

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF THE CONSOLIDATED RESULTS OF OPERATIONS
FOR THE THREE MONTHS ENDED MARCH 31, 2006**

Consolidated Results of Operations

The accompanying consolidated financial information reflects the operating results of the Authority and LIPA for the three months ended March 31, 2006 and 2005.

Change in Net assets

The Authority generated revenue over expenses of \$25 million for the three months ended March 31, 2006 compared with expenses over revenue of \$64 million for the three months ended 2005.

Revenue

Revenue for the three months ended March 31, 2006, increased approximately \$138 million. The increase is attributable to higher recoveries of excess fuel costs totaling approximately \$149 million, higher average pricing of approximately \$6 million, offset by decreased load and sales mix totaling approximately \$10 million and the negative effects of weather estimated to be \$7 million.

Fuel and Purchased Power Costs

LIPA's tariff includes a fuel recovery provision—the Fuel and Purchased Power Cost Adjustment ("FPPCA"). The FPPCA was modified by the Board in 2004 to allow LIPA to recover in the period incurred fuel and purchased power costs beyond those included in base rates ("Excess Fuel Costs"). As a result of this modification, the FPPCA was designed to recover a sufficient amount of Excess Fuel Costs to allow the Authority to earn \$20 million of excess revenue over expenses each year as a reserve. If fuel prices change such that LIPA would exceed or fail to meet that financial target, the FPPCA will be reduced or increased accordingly. As a result of continuing increases in fuel and purchased power costs, the Authority increased the FPPCA in 2004 by an annual rate of 4.5% in February, and by an additional annual rate of 5.0% and 1.0% in June and October, respectively. In 2005, the Authority increased the FPPCA by 1.9% annually, effective June 8, and an additional 5.5% annually, effective October 8, as a result of the increasing fuel and purchased power costs. In December 2005 the Authority proposed a modification to the FPPCA to allow the Authority to achieve \$75 million of excess revenue over expenses each year with a variance of \$50 million above or below such amount in each year. This modification was approved by the Board of Trustees in April 2006 after public hearings held in March and April specifically to address public concerns regarding this modification. Also in connection with the adoption of the 2006 Operating Budget in December 2005, the Authority decreased the FPPCA by 1% annually effective January 1, 2006.

Fuel and purchased power costs for the three months ended March 31, 2006, increased approximately \$50 million as compared to the same period in 2005. This increase is primarily attributable to increased commodity costs totaling \$61 million partially offset by lower sales volumes totaling approximately \$11 million.

Operations and maintenance

Operations and maintenance increased approximately \$1 million due to increased PSA costs totaling \$8 million, higher storm cost accruals totaling approximately \$3 million, higher bad debt expense totaling approximately \$2 million and various other items totaling approximately \$1 million. These increases were offset by lower MSA expenses totaling approximately \$13 million, due in part to the newly negotiated annual fee, which through March contributed approximately \$3 million to this decrease. The remaining change is due to the timing and type of work performed under the agreement.

Depreciation and amortization

Depreciation and amortization increased approximately \$2 million due to higher utility plant balances in 2006 when compared to 2005.

Other income

Other income increased approximately \$6 million due primarily to higher sales of emissions credits totaling approximately \$4 million and higher earnings on investment balances totaling approximately \$2 million.

Interest charges

Interest charges increased approximately \$1 million due primarily to higher rates on variable rate debt.

Cash flow from operations

Cash flow from operations decreased approximately \$52 million primarily as a result of changes in the flows of collateral and higher outlays for fuel and purchased power, partially offset by higher receipts from customers. During the quarter ended March 31, 2006 the Authority returned approximately \$117 million of collateral to counterparties, whereas in the quarter ended March 31, 2005, the Authority had received approximately \$51 million of collateral; a change of nearly \$168 million. In addition, the Authority paid out approximately \$64 million more for fuel and purchased power than in the quarter ended March 31, 2005. These negative events were partially offset by higher receipts from customers totaling approximately \$179 million and lower PILOTS of approximately \$1 million.

Other Significant Events

2006 Financing

In March 2006, the Authority issued Series 2006A Electric System General Revenue Bonds, totaling approximately \$853 million to refund approximately \$844 million par value of Series 1998 bonds. The Authority expects this refunding to produce approximately \$49 million net present value savings. The Authority also issued Series 2006B Electric System General Revenue Bonds, totaling approximately \$97 million to reimburse LIPA's treasury for or to fund capital expenditures for system improvements. The 2006B bonds have an average life of 29

years and an all in cost of 4.8%. In addition, the Authority remarketed its \$27 million Series 8F Subordinated Bonds in April 2006.

Voluntary filing with New York State Public Service Commission (PSC)

On May 3, 2006, the Authority voluntarily filed two petitions seeking PSC review of LIPA's FPPCA surcharge including the appropriateness of its charges to customers and seeking a confirmation that LIPA is treating fuel and purchased power costs properly and similar to other New York electric companies. The first petition seeks a declaratory ruling regarding the PSC's interpretation of its rule on escalation clauses, that the PSC allows utilities to automatically recover increased fuel and purchased power and other costs through escalation clauses. The second petition asks the PSC to confirm the appropriateness of the actual costs that LIPA recovers through its fuel and purchased power cost adjustment clause.

**Consolidated Statement of Revenues, Expenses and
Changes in Net Assets
(Thousands of Dollars)**

	Three Months Ended March 31,	
	2006 (unaudited)	2005 (unaudited)
Operating revenues - electric sales	\$ 810,360	\$ 672,207
Operating expenses:		
Operations - fuel and purchased power		
Fuel and purchased power costs	402,751	352,240
Recovery of 2003 Excess Fuel Costs	8,280	9,165
	<u>411,031</u>	<u>361,405</u>
Operations and maintenance	183,932	183,215
General and administrative	9,757	10,122
Depreciation and amortization	60,344	58,328
Payments in lieu of taxes	55,119	54,390
	<u>720,183</u>	<u>667,460</u>
Operating Income	<u>90,177</u>	<u>4,747</u>
Nonoperating revenues and expenses:		
Other income, net		
Investment income	5,013	2,908
Carrying charges on regulatory asset	8,176	8,047
Other	4,379	816
Total other income, net	<u>17,568</u>	<u>11,771</u>
Change in net assets before interest charges and (credits)	<u>107,745</u>	<u>16,518</u>
Interest charges and (credits):		
Interest on long-term debt, net	78,088	75,989
Other interest	5,269	5,231
Allowance for borrowed funds used during construction	(973)	(421)
Total interest charges	<u>82,384</u>	<u>80,799</u>
Change in net assets	25,361	(64,281)
Net assets		
Total net assets, beginning of year	<u>51,620</u>	<u>31,620</u>
Total net assets, end of period	<u>\$ 76,981</u>	<u>\$ (32,661)</u>

Consolidated Balance Sheet
(Thousands of Dollars)

	March 31, 2006 (unaudited)	December 31, 2005 (audited)
Current assets:		
Cash and cash equivalents	\$ 535,152	\$ 454,414
Investments	9,577	16,466
Accounts receivable (less allowance for doubtful accounts of \$19,485)	265,917	343,673
Other accounts receivable	11,321	23,902
Fuel inventory	110,309	104,652
Material and supplies inventory	7,715	7,365
Interest receivable	-	153
Prepayments and other current assets	23,342	21,273
Total Current Assets	<u>963,333</u>	<u>971,898</u>
Noncurrent assets:		
Utility plant and property and equipment, net	4,011,170	4,004,646
Promissory Notes Receivable-KeySpan Energy	155,425	155,425
Nonutility Property and Other Investments	341,275	464,334
Deferred loss - financial derivatives	42,670	88,778
Deferred Charges	<u>88,782</u>	<u>85,050</u>
Regulatory Assets		
Shoreham settlement	568,543	568,316
Fuel and purchased power costs	<u>282,917</u>	<u>291,197</u>
Total Regulatory Assets	<u>851,460</u>	<u>859,513</u>
Acquisition Adjustment (net of accumulated amortization of \$1,043,743 and \$1,015,572, respectively)	<u>3,051,769</u>	<u>3,079,939</u>
Total assets	<u>\$ 9,505,884</u>	<u>\$ 9,709,583</u>
Current liabilities:		
Short-term debt	\$ 100,000	\$ 100,000
Current maturities of long-term debt	216,125	202,325
Current portion of capital lease obligation	121,875	121,813
Accounts payable and accrued expenses	272,217	332,008
Accrued payments in lieu of taxes	30,728	43,552
Accrued interest	62,497	44,780
Counterparty collateral	115,084	232,424
Customer deposits	<u>23,448</u>	<u>23,224</u>
Total current liabilities	<u>941,974</u>	<u>1,100,126</u>
Noncurrent liabilities:		
Long-term debt	6,795,556	6,686,136
Capital lease obligation	1,083,923	1,097,055
Asset retirement obligation	82,620	81,463
Deferred credits	72,664	68,601
Deferred credits - financial derivatives	174,201	222,996
Deferred gain - financial derivatives	6,532	6,339
Regulatory liability-fuel derivatives	246,119	368,666
Claims, damages and storm reserves	<u>25,314</u>	<u>26,581</u>
Total noncurrent liabilities	<u>8,486,929</u>	<u>8,557,837</u>
Net assets		
Invested in capital assets net of related debt	(596,507)	(475,991)
Unrestricted	<u>673,488</u>	<u>527,611</u>
Total net assets	<u>76,981</u>	<u>51,620</u>
Total liabilities and net assets	<u>\$ 9,505,884</u>	<u>\$ 9,709,583</u>

Statement of Cash Flows
(Thousands of Dollars)

	Three Months	
	Ended	
	March 31,	
	2006	2005
	(unaudited)	(unaudited)
Cash flows from operating activities:		
Received from customers for the system sales, net of refunds	\$ 894,722	\$ 715,356
Other operating revenues received	14,942	5,363
Paid to suppliers and employees		
Operations and maintenance	(223,292)	(214,123)
Fuel and purchased power	(416,900)	(352,695)
Payments in lieu of taxes	(89,641)	(91,031)
Margin calls on fuel derivative transactions, net	(117,340)	51,356
Net cash provided by operating activities	<u>62,491</u>	<u>114,226</u>
Investing activities:		
Net sales of investment securities	6,889	32,986
Earnings received on investments	4,701	2,373
Other	3,820	1,531
Net cash provided by investing activities	<u>15,410</u>	<u>36,890</u>
Cash flows from capital and related financing activities:		
Capital and nuclear fuel expenditures	(51,867)	(44,593)
Proceeds from the issuance of commercial paper notes and bonds	993,063	-
Bond issuance costs	(11,963)	-
Interest paid, net	(45,287)	(38,844)
Redemption of long-term debt	(881,109)	-
Net cash provided by (used in) capital and related financing activities	<u>2,837</u>	<u>(83,437)</u>
Net increase in cash and cash equivalents	80,738	67,679
Cash and cash equivalents at beginning of period	454,414	335,068
Cash and cash equivalents at end of period	<u>\$ 535,152</u>	<u>\$ 402,747</u>
Reconciliation to net cash provided by operating activities:		
Operating income	\$ 90,177	\$ 4,747
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	60,344	58,328
Nuclear fuel burned	1,074	1,462
Shoreham surcharge recovery (credits)	7,949	8,155
Provision for claims and damages	4,313	1,788
Accretion of asset retirement obligation	1,157	1,024
Other	1,566	2,177
Changes in operating assets and liabilities:		
Accounts receivable, net	90,337	27,527
Fuel and Material & supplies inventory	(6,007)	(18,912)
Fuel and purchased power costs recovered related to prior periods	8,280	9,165
Counterparty collateral	(117,340)	51,356
Accounts payable and accrued expenses and other	(79,359)	(32,591)
Net cash provided by operating activities	<u>\$ 62,491</u>	<u>\$ 114,226</u>