

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF THE CONSOLIDATED RESULTS OF OPERATIONS  
FOR THE THREE MONTHS ENDED MARCH 31, 2007**

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, 2007 and 2006.

Change in Net Assets

The Authority generated expenses over revenue of \$24 million for the three months ended March 31, 2007 compared with revenue over expenses of \$25 million for the three months ended March 31, 2006.

Revenue

Revenue for the three months ended March 31, 2007, decreased approximately \$32 million. The decrease is attributable to lower power supply costs revenues (discussed below) totaling approximately \$42 million. This decrease was partially offset by the positive effects of weather estimated to be \$6 million relative to the same period in 2006, increased load growth totaling approximately \$3 million, and higher average pricing totaling approximately \$1 million.

Fuel and Purchased Power Costs

LIPA's tariff includes a fuel recovery provision—the Fuel and Purchased Power Cost Adjustment ("FPPCA") that provides for the amount and timing of fuel and purchased power cost recoveries. The FPPCA provides for the recovery of fuel and purchased power costs in the period incurred, in amounts sufficient to allow the Authority to earn a financial target of \$75 million with a variance of \$50 million above or below such amount in each year. Should fuel and purchased power prices change such that LIPA would exceed or fail to meet its financial target, the FPPCA would be reduced or increased accordingly. In no event, however, can LIPA recover an amount that exceeds its fuel and purchased costs incurred.

As a result of lower than anticipated fuel and purchased power costs, the Authority decreased the FPPCA in January 2006 by \$24 million annually. In October 2006, the FPPCA was decreased by an additional \$161 million followed by an additional \$71 million annual reduction in February 2007.

Fuel and purchased power costs for the three months ended March 31, 2007, increased approximately \$20 million as compared to the same period in 2006. This increase is due to higher commodity costs totaling approximately \$43 million and higher sales volumes totaling approximately \$11 million. These increases were partially offset by the net change in the regulatory liability related to fuel cost recovery totaling approximately \$34 million as a result of the October 2006 and February 2007 FPPCA reductions.

Operations and Maintenance

Operations and maintenance expense remained relatively unchanged, however, MSA costs decreased approximately \$5 million which was offset by increased clean energy expenses totaling \$3 million and increased storm accruals totaling approximately \$2 million.

General and administrative

General and administrative expenses decreased approximately \$1 million due to an insurance reimbursement of legal fees.

Depreciation and Amortization

Depreciation and amortization increased approximately \$1 million due to increased depreciation expense as a result of higher utility plant balances in 2007 when compared to 2006.

Payments in Lieu of Taxes

Payments in lieu of taxes increased approximately \$1 million due primarily to increased property taxes.

Other Income

Other income increased approximately \$2 million due to higher investment earnings of approximately \$5 million resulting from higher investment balances coupled with higher interest rates offset by approximately \$3 million of lower sales of emissions allowances.

Interest Charges

Total interest charges decreased approximately \$1 million due primarily to the lack of counterparty collateral held by LIPA on its fuel derivatives in 2007.

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

	<b>Three Months Ended March 31,</b>	
	<b>2007 (unaudited)</b>	<b>2006 (unaudited)</b>
<b>Operating revenues - electric sales</b>	\$ 778,656	\$ 810,360
<b>Operating expenses:</b>		
Operations - fuel and purchased power		
Fuel and purchased power costs	465,656	402,751
Recovery of 2003 Excess Fuel Costs	8,481	8,280
Refund of 2006 Excess Recovery of Fuel Costs	(43,202)	-
	<u>430,935</u>	<u>411,031</u>
Operations and maintenance	184,011	183,932
General and administrative	9,122	9,757
Depreciation and amortization	61,180	60,344
Payments in lieu of taxes	55,825	55,119
	<u>741,073</u>	<u>720,183</u>
<b>Total Operating Expenses</b>	<u>741,073</u>	<u>720,183</u>
<b>Operating Income</b>	<u>37,583</u>	<u>90,177</u>
Nonoperating revenues and expenses:		
<b>Other income, net</b>		
Investment income	10,076	5,013
Carrying charges on regulatory asset	8,122	8,176
Other	1,140	4,379
<b>Total other income, net</b>	<u>19,338</u>	<u>17,568</u>
<b>Change in net assets before interest charges and (credits)</b>	<u>56,921</u>	<u>107,745</u>
<b>Interest charges and (credits):</b>		
Interest on long-term debt, net	78,712	78,088
Other interest	3,385	5,269
Allowance for borrowed funds used during construction	(818)	(973)
<b>Total interest charges</b>	<u>81,279</u>	<u>82,384</u>
<b>Change in net assets</b>	(24,358)	25,361
<b>Net assets</b>		
Total net assets, beginning of year	<u>169,790</u>	<u>51,620</u>
Total net assets, end of period	<u>\$ 145,432</u>	<u>\$ 76,981</u>

**Consolidated Balance Sheet**  
**(Thousands of Dollars)**

	<b>March 31, 2007 (unaudited)</b>	<b>December 31, 2006 (audited)</b>
<b>Current assets:</b>		
Cash and cash equivalents	\$ 533,794	\$ 501,244
Investments	217,981	208,755
Accounts receivable (less allowance for doubtful accounts of \$19,485)	229,572	269,477
Other accounts receivable	6,216	9,615
Fuel inventory	103,404	138,175
Material and supplies inventory	6,846	6,871
Interest receivable	726	460
Prepayments and other current assets	26,488	27,400
Total Current Assets	1,125,027	1,161,997
<b>Noncurrent assets:</b>		
Utility plant and property and equipment, net	4,140,199	4,118,775
Promissory Notes Receivable-KeySpan Energy	155,425	155,425
Nonutility Property and Other Investments	121,141	69,129
Deferred loss - financial derivatives	40,852	46,187
Deferred Charges	87,926	89,643
Regulatory Assets		
Shoreham settlement	565,622	565,392
Fuel and purchased power costs	246,769	295,928
Total Regulatory Assets	812,391	861,320
Acquisition Adjustment (net of accumulated amortization of \$1,156,423 and \$1,128,253 respectively)	2,939,088	2,967,258
Total assets	\$ 9,422,049	\$ 9,469,734
<b>Current liabilities:</b>		
Short-term debt	\$ 100,000	\$ 100,000
Current maturities of long-term debt	218,605	218,605
Current portion of capital lease obligation	120,828	121,380
Accounts payable and accrued expenses	297,301	286,738
Regulatory liability-fuel and purchased power costs	213,662	197,918
Accrued payments in lieu of taxes	26,467	43,462
Accrued interest	66,146	42,771
Customer deposits	25,899	25,137
Total current liabilities	1,068,908	1,036,011
<b>Noncurrent liabilities:</b>		
Long-term debt	6,811,945	6,806,290
Capital lease obligation	1,030,898	1,044,240
Asset retirement obligation	86,357	85,086
Deferred credits	75,365	74,367
Deferred credits - derivatives	157,789	209,973
Deferred gain - derivatives	18,150	12,338
Claims, damages and storm reserves	27,205	31,639
Total noncurrent liabilities	8,207,709	8,263,933
<b>Net assets</b>		
Invested in capital assets net of related debt	(410,728)	(417,837)
Unrestricted	556,160	587,627
Total net assets	145,432	169,790
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Total liabilities and net assets	\$ 9,422,049	\$ 9,469,734

**Statement of Cash Flows**  
**(Thousands of Dollars)**

	<b>Three Months</b>	
	<b>Ended</b>	
	<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(unaudited)</b>	<b>(unaudited)</b>
<b>Cash flows from operating activities:</b>		
Received from customers for the system sales, net of refunds	\$ 830,584	\$ 894,722
Other operating revenues received	11,668	14,942
Paid to suppliers and employees		
Operations and maintenance	(204,133)	(223,292)
Fuel and purchased power	(391,642)	(416,900)
Payments in lieu of taxes	(95,308)	(89,641)
Margin calls on fuel derivative transactions, net	-	(117,340)
Net cash provided by operating activities	<u>151,169</u>	<u>62,491</u>
<b>Investing activities:</b>		
Net (purchases) sales of investment securities	(9,226)	6,889
Earnings received on investments	9,302	4,701
Other	733	3,820
Net cash provided by investing activities	<u>809</u>	<u>15,410</u>
<b>Cash flows from capital and related financing activities:</b>		
Capital and nuclear fuel expenditures	(68,820)	(51,867)
Proceeds from the issuance of commercial paper notes and bonds	-	993,063
Bond issuance costs	(430)	(11,963)
Interest paid, net	(50,178)	(45,287)
Redemption of long-term debt	-	(881,109)
Net cash (used in) provided by capital and related financing activities	<u>(119,428)</u>	<u>2,837</u>
Net increase in cash and cash equivalents	32,550	80,738
Cash and cash equivalents at beginning of period	501,244	454,414
Cash and cash equivalents at end of period	<u>\$ 533,794</u>	<u>\$ 535,152</u>
<b>Reconciliation to net cash provided by operating activities:</b>		
Operating income	\$ 37,583	\$ 90,177
<b>Adjustments to reconcile operating income to net cash provided by operating activities:</b>		
Depreciation and amortization	61,180	60,344
Nuclear fuel burned	1,310	1,074
Shoreham surcharge recovery (credits)	7,892	7,949
Provision for claims and damages	6,513	4,313
Accretion of asset retirement obligation	1,271	1,157
Other	782	1,566
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable, net	43,304	90,337
Fuel and Material & supplies inventory	34,796	(6,007)
Fuel and purchased power costs, net	(26,122)	8,280
Counterparty collateral	-	(117,340)
Accounts payable and accrued expenses and other	(17,340)	(79,359)
Net cash provided by operating activities	<u>\$ 151,169</u>	<u>\$ 62,491</u>