Public Service Company of North Carolina, Incorporated

Consolidated Financial Statements

Quarter Ended September 30, 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
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)	September 30, 2019	December 31, 2018
ASSETS		
Gas utility plant	$ 2,734,669	$ 2,544,876
Accumulated depreciation	(560,384)	(527,702)
Goodwill, net of writedown of $229,590	209,824	209,824
Gas Utility Plant, Net	2,384,109	2,226,998
Investments	21,629	17,363
Current Assets:		
Cash and cash equivalents	921	1,290
Receivables, net of allowance for uncollectible accounts of $331 and $712	42,124	118,331
Receivables-affiliated companies	3,195	7,813
Receivables-income taxes	699	—
Inventories (at average cost):		
Stored gas	35,024	36,226
Materials and supplies	12,329	11,296
Regulatory assets	42,499	31,650
Prepayments and other	1,666	2,867
Total Current Assets	138,457	209,473
Deferred Debits and Other Assets:		
Regulatory assets	114,110	116,215
Other	2,572	266
Total Deferred Debits and Other Assets	116,682	116,481
Total Assets	$ 2,660,877	$ 2,570,315

See Notes to Consolidated Financial Statements.

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

(thousands)	September 30, 2019	December 31, 2018
CAPITALIZATION AND LIABILITIES		
Common Stock - no par value, 1,000 shares outstanding	**$ 706,080**	$ 636,080
Retained earnings	**262,872**	225,474
Accumulated other comprehensive loss	**(1,331)**	(865)
Total Common Equity	**967,621**	860,689
Long-term debt, net	**598,577**	698,476
Total Capitalization	**1,566,198**	1,559,165
Current Liabilities:		
Short-term borrowings	**—**	97,748
Current portion of long-term debt	**100,000**	—
Accounts payable	**35,898**	61,261
Accounts payable-affiliated companies	**134,309**	93,598
Customer deposits and customer prepayments	**17,061**	15,105
Taxes accrued	**8,555**	1,782
Interest accrued	**6,988**	6,593
Dividends declared	**—**	12,700
Regulatory liabilities	**8,781**	3,508
Other	**11,559**	2,923
Total Current Liabilities	**323,151**	295,218
Deferred Credits and Other Liabilities:		
Deferred income taxes, net	**192,534**	190,405
Pension and other postretirement benefits	**76,812**	79,265
Asset retirement obligations	**79,848**	35,488
Regulatory liabilities	**416,160**	406,766
Other	**6,174**	4,008
Total Deferred Credits and Other Liabilities	**771,528**	715,932
Commitments and Contingencies (Note 11)		
Total Capitalization and Liabilities	**$ 2,660,877**	$ 2,570,315

See Notes to Consolidated Financial Statements.

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

(thousands)	Three Months Ended September 30, 2019	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2019	Nine Months Ended September 30, 2018
Operating Revenues	**$ 62,066**	$ 52,706	**$ 374,113**	$ 328,267
Cost of Gas	**17,102**	15,373	**156,920**	132,643
Margin	**44,964**	37,333	**217,193**	195,624
Operating Expenses:				
Other operations and maintenance	**25,421**	25,980	**91,004**	77,808
Depreciation and amortization	**17,254**	15,040	**49,534**	44,399
Other taxes	**4,181**	3,323	**13,136**	11,322
Total Operating Expenses	**46,856**	44,343	**153,674**	133,529
Operating Income (Loss)	**(1,892)**	(7,010)	**63,519**	62,095
Other income, net	**1,824**	5,336	**8,386**	14,567
Interest charges, net of allowance for borrowed funds used during construction of $418, $932, $1,832 and $2,064	**(10,331)**	(9,313)	**(29,905)**	(26,835)
Income (Loss) Before Income Taxes and Earnings from Equity Method Investments	**(10,399)**	(10,987)	**42,000**	49,827
Income tax benefit (expense)	**3,288**	3,023	**(6,302)**	(10,515)
Income (Loss) Before Earnings from Equity Method Investments	**(7,111)**	(7,964)	**35,698**	39,312
Earnings from Equity Method Investments	**479**	507	**1,416**	587
Net Income (Loss)	**$ (6,632)**	$ (7,457)	**$ 37,114**	$ 39,899

See Notes to Consolidated Financial Statements.

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

(thousands)	Three Months Ended September 30, 2019	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2019	Nine Months Ended September 30, 2018
Net Income (Loss)	**$ (6,632)**	$ (7,457)	**$ 37,114**	$ 39,899
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 $(103), $(24), $(291) and $(3)	**(346)**	(77)	**(965)**	(7)
Reclassified to earnings from equity method investments, net of tax of $46, $44, $129 and $89	**153**	144	**433**	293
Net unrealized gains (losses) on cash flow hedging activities of equity method investees	**(193)**	67	**(532)**	286
Deferred costs of employee benefit plans, net of tax of $61, $41, $114 and $55	**204**	133	**350**	180
Other Comprehensive Income (Loss)	**11**	200	**(182)**	466
Total Comprehensive Income (Loss)	**$ (6,621)**	$ (7,257)	**$ 36,932**	$ 40,365

See Notes to Consolidated Financial Statements.

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

	Nine Months Ended September 30,	
(thousands)	**2019**	2018
Cash Flows From Operating Activities		
Net Income	**$ 37,114**	$ 39,899
Adjustments to reconcile net income to net cash provided from operating activities:		
Earnings from equity method investments, net of distributions	**(1,416)**	(587)
Deferred income taxes, net	**2,835**	2,704
Depreciation and amortization	**53,389**	48,045
Allowance for equity funds used during construction	**(4,786)**	(5,436)
Changes in certain assets and liabilities:		
Receivables	**80,825**	98,173
Receivables-income taxes	**(699)**	(5,024)
Inventories	**(14,840)**	(23,630)
Regulatory assets	**(25,707)**	(13,962)
Regulatory liabilities	**7,344**	10,091
Accounts payable	**(16,999)**	(19,706)
Customer deposits and customer prepayments	**1,955**	(11,839)
Taxes accrued	**6,773**	5,374
Other assets	**(5,136)**	(5,628)
Other liabilities	**14,660**	2,784
Net Cash Provided From Operating Activities	**135,312**	121,258
Cash Flows From Investing Activities		
Property additions and construction expenditures	**(124,035)**	(192,850)
Proceeds from investments	**2,406**	1,198
Investment in affiliate	**(5,950)**	(10,847)
Short-term investments-affiliate, net	**—**	(7,900)
Net Cash Used For Investing Activities	**(127,579)**	(210,399)
Cash Flows From Financing Activities		
Proceeds from issuance of long-term debt	**—**	99,667
Dividends	**(12,700)**	(32,500)
Contribution from parent	**70,000**	—
Borrowings from affiliate, net	**32,346**	(22,400)
Short-term borrowings, net	**(97,748)**	38,589
Net Cash Provided From (Used For) Financing Activities	**(8,102)**	83,356
Net Decrease in Cash and Cash Equivalents	**(369)**	(5,785)
Cash, Restricted Cash and Equivalents, January 1(1)	**1,290**	6,851
Cash, Restricted Cash and Equivalents, September 30(1)	**$ 921**	$ 1,066
Supplemental Cash Flow Information:		
Noncash Investing and Financing Activities:(2)		
Accrued construction expenditures	**$ 15,274**	21,749

(1) No amounts were held in restricted cash and equivalents in any of the periods presented.
(2) See Note 12 for information regarding leases.

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, 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.

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 Operations 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.

PSNC purchases shared services from DESS, an affiliated variable interest entity that provides accounting, legal, finance and certain administrative and technical services to all SCANA subsidiaries, including PSNC. PSNC has determined that it is not the primary beneficiary of DESS as it does not have either the power to direct the activities that most significantly impact its economic performance or an obligation to absorb losses and benefits which could be significant to it. See Note 13 for amounts attributable to affiliates.

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 November 22, 2019 which is the date these Consolidated Financial Statements were issued.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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, 43% of PSNC's natural gas inventory at September 30, 2019 and 46% at December 31, 2018, with a carrying value of $13.0 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.

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.

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 Operations.

Certain leases include one or more options to renew, with renewal terms that can extend the lease from one to five years. The exercise of renewal options is solely at PSNC's discretion and is included in the lease term if the option is reasonably certain to be exercised. A right-of-use asset and corresponding lease liability for leases with original lease terms of one year or less are not included in the Consolidated Balance Sheets, unless such leases contain renewal options that PSNC is reasonably certain will be exercised.

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 12 for additional information.

2. RATE AND OTHER REGULATORY MATTERS

Rate Matters

Other than the following matters, there have been no significant developments regarding the pending regulatory matters disclosed in Note 2 to PSNC's Consolidated Financial Statements for the year ended December 31, 2018 or Note 2 to PSNC's Consolidated Financial Statements for the quarters ended March 31, 2019 and June 30, 2019.

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 $20.8 million, an increase of $2.5 million over its previous filing, effective March 2019. In August 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 $21.2 million, an increase of $0.4 million over its previous filing, effective September 2019. Projected integrity management plant investment for the period 2019 - 2021 for which recovery is expected totals $142.2 million.

As a condition to the SCANA Merger Approval Order, PSNC agreed to 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, included in other current regulatory liabilities and other noncurrent regulatory liabilities in the table below. 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 table. 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)	September 30, 2019	December 31, 2018
Regulatory Assets:		
Undercollections-Rider D and CUT	**$ 33,649**	$ 23,789
Pipeline integrity management costs	**5,284**	4,362
Deferred employee benefit plan costs	**1,842**	2,086
Environmental remediation costs	**1,350**	1,350
Other	**374**	63
Regulatory assets - current	**42,499**	31,650
Pipeline integrity management costs	**75,439**	59,319
Deferred employee benefit plan costs	**21,883**	28,206
Environmental remediation costs	**1,462**	2,473
AROs	**15,100**	25,846
Other	**226**	371
Regulatory assets - noncurrent	**114,110**	116,215
Total Regulatory Assets	**$ 156,609**	$ 147,865
Regulatory Liabilities:		
Overcollections-Rider D and CUT	**$ 7,531**	$ 3,508
Other	**1,250**	—
Regulatory liabilities - current	**8,781**	3,508
Income taxes refundable through future rates	**155,842**	155,182
Asset removal costs	**242,874**	236,211
Revenues subject to refund	**16,175**	15,355
Other	**1,269**	18
Regulatory liabilities - noncurrent	**416,160**	406,766
Total Regulatory Liabilities	**$ 424,941**	$ 410,274

Undercollections and overcollections - Rider D and CUT represent amounts under- or over-collected from customers pursuant to PSNC's Rider D and CUT mechanisms approved by the North Carolina Commission. The Rider D 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. The CUT is a decoupling mechanism, which allows PSNC to adjust its base rates semi-annually for residential and commercial customers based on average per customer consumption.

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 a 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 September 30, 2019, costs of $71.6 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 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:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(thousands)	**2019**	2018	**2019**	2018
Customer class:				
Residential	**$ 27,649**	$ 27,429	**$ 217,939**	$ 210,657
Commercial	**17,127**	16,919	**91,435**	84,646
Industrial	**2,997**	1,778	**13,596**	10,129
Other	**15,055**	6,997	**42,518**	22,275
Revenues from contracts with customers	**62,828**	53,123	**365,488**	327,707
Other revenues	**(762)**	(417)	**8,625**	560
Total Operating Revenues	**$ 62,066**	$ 52,706	**$ 374,113**	$ 328,267

4. COMMON EQUITY

Changes in common equity during the nine months ended September 30, 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 Plan Costs	Total AOCI	Total Common Equity
Balance as of January 1, 2018	$635,239	$174,592	$ 144	$ (1,462)	$ (1,318)	$808,513
Net Income		39,899				39,899
Other Comprehensive Income			286	180	466	466
Total Comprehensive Income		39,899	286	180	466	40,365
Dividends Declared		(32,130)				(32,130)
Balance as of September 30, 2018	$635,239	$182,361	$ 430	$ (1,282)	$ (852)	$816,748
Balance as of January 1, 2019	**$636,080**	**$225,474**	**$ 464**	**$ (1,329)**	**$ (865)**	**$860,689**
Cumulative effect of change in accounting principle		**284**		**(284)**	**(284)**	**—**
Contribution from parent	**70,000**					**70,000**
Net Income		**37,114**				**37,114**
Other Comprehensive Income			**(532)**	**350**	**(182)**	**(182)**
Total Comprehensive Income		**37,114**	**(532)**	**350**	**(182)**	**36,932**
Balance as of September 30, 2019	**$706,080**	**$262,872**	**$ (68)**	**$ (1,263)**	**$ (1,331)**	**$967,621**

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

In June 2019, PSNC received from SCANA a $70.0 million capital contribution, used to repay intercompany borrowings.

Reclassifications from AOCI into earnings of gains or losses on interest rate contracts are reflected within earnings from equity method investments on the Consolidated Statements of Operations. Reclassifications for the amortization of deferred employee benefit costs are recorded within operations and maintenance and other expenses on the Consolidated Statements of Operations, 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 $30.0 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 September 30, 2019, this limitation would permit PSNC to pay cash distributions in excess of $545.4 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's 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 $400.0 million. At September 30, 2019, PSNC had borrowings outstanding under this credit agreement totaling $113.0 million, which is included in accounts payable-affiliated companies in the Consolidated Balance Sheet.

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 $200.0 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 $97.7 million in commercial paper borrowings outstanding at a weighted-average interest rate of 3.49%.

6. INCOME TAXES

For the nine months ended September 30, 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 PSNC’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 on a gross basis 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 exchange-traded 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 9.0 bcf at September 30, 2019 and 6.4 bcf at December 31, 2018.

The fair value of commodity derivatives, none of which were designated as hedging instruments, totaled $0.9 million at September 30, 2019 and $1.2 million at December 31, 2018. Such amounts are reflected on the Consolidated Balance Sheets within Prepayments and other and offset to Regulatory assets - Current. PSNC was not party to any other derivatives or other financial instruments requiring fair value to be recorded in its statements of financial position for any other period presented.

For a discussion of interest rate swaps used by PSNC's equity method investees, see Note 13.

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

Fair value is based on actively-quoted market prices, if available. In the absence of actively-quoted market prices, price information is sought from external sources, including industry publications.

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. Instruments categorized in Level 1 include certain exchange-traded derivatives.
- 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 certain exchange-traded options and 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.

All of the commodity derivatives were considered to be Level 2 in the fair value hierarchy as of September 30, 2019 and Level 1 in the fair value hierarchy as of December 31, 2018.

There were no Level 3 fair value measurements during any 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:

	September 30, 2019		December 31, 2018	
	Carrying Amount	**Estimated Fair Value[(1)]**	Carrying Amount	Estimated Fair Value[(1)]
(thousands)				
Long-term debt[(2)]	**$ 698,577**	**$ 868,983**	$ 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 September 30				
Service cost	**$ 630**	$ 796	**$ 152**	$ 170
Interest cost	**826**	950	**417**	335
Expected return on assets	**(1,444)**	(1,557)	**—**	—
Prior service cost amortization	**11**	14	**—**	—
Amortization of actuarial (gains) losses	**170**	412	**—**	(81)
Loss due to settlement	**1,533**	—	**—**	—
Net periodic benefit cost	**$ 1,726**	$ 615	**$ 569**	$ 424
Nine Months Ended September 30				
Service cost	**$ 1,856**	$ 2,138	**$ 456**	$ 521
Interest cost	**2,726**	2,852	**1,251**	1,150
Expected return on assets	**(4,106)**	(4,743)	**—**	—
Prior service cost amortization	**33**	43	**—**	—
Amortization of actuarial losses	**1,087**	1,072	**—**	83
Loss due to curtailment	**869**	—	**543**	—
Loss due to settlement	**1,533**	—	**—**	—
Net periodic benefit cost	**$ 3,998**	$ 1,362	**$ 2,250**	$ 1,754

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, who meet certain age and service requirements. In the second quarter of 2019, upon the determination made concerning the number of employees that elected to participate in the program, PSNC recorded a charge of $11.5 million ($8.8 million after-tax) included within other operations and maintenance expense ($9.7 million), other taxes ($0.4 million) and other income, net ($1.4 million) in the Consolidated Statements of Operations. In addition, as a result of the voluntary retirement program, PSNC recorded pension plan settlement losses of $1.5 million within other income, net in the third quarter of 2019. PSNC expects to recognize additional pension plan settlement losses in the fourth quarter of 2019. While PSNC is currently unable to estimate the amount of such additional settlement losses, they could be material to its results of operations and financial condition.

In the third quarter of 2019, PSNC remeasured a pension plan as a result of a settlement from the voluntary retirement program. The settlement and related remeasurement resulted in an increase in the pension benefit obligation of $2.7 million and an increase in the fair value of the pension plan assets of $3.7 million for PSNC. The impact of the remeasurement on net periodic benefit cost (credit) was recognized prospectively from the remeasurement date. The remeasurement is expected to decrease the net periodic benefit cost for 2019 by $0.4 million. The discount rate used for the remeasurement was 3.57%. All other assumptions used for the remeasurement were consistent with the measurement as of December 31, 2018.

10. UTILITY PLANT AND NONUTILITY PROPERTY

In May 2019, PSNC entered into an agreement to sell certain warranty service contract assets for total consideration of $1.4 million. The transaction closed in August 2019, resulting in a $1.4 million ($1.1 million after-tax) gain recorded in other operations and maintenance expense in PSNC’s Consolidated Statements of Operations. Pursuant to the agreement, upon closing PSNC entered into a commission agreement with the buyer under which the buyer will compensate PSNC in connection with the right to use PSNC’s brand in marketing materials and other services over a ten-year term.

11. 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 PSNC's results of operations, cash flows or financial condition.

12. LEASES

At September 30, 2019, PSNC had the following operating lease assets and liabilities recorded in the Consolidated Balance Sheets:

(thousands)		September 30, 2019
Lease assets:		
Operating lease assets(1)	**$**	**1,066.5**
Total lease assets	**$**	**1,066.5**
Lease liabilities:		
Operating lease - current(2)	**$**	**289.6**
Operating lease - noncurrent(3)		**827.6**
Total lease liabilities	**$**	**1,117.2**

(1) Included primarily in other deferred debits and other assets in the Consolidated Balance Sheets.

(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 Operations. For the three and nine months ended September 30, 2019, total lease costs were $0.2 million and $0.4 million, respectively.

For the three and nine months ended September 30, 2019, cash paid for amounts included in the measurement of operating lease liabilities in the Consolidated Statements of Cash Flows was $0.1 million and $0.3 million, respectively.

At September 30, 2019, the weighted average remaining lease term and weighted average discount rate for operating leases were as follows

	September 30, 2019
Weighted average remaining lease term	**4 years**
Weighted average discount rate	**4.08%**

Operating lease liabilities have the following scheduled maturities:

(thousands)		
2019	$	82
2020		329
2021		318
2022		212
2023		134
After 2023		143
Total undiscounted lease payments		1,218
Present value adjustment		(101)
Present value of lease liabilities	$	1,117

13. 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 $2.3 million and $6.8 million for the three and nine months ended September 30, 2019, respectively. For the three and nine months ended September 30, 2018, these costs totaled $2.4 million and $7.0 million, respectively. PSNC owed these investees $0.7 million at September 30, 2019 and $0.8 million at December 31, 2018, which amounts are included in Accounts payable-affiliated companies in the Consolidated Balance Sheets. PSNC received distributions from these investments of $2.4 million and $1.2 million for the nine months ended September 30, 2019 and 2018, respectively.

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 $1.4 million and $4.5 million for the three and nine months ended September 30, 2019, respectively. PSNC owed these entities $0.5 million at September 30, 2019, which is included in Accounts payable-affiliated companies in the Consolidated Balance Sheets.

In April 2019, PSNC made a $6.0 million capital contribution to Pine Needle, which was PSNC's portion of Pine Needle's outstanding long-term debt payoff.

Cardinal uses an interest rate swap designated as cash flow hedge to manage interest rate risk on its variable rate debt instrument by converting it synthetically to a fixed rate. PSNC's share of the effective portion of changes in the fair value of this interest rate swap is recorded in AOCI in PSNC’s Consolidated Balance Sheets.

PSNC had sales to an affiliate for natural gas and transportation services of $0.2 million and $0.7 million for the three and nine months ended September 30, 2019, respectively. PSNC had sales to an affiliate for natural gas and transportation services of $0.1 million and $0.2 million for the three and nine months ended September 30, 2018, respectively. Purchases of natural gas from an affiliate were insignificant for the three and nine months ended September 30, 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, legal services, gas supply and capacity management, strategic planning, general administrative services, and retirement benefits. Costs for these services totaled $13.5 million and $50.2 million for the three and nine months ended September 30, 2019, respectively, and $13.6 million and $41.3 million for the three and nine months ended September 30, 2018, respectively. In addition, DESS processes and pays invoices for PSNC and is reimbursed. PSNC’s payables to DESS were $6.1 million at both September 30, 2019 and December 31, 2018.

Borrowings from an affiliate are described in Note 5.

14. OTHER INCOME, NET

Components of other income, net, are as follows:

(thousands)	Three Months Ended September 30, 2019	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2019	Nine Months Ended September 30, 2018
Revenues from contracts with customers	**$ 4,331**	$ 5,465	**$ 15,007**	$ 17,063
Other revenues	**607**	611	**1,771**	1,789
Other expenses[1]	**(4,197)**	(3,199)	**(13,178)**	(9,721)
Allowance for equity used during construction	**1,083**	2,459	**4,786**	5,436
Other income, net	**$ 1,824**	$ 5,336	**$ 8,386**	$ 14,567

[1] *See Note 9 for discussion of voluntary retirement program.*