	15,105
Taxes accrued	5,106	1,782
Interest accrued	10,256	6,593
Dividends declared	—	12,700
Regulatory liabilities	9,256	3,508
Other	4,882	2,923
Total Current Liabilities	336,880	295,218
Deferred Credits and Other Liabilities:		
Deferred income taxes, net	190,647	190,405
Pension and other postretirement benefits	79,595	79,265
Asset retirement obligations	79,087	35,488
Regulatory liabilities	410,778	406,766
Other	4,896	4,008
Total Deferred Credits and Other Liabilities	765,003	715,932
Commitments and Contingencies (Note 10)		
Total Capitalization and Liabilities	$ 2,611,507	$ 2,570,315

See Notes to Consolidated Financial Statements.

Public Service Company of North Carolina, Incorporated and Subsidiaries
Consolidated Statements of Income
(Unaudited)

(thousands)	Three Months Ended March 31, 2019	2018
Operating Revenues	$ 232,268	$ 206,391
Cost of Gas	115,047	95,189
Margin	117,221	111,202
Operating Expenses:		
Operations and maintenance	27,920	25,810
Depreciation and amortization	15,568	14,540
Other taxes	4,249	3,936
Total Operating Expenses	47,737	44,286
Operating Income	69,484	66,916
Other Income, net	4,400	4,669
Interest Charges, net of allowance for borrowed funds used during construction of $933 and $488	(10,025)	(8,728)
Income Before Income Taxes and Earnings from Equity Method Investments	63,859	62,857
Income Tax Expense	(13,596)	(14,504)
Income Before Earnings from Equity Method Investments	50,263	48,353
Earnings from Equity Method Investments	350	481
Net Income	$ 50,613	$ 48,834

See Notes to Consolidated Financial Statements.

Public Service Company of North Carolina, Incorporated and Subsidiaries
Consolidated Statements of Comprehensive Income
(Unaudited)

(thousands)	Three Months Ended March 31, 2019	Three Months Ended March 31, 2018
Net Income	$ 50,613	$ 48,834
Other Comprehensive Income (Loss), net of tax:		
Unrealized Gains (Losses) on Cash Flow Hedging Activities of Equity Method Investees:		
Arising during period, net of tax of $175 and $21	587	70
Reclassified to earnings from equity method investments, net of tax of $(240) and $45	(792)	149
Net gains (losses) on cash flow hedging activities of equity method investees	(205)	219
Deferred costs of employee benefit plans, net of tax of $15 and $7	17	24
Other Comprehensive Income (Loss)	(188)	243
Comprehensive Income	$ 50,425	$ 49,077

See Notes to Consolidated Financial Statements.

Public Service Company of North Carolina, Incorporated and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)

(thousands)	Three Months Ended March 31, 2019	Three Months Ended March 31, 2018
Cash Flows From Operating Activities:		
Net income	$ 50,613	$ 48,834
Adjustments to reconcile net income to net cash provided from operating activities:		
Earnings from equity method investment, net of distributions	(350)	(481)
Deferred income taxes, net	370	157
Depreciation and amortization	17,192	15,732
Allowance for equity funds used during construction	(2,450)	(1,280)
Changes in certain assets and liabilities:		
Receivables	5,072	23,011
Inventories	9,536	6,616
Regulatory assets	11,854	(2,585)
Regulatory liabilities	7,283	-
Accounts payable	752	(8,883)
Customer deposits and customer prepayments	(4,053)	6,675
Taxes accrued	3,324	14,260
Other assets	(1,400)	(1,474)
Other liabilities	6,075	(3,082)
Net Cash Provided From Operating Activities	103,818	97,500
Cash Flows From Investing Activities:		
Property additions and construction expenditures	(36,093)	(61,968)
Proceeds from investments	802	300
Net Cash Used For Investing Activities	(35,291)	(61,668)
Cash Flows From Financing Activities:		
Dividends	(12,700)	(11,800)
Borrowings from affiliate, net	41,686	(22,400)
Short-term borrowings, net	(97,748)	(7,361)
Net Cash Used For Financing Activities	(68,762)	(41,561)
Net Decrease in Cash and Cash Equivalents	(235)	(5,729)
Cash and Cash Equivalents, January 1	1,290	6,851
Cash and Cash Equivalents, March 31	$ 1,055	$ 1,122
Supplemental Cash Flow Information:		
Noncash Investing and Financing Activities: [1]		
Accrued construction expenditures	$ 14,577	$ 14,052

[1] *See Note 11 for lease information*

See Notes to Consolidated Financial Statements.

Public Service Company of North Carolina, Incorporated and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

Public Service Company of North Carolina, Incorporated (PSNC), a public utility, was organized as a North Carolina corporation in 1938. Effective January 1, 2000, SCANA, a South Carolina holding company, acquired PSNC. As a result, PSNC became a wholly-owned subsidiary of SCANA, incorporated under the laws of South Carolina. Effective January 1, 2019, SCANA became a wholly-owned subsidiary of Dominion Energy, Inc.

The following notes should be read in conjunction with the Notes to Consolidated Financial Statements of PSNC for the year ended December 31, 2018. These are interim financial statements and, due to the seasonality of PSNC's business and matters that may occur during the rest of the year, the amounts reported in the Consolidated Statements of Income are not necessarily indicative of amounts expected for the full year. In the opinion of management, the information furnished herein reflects all adjustments which are necessary for the fair statement of the results for the interim periods reported, and such adjustments are of a normal recurring nature. In addition, the preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Certain amounts in PSNC's 2018 Consolidated Financial Statements and Notes have been reclassified to conform to the 2019 presentation for comparative purposes; however, such reclassifications did not affect PSNC's net income and other comprehensive income, total assets, liabilities, equity or cash flows.

PSNC has evaluated subsequent events through May 29, 2019 which is the date these Consolidated Financial Statements were issued.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Significant Accounting Policies

There have been no significant changes from Note 1 to PSNC's Consolidated Financial Statements for the year ended December 31, 2018, with the exception of the items discussed below.

Asset Management and Supply Service Agreement

PSNC utilizes an asset management and supply service agreement with a counterparty for certain natural gas storage facilities. Such counterparty held, through an agency relationship, 31% of PSNC's natural gas inventory at March 31, 2019 and 46% at December 31, 2018, with a carrying value of $4.5 million and $13.9 million, respectively. Under the terms of this agreement, PSNC receives storage asset management fees, of which 75% are credited to customers. This agreement expires October 31, 2020.

Leases

PSNC leases certain assets including real estate, office equipment and other assets under operating leases. Rent expense is expensed as incurred over the term of the lease and is primarily recorded in operations and maintenance expense in the Consolidated Statements of Income.

Certain operating leases include one or more options to renew, with renewal terms that can extend the lease from one to five years. The exercise of lease renewal options is at PSNC's sole discretion. Leases with original lease terms of one year or less are not included in the Consolidated Balance Sheets and PSNC has concluded that the renewal of such leases is unlikely. Were such leases to contain renewal options that PSNC is reasonably certain will be exercised, the related right-of-use asset and lease liability would be included in the Consolidated Balance Sheets.

The determination of the discount rate utilized has a significant impact on the calculation of the present value of the lease liability included in the Consolidated Balance Sheets. For PSNC's leased assets, the discount rate implicit in the lease is generally unable to be determined from a lessee perspective. As such, PSNC uses internally-developed incremental borrowing rates as a discount rate in the calculation of the present value of the lease liability. The incremental borrowing rates are determined based on an analysis of PSNC's publicly available secured borrowing rates over various lengths of time that most closely corresponds to PSNC's lease maturities.

Recently Adopted Accounting Matters

In February 2016, the FASB issued revised accounting guidance for the recognition, measurement, presentation and disclosure of leasing arrangements. The update requires that a liability and corresponding right-of-use asset are recorded on the balance sheet for all leases, including those leases currently classified as operating leases, while also refining the definition of a lease. In addition lessees will be required to disclose key information about the amount, timing, and uncertainty of cash flows arising from leasing arrangements. Lessor accounting remains largely unchanged.

The guidance became effective for PSNC's interim and annual reporting periods beginning January 1, 2019. PSNC adopted this revised accounting guidance using a modified retrospective approach, which requires lessees and lessors to recognize and measure leases at the date of adoption. Under this approach, PSNC utilized the transition practical expedient to maintain historical presentation for periods before January 1, 2019. PSNC also applied the other practical expedients, which required no reassessment of whether existing contracts are or contain leases, no reassessment of lease classification for existing leases, and no evaluation of existing or expired land easements that were not previously accounted for as leases. In connection with the adoption of this revised accounting guidance, PSNC recorded $1.3 million of offsetting right-of-use assets and liabilities for operating leases in effect at the adoption date. See Note 11 for additional information.

2. RATE AND OTHER REGULATORY MATTERS

Rate Matters

Other than the items discussed below, which are pending or have been resolved during the period, there have been no changes to the regulatory matters discussed in Note 2 to PSNC's Consolidated Financial Statements for the year ended December 31, 2018.

Other

The North Carolina Commission has authorized PSNC to use a tracker mechanism to recover the incurred capital investment and associated costs of complying with federal standards for pipeline integrity and safety requirements that are not in current base rates. In February 2019, PSNC submitted its biannual application to adjust rates associated with its pipeline integrity tracker. As approved by the North Carolina Commission, the filing increases PSNC's integrity management revenue requirement to $21 million, an increase of $3 million over its previous filing, effective March 2019. Projected integrity management plant investment for the period 2019 - 2021 for which recovery is expected totals $142 million.

As a condition to the SCANA Merger Approval Order, PSNC will provide customer bill credits of $1.3 million in each of January 2019, 2020 and 2021. As a result, in the first quarter of 2019, PSNC recorded a reduction in operating revenue and a corresponding regulatory liability of $3.8 million. In addition, the SCANA Merger Approval Order included a rate moratorium until November 1, 2021 other than for rate adjustments pursuant to the CUT, the IMT and the PGA and an agreement that direct merger-related expenses will be excluded from PSNC's regulated expenses for ratemaking purposes.

Regulatory Assets and Regulatory Liabilities

Rate-regulated utilities recognize in their financial statements certain revenues and expenses in different periods than do other enterprises. As a result, PSNC has recorded regulatory assets and regulatory liabilities which are summarized in the following tables. Substantially all of its regulatory assets are either explicitly excluded from rate base or are effectively excluded from rate base due to their being offset by related liabilities.

(thousands)	March 31, 2019	December 31, 2018
Regulatory Assets:		
Undercollections - Rider D	$ 8,261	$ 23,789
Pipeline integrity management costs	4,362	4,362
Deferred employee benefit plan costs	1,842	2,086
Environmental remediation costs	1,350	1,350
Other	63	63
Regulatory assets - current	15,878	31,650
Pipeline integrity management costs	63,474	59,319
Deferred employee benefit plan costs	27,991	28,206
Environmental remediation costs	2,137	2,473
AROs	14,530	25,846
Other	280	371
Regulatory assets - noncurrent	108,412	116,215
Total Regulatory Assets	$ 124,290	$ 147,865
Regulatory Liabilities:		
Overcollections - Rider D	$ 8,006	$ 3,508
Other	1,250	-
Regulatory liabilities - current	9,256	3,508
Income taxes refundable through future rates	155,262	155,182
Asset removal costs	238,609	236,211
Revenues subject to refund	15,623	15,355
Other	1,284	18
Regulatory liabilities - noncurrent	410,778	406,766
Total Regulatory Liabilities	$ 420,034	$ 410,274

Undercollections and overcollections - Rider D represent amounts under- or over-collected from customers pursuant to the PSNC's Rider D mechanism approved by the North Carolina Commission. This mechanism allows PSNC to recover from customers all prudently incurred gas costs and certain uncollectible expenses as well as losses on negotiated gas and transportation sales.

AROs represent deferred depreciation and accretion expense related to legal obligations associated with the future retirement of transmission and distribution properties. These regulatory assets are expected to be recovered over the related property lives which may range up to approximately 90 years.

Employee benefit plan costs have historically been recovered as they have been recorded under GAAP. Deferred employee benefit plan costs represent pension and other postretirement benefit costs which were accrued as liabilities and treated as regulatory assets pursuant to an North Carolina Commission order. These deferred benefit costs are expected to be recovered through utility rates, primarily over average service periods of participating employees, up to approximately 11 years.

Pipeline integrity management costs represent operating costs incurred to comply with federal regulatory requirements related to natural gas pipelines. PSNC is recovering costs totaling $4.4 million annually through 2021. PSNC is continuing to defer pipeline integrity costs, and as of March 31, 2019, costs of $56.6 million have been deferred pending future approval of rate recovery.

Environmental remediation costs represent costs associated with the assessment and clean-up of sites currently or formerly owned by PSNC. Such remediation costs are being recovered over a period that will end in 2021.

Income taxes refundable through future rates include (i) excess deferred income taxes arising from the remeasurement of deferred income taxes in connection with the enactment of the 2017 Tax Reform Act (certain of which are protected under normalization rules and will be amortized over the remaining lives of related property, and certain of which will be amortized to the benefit of customers over prescribed periods as instructed by regulators) and (ii) deferred income taxes arising from investment tax credits, offset by (iii) deferred income taxes that arise from utility operations that have not been included in customer rates (a portion of which relate to depreciation and are expected to be recovered over the remaining lives of the related property which may range up to 90 years). See also Note 6.

Asset removal costs represent estimated net collections through depreciation rates of amounts to be expended for the removal of assets in the future.

Revenues subject to refund represent the revenues deferred by PSNC resulting from the North Carolina Commission order addressing the reduction in the federal income tax rate from 35% to 21% effective January 1, 2018.

The North Carolina Commission has reviewed and approved through specific orders most of the items shown as regulatory assets. Other regulatory assets include, but are not limited to, certain costs which have not been specifically approved for recovery by the North Carolina Commission. In recording such costs as regulatory assets, management believes the costs will be allowable under existing rate-making concepts that are embodied in rate orders received by PSNC. The costs are currently not being recovered, but are expected to be recovered through rates in future periods. In the future, as a result of deregulation or other changes in the regulatory environment or changes in accounting requirements, PSNC could be required to write off its regulatory assets and liabilities. Such an event could have a material effect on PSNC's results of operations, liquidity or financial position in the period the write-off would be recorded.

3. REVENUE RECOGNITION

PSNC has disaggregated operating revenues by customer class as follows:

Operating Revenue Disaggregation (thousands)	Three Months Ended March 31, 2019	Three Months Ended March 31, 2018
Customer class:		
Residential	$ 153,707	$ 145,547
Commercial	53,653	48,202
Industrial	6,531	5,945
Transportation	12,203	7,882
Revenues from contracts with customers	226,094	207,576
Other revenues	6,174	(1,185)
Total Operating Revenues	$ 232,268	$ 206,391

4. COMMON EQUITY

Changes in common equity during the three months ended March 31, 2019 and 2018 were as follows:

			Accumulated Other Comprehensive Income (Loss)			
(thousands)	Common Stock	Retained Earnings	Gains (Losses) on Cash Flow Hedges	Deferred Employee Benefit Plans Cost	Total AOCI	Total Common Equity
Balance as of January 1, 2019	$ 636,080	$ 225,474	$ 464	$ (1,329)	$ (865)	$ 860,689
Cumulative Effect of Change in Accounting Principle		285	—	(285)	(285)	—
Net Income		50,613				50,613
Other Comprehensive Income			(205)	17	(188)	(188)
Total Comprehensive Income		$ 50,613	$ (205)	$ 17	$ (188)	$ 50,425
Balance as of March 31, 2019	$ 636,080	$ 276,372	$ 259	$ (1,597)	$ (1,338)	$ 911,114
Balance as of January 1, 2018	$ 635,239	$ 174,592	$ 144	$ (1,462)	$ (1,318)	$ 808,513
Net Income		48,834				48,834
Other Comprehensive Income			219	24	243	243
Total Comprehensive Income		48,834				48,834
Dividends Declared		(9,850)				(9,850)
Balance as of March 31, 2018	$ 635,239	$ 213,576	$ 363	$ (1,438)	$ (1,075)	$ 847,740

PSNC had one thousand shares of common stock authorized, without par value, issued and outstanding during both periods shown.

Reclassifications from AOCI into earnings of gains or losses on interest rate contracts are reflected within earnings from equity method investments on the income statement. Reclassifications for the amortization of deferred employee benefit costs are recorded within operations and maintenance and other expenses on the Consolidated Statements of Income, and capitalized in gas utility plant on the Consolidated Balance Sheets.

PSNC’s note purchase and debenture purchase agreements contain provisions that could limit the payment of cash distributions, including dividends, on PSNC's common stock. These agreements generally limit the sum of distributions to an amount that does not exceed $30 million plus 85% of Consolidated Net Income (as therein defined) accumulated after December 31, 2008, plus the net proceeds of issuances by PSNC of equity or convertible debt securities (as therein defined). As of March 31, 2019, this limitation would permit PSNC to pay cash distributions in excess of $557 million.

The North Carolina Commission, in its order approving the SCANA Combination, limited cumulative dividends payable to Dominion Energy by PSNC to (i) the amount of retained earnings at closing of the SCANA Combination plus (ii) any future earnings recorded by PSNC after such date. In addition, notice to the North Carolina Commission is required if payment of dividends causes the equity component of PSNC capital structure to fall below 45%.

5. LONG-TERM DEBT AND SHORT-TERM DEBT

In March 2019, PSNC entered into an inter-company credit agreement with Dominion Energy under which PSNC may have short-term borrowings outstanding up to $400 million. At March 31, 2019, PSNC had borrowings outstanding under this credit agreement totaling $122 million.

In the first quarter of 2019, PSNC canceled its previous committed long-term facility which was a revolving line of credit under a credit agreement with a syndicate of banks. This committed line of credit totaled $200 million and was used for general corporate purposes, including liquidity support for PSNC's commercial paper program and working capital needs, and was set to expire in December 2020. In addition, the commercial paper program of PSNC was canceled in the first quarter of 2019. At December 31, 2018, PSNC had $98 million in commercial paper borrowings outstanding at a weighted-average interest rate of 3.49%.

6. INCOME TAXES

For the three months ended March 31, 2019, PSNC recorded an estimate of the portion of excess deferred income tax amortization expected to occur in 2019. The reversal of these excess deferred income taxes will impact the effective tax rate and may ultimately impact rates charged to customers. Therefore, PSNC decreased revenue and increased regulatory liabilities to offset these deferred tax impacts in accordance with applicable regulatory guidance.

The State of North Carolina lowered its corporate income tax rate to 3.0% in 2017 and 2.5% effective January 1, 2019. In connection with these changes in tax rates, related state deferred tax amounts were remeasured, with the change in their balances being credited to a regulatory liability. The changes in income tax rates did not and are not expected to have a material impact on SCANA's financial position, results of operations or cash flows.

7. DERIVATIVE FINANCIAL INSTRUMENTS

PSNC recognizes all derivative instruments as either assets or liabilities in the statement of financial position and measures those instruments at fair value. PSNC recognizes changes in the fair value of derivative instruments either in earnings, as a component of AOCI, or within regulatory assets or regulatory liabilities, depending upon the intended use of the derivative and the resulting designation. Written policies define the physical and financial transactions that are approved, as well as the authorization requirements and limits for transactions.

PSNC hedges natural gas purchasing activities using over-the-counter options and swaps and NYMEX futures and options. PSNC's tariffs also include a provision for the recovery of actual gas costs incurred, including any costs for hedging. PSNC records premiums, transaction fees, margin requirements and any realized gains or losses from its hedging program in deferred accounts as a regulatory asset or liability for the over- or under-recovery of gas costs. These derivative financial instruments are not designated as hedges for accounting purposes.

Quantitative Disclosures Related to Derivatives

PSNC was party to natural gas derivative contracts for 5.7 bcf at March 31, 2019 and 6.4 bcf at December 31, 2018.

The fair value of commodity derivatives, none of which were designated as hedging instruments, totaled $1.1 million at March 31, 2019 and $1.2 million at December 31, 2018. Such amounts are reflected on the balance sheet within Prepayments and other and offset to Regulatory Assets - Current. PSNC did not have any other derivatives or other financial instruments in the statement of financial position during any period presented.

For a discussion of interest rate swaps used by PSNC's equity method investees, see Note 12.

Credit Risk Considerations

PSNC limits credit risk in its commodity and interest rate derivatives activities by assessing the creditworthiness of potential counterparties before entering into transactions with them and continuing to evaluate their creditworthiness on an ongoing basis. In this regard, PSNC uses credit ratings provided by credit rating agencies and current market-based qualitative and quantitative data, as well as financial statements, to assess the financial health of counterparties on an ongoing basis. PSNC uses standardized master agreements which generally include collateral requirements. These master agreements permit the netting of cash flows associated with a single counterparty. Cash, letters of credit and parental/affiliate guarantees may be obtained as security from counterparties in order to mitigate credit risk. The collateral agreements require a counterparty to post cash or letters of credit in the event an exposure exceeds the established threshold. The threshold represents an unsecured credit limit which may be supported by a parental/affiliate guaranty, as determined in accordance with PSNC's credit policies and due diligence. In addition, collateral agreements allow for the termination and liquidation of all positions in the event of a failure or inability to post collateral.

PSNC had no derivative instruments in a liability position for any period presented. In addition, PSNC did not have derivative instruments with underlying contingent features which, if triggered, would have permitted PSNC to request collateral from its counterparties for any period presented.

8. FAIR VALUE MEASUREMENTS, INCLUDING DERIVATIVES

Levels

PSNC utilizes the following fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value into three broad levels:

- Level 1-Quoted prices (unadjusted) in active markets for identical assets and liabilities that they have the ability to access at the measurement date.
- Level 2-Inputs other than quoted prices included within Level 1 that are either directly or indirectly observable for the asset or liability, including quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, inputs other than quoted prices that are observable for the asset or liability, and inputs that are derived from observable market data by correlation or other means. Instruments categorized in Level 2 include interest rate swaps.
- Level 3-Unobservable inputs for the asset or liability, including situations where there is little, if any, market activity for the asset or liability.

The fair value hierarchy gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable data (Level 3). In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. In these cases, the lowest level input that is significant to a fair value measurement in its entirety determines the applicable level in the fair value hierarchy. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.

PSNC utilizes unadjusted NYMEX prices to determine fair value for commodity derivative assets and liabilities, and considers such measures of fair value to be Level 1 for exchange traded instruments and Level 2 for over-the-counter instruments. All of the commodity derivatives were considered to be Level 1 in the fair value hierarchy as of March 31, 2019 and December 31, 2018.

There were no Level 3 fair value measurements during either period presented.

Fair Value of Financial Instruments

PSNC's financial instruments are recorded at fair value, with the exception of the instruments described below, which are reported at historical cost. Estimated fair values have been determined using available market information and valuation methodologies considered appropriate by management. The carrying amount of financial instruments classified within current assets and current liabilities are representative of fair value because of the short-term nature of these instruments. For financial instruments that are not recorded at fair value, the carrying amounts and estimated fair values are as follows:

	As of March 31, 2019		As of December 31, 2018	
(thousands)	Carrying Amount	Estimated Fair Value [1]	Carrying Amount	Estimated Fair Value [1]
Long-term debt [2]	$698,510	$808,260	$698,476	$788,371

[1] *Fair value is estimated based on net present value calculations using independently sourced market data that incorporate a developed discount rate using similarly rated long-term debt, along with benchmark interest rates. All fair value measurements are classified as Level 2. The carrying amount of debt issuances with short-term maturities and variable rates refinanced at current market rates is a reasonable estimate of their fair value.*

[2] *Carrying amount includes the current portion of long-term debt and the unamortized debt issuance costs.*

9. EMPLOYEE BENEFIT PLANS

Pension and Other Postretirement Benefit Plans

Components of net periodic benefit cost recorded by PSNC were as follows:

	Pension Benefits		Other Postretirement Benefits	
	2019	2018	2019	2018
(thousands)				
Three months ended March 31				
Service cost	$ 616	$ 671	$ 145	$ 176
Interest cost	1,037	951	429	407
Expected return on assets	(1,365)	(1,593)	-	-
Prior service cost amortization	11	15	-	-
Amortization of actuarial losses	479	330	-	82
Net periodic benefit cost	$ 778	$ 374	$ 574	$ 665

PSNC recovers pension costs through cost of service rates.

Voluntary Retirement Program

In March 2019, Dominion Energy announced a voluntary retirement program to employees, including employees of PSNC, that meet certain age and service requirements. PSNC expects to incur a charge in the second quarter of 2019 as determinations are made concerning the number of employees that elect to participate in the program. The voluntary retirement program will not compromise safety or PSNC's ability to comply with applicable laws and regulations. While PSNC is unable to estimate the amount, the charge could be material to PSNC's results of operations and financial condition.

10. COMMITMENTS AND CONTINGENCIES

PSNC is subject to various claims and litigation incidental to its business operations which management anticipates will be resolved without material adverse impact on the PSNC's results of operations, cash flows or financial condition.

11. LEASES

At March 31, 2019, PSNC had the following operating lease assets and liabilities recorded in the Consolidated Balance Sheets:

(thousands)	March 31, 2019
Lease assets:	
Operating lease assets [1]	$ 1,260
Total lease assets	$ 1,260
Lease liabilities:	
Operating lease - current [2]	$ 282
Operating lease - noncurrent [3]	972
Total lease liabilities	$ 1,254

[1] Included primarily in other deferred debits and other assets in the Consolidated Balance Sheets, net of accumulated depreciation.
[2] Included in other current liabilities in the Consolidated Balance Sheets.
[3] Included in other deferred credits and other liabilities in the Consolidated Balance Sheets.

Costs associated with operating leases are primarily recorded in operations and maintenance expenses in the Consolidated Statements of Income. For the three months ended March 31, 2019, total lease costs were insignificant.

For the three months ended March 31, 2019, cash paid for amounts included in the measurement of operating lease liabilities in the Consolidated Statements of Cash Flows was insignificant.

At March 31, 2019, the weighted average remaining lease term and weighted average discount rate for operating leases were as follows:

	March 31, 2019
Weighted average remaining lease term	5 years
Weighted average discount rate	4.07%

Operating lease liabilities have the following scheduled maturities:

(thousands)		
2019	$	246
2020		328
2021		317
2022		211
2023		134
After 2023		143
Total undiscounted lease payments	$	1,379
Present value adjustment		125
Present value of lease liabilities	$	1,254

12. AFFILIATED TRANSACTIONS

PSNC owns, through its wholly owned subsidiaries, 17% of Pine Needle, an LNG storage facility in North Carolina, and 33.2% of Cardinal, an intrastate natural gas pipeline. PSNC accounts for each of these investments using the equity method.

PSNC records as cost of gas the storage and transportation costs charged by its equity method investees. These costs totaled $2.2 million for each of the three months ended March 31, 2019 and 2018. PSNC owed these investees $0.8 million at March 31, 2019 and December 31, 2018, which amounts are included in Accounts payable-affiliated companies in the Consolidated Balance Sheets. PSNC received no cash distributions representing earnings on invested capital from these investees for the three months ended March 31, 2019 and March 31, 2018.

In connection with the SCANA combination, purchases from certain entities owned by Dominion Energy became affiliated transactions in 2019. PSNC records as cost of gas the storage and transportation costs charged by two such affiliates, Dominion Energy Cove Point LNG, LP and Dominion Energy Transmission, Inc. These costs totaled $1.7 million for the three months ended March 31, 2019. PSNC owed these entities $0.6 million at March 31, 2019, which is included in Accounts payable-affiliated companies in the Consolidated Balance Sheets.

Pine Needle and Cardinal use interest rate swaps designated as cash flow hedges to manage interest rate risk on variable rate debt instruments by converting them synthetically to a fixed rate. PSNC's share of the effective portion of changes in the fair value of these interest rate swaps are recorded in AOCI in PSNC’s Consolidated Balance Sheets.

PSNC had sales to an affiliate for natural gas and transportation services of $0.5 million and $0.1 million for the three months ended March 31, 2019 and March 31, 2018, respectively. Purchases of natural gas from an affiliate were insignificant for each of the three months ended March 31, 2019 and 2018.

DESS, on behalf of itself and its parent company, provides the following services to PSNC at direct or allocated cost: gas services, information systems services, telecommunications services, customer services, marketing and sales, human resources, corporate compliance, purchasing, financial services, risk management, public affairs, legal services, investor relations, gas supply and capacity management, strategic planning, general administrative services, and retirement benefits. Costs for these services totaled $14.8 million and $12.8 million for the three months ended March 31, 2019 and March 31, 2018, respectively. In addition, DESS processes and pays invoices for PSNC and is reimbursed. PSNC's payables to DESS were $5.5 million at March 31, 2019 and $6.1 million at December 31, 2018.

Borrowings from an affiliate are described in Note 5.

13. OTHER INCOME, NET

Components of other income, net are as follows:

	Three Months Ended March 31,	
(thousands)	2019	2018
Revenues from contracts with customers	$ 5,713	$ 6,016
Other revenues	620	825
Other expenses	(4,383)	(3,452)
Allowance for equity used during construction	2,450	1,280
Other income, net	$ 4,400	$ 4,669