

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF THE CONSOLIDATED RESULTS OF OPERATIONS
FOR THE SIX MONTHS ENDED
JUNE 30, 2008**

Consolidated Results of Operations

The accompanying consolidated financial information reflects the operating results of the Authority and LIPA, (referred to collectively as the "Authority") for the six months ended June 30, 2008 and 2007.

Change in Net Assets

The Authority generated expenses over revenues of approximately \$93 million for the six months ended June 30, 2008 compared with revenues over expenses approximately \$5 million for the six months ended June 30, 2007.

Revenue

Revenue for the six months ended June 30, 2008 increased approximately \$19 million when compared to the similar period of 2007. This increase is primarily attributable to the higher recoveries of power supply costs (discussed below) totaling approximately \$31 million. This increase was partially offset by the negative effects of weather and sales mix resulting in a decrease of approximately \$9 million and lower average commercial customer usage totaling approximately \$3 million.

Fuel and Purchased Power Costs

The Authority's tariff includes a fuel recovery provision—the Fuel and Purchased Power Cost Adjustment ("FPPCA") that 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 the Authority would exceed or fail to meet its financial target, the FPPCA would be reduced or increased accordingly. In no event, however, can the Authority recover an amount that exceeds its fuel and purchased power costs incurred.

For 2008, the Authority increased its FPPCA by \$79 million annually, effective January 1, 2008, in order to collect an amount of incurred fuel costs sufficient to meet its financial target. Effective July 1, 2008, the Authority increased its FPPCA by an additional \$62 million.

Before the effects of the accounting adjustments required by the FPPCA tariff, fuel and purchased power costs for the six months ended June 30, 2008, increased approximately \$121 million. Approximately \$129 million is attributable to higher commodity costs offset by approximately \$8 million as a result of lower sales. In addition, fuel and purchased power costs decreased approximately \$7 million as a result of the net change in the regulatory liability related to fuel cost recovery mechanisms.

Operations and Maintenance

Operations and maintenance expense remained relatively unchanged, however, the Authority experienced higher PSA costs totaling approximately \$6 million as a result of higher capacity costs which were offset by lower clean energy costs totaling approximately \$4 million and lower various items totaling approximately \$2 million.

PILOTs

PILOTs increased approximately \$5 million due to higher Nassau and Suffolk County school and town taxes.

Other Income, Net

Other income increased approximately \$2 million. This is due primarily to the termination of two offsetting interest rate swaps which allowed the Authority to recognize as income the unamortized balance of premiums received in 2003 totaling approximately \$7 million. These increases were offset by lower investment earnings totaling approximately \$3 million as a result of lower rates and lower sales of emissions allowance credits totaling approximately \$2 million.

Interest Charges

Total interest charges decreased approximately \$4 million due primarily to lower debt outstanding in 2008 compared to 2007.

Extraordinary loss on early extinguishment of debt

In March 2008, the Authority redeemed \$200 million of its insured variable rate Electric System General Revenue Bonds to lower the risks associated with their marketability. The Authority used cash on hand to redeem these securities. The Authority had deferred charges totaling approximately \$4 million associated with these bonds that were written-off as a result of this redemption.

Plan of Finance

In response to the market-wide disruption on the Auction Rate Securities market, the Authority converted \$293.6 million of its 2003 Electric System General Revenue Bonds Series I through O from Auction Rate mode to weekly variable rate demand notes.

Other significant events

Cross Sound Cable—Effective July 1, 2008, the Cross Sound Cable will operate under the terms of the Firm Transmission Capacity Supply Agreement as amended in December 2004. The cable has been operating under a bridge agreement that will expire June 30, 2008. As a result of this change, the annual lease payment is expected to increase approximately \$3 million.

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

	Six Months Ended June 30,	
	2008 (unaudited)	2007 (unaudited)
Operating revenues - electric sales	\$ 1,628,528	\$ 1,609,324
Operating expenses:		
Operations - fuel and purchased power		
Fuel and purchased power costs	1,010,533	941,511
Recovery of 2003 Excess Fuel Costs	16,859	17,192
Refund of Prior Year Excess Recovery of Fuel Costs	(45,974)	(90,888)
	981,418	867,815
Operations and maintenance	366,335	366,029
General and administrative	18,554	18,376
Depreciation and amortization	123,023	122,630
Payments in lieu of taxes	116,257	110,840
Total Operating Expenses	1,605,587	1,485,690
Operating Income	22,941	123,634
 Nonoperating revenues and expenses:		
Other income, net		
Investment income	16,157	18,853
Carrying charges on regulatory asset	16,039	16,196
Other	11,193	6,080
Total other income, net	43,389	41,129
 Change in net assets before interest charges and (credits)	66,330	164,763
 Interest charges and (credits):		
Interest on long-term debt, net	151,062	157,478
Other interest	8,313	6,385
Allowance for borrowed funds used during construction	(3,893)	(4,332)
Total interest charges	155,482	159,531
 Change in net assets before extraordinary loss	(89,152)	5,232
Extraordinary loss on early extinguishment of debt	(3,840)	-
Change in net assets	(92,992)	5,232
 Net assets		
Total net assets, beginning of year	262,836	169,790
Total net assets, end of period	\$ 169,844	\$ 175,022

Consolidated Balance Sheet
(Thousands of Dollars)

	June 30, 2008 (unaudited)	December 31, 2007 (audited)
Current assets:		
Cash and cash equivalents	\$ 900,935	\$ 526,531
Investments	342,233	287,881
Accounts receivable (less allowance for doubtful accounts of \$19,485)	270,844	272,666
Other accounts receivable	115,701	101,146
Fuel inventory	185,937	143,206
Fuel derivatives	1,065,737	155,153
Material and supplies inventory	6,784	6,720
Interest receivable	486	690
Prepayments and other current assets	41,554	16,532
Total current assets	2,930,211	1,510,525
Noncurrent assets:		
Utility plant and property and equipment, net	5,345,126	5,320,740
Promissory Notes Receivable-KeySpan Energy	155,425	155,425
Nonutility Property and Other Investments	69,488	70,979
Other long - term receivables	99,474	90,953
Deferred loss - financial derivatives	86,589	71,599
Deferred Charges	87,296	82,208
Regulatory Assets		
Shoreham settlement	562,453	562,212
Fuel and purchased power costs	201,794	218,655
Acquisition Adjustment (net of accumulated amortization of \$1,297,275 and \$1,240,934, respectively)	2,798,237	2,854,578
Total noncurrent assets	9,405,882	9,427,349
Total assets	\$ 12,336,093	\$ 10,937,874
Current liabilities:		
Short-term debt	\$ 100,000	\$ 100,000
Current maturities of long-term debt	213,195	426,570
Current portion of capital lease obligation	202,127	202,336
Accounts payable and accrued expenses	618,850	518,687
Regulatory liability-fuel and purchased power costs	1,134,170	269,476
Accrued payments in lieu of taxes	14,532	38,237
Accrued interest	42,575	43,330
Counterparty collateral	929,275	2,900
Customer deposits	27,547	26,977
Total current liabilities	3,282,271	1,628,513
Noncurrent liabilities:		
Long-term debt	6,290,074	6,402,713
Capital lease obligation	1,973,993	2,018,661
Asset retirement obligation	91,355	91,541
Deferred credits	291,481	298,857
Deferred credits - derivatives	200,673	195,500
Claims, damages and storm reserves	36,402	39,253
Total noncurrent liabilities	8,883,978	9,046,525
Net assets		
Invested in capital assets net of related debt	135,028	(190,510)
Unrestricted	34,816	453,346
Total net assets	169,844	262,836
Total liabilities and net assets	\$ 12,336,093	\$ 10,937,874

Statement of Cash Flows
(Thousands of Dollars)

	Six Months Ended June 30,	
	2008 (unaudited)	2007 (unaudited)
Cash flows from operating activities:		
Received from customers for the system sales, net of refunds	\$ 1,642,912	\$ 1,636,560
Other operating revenues received	16,103	19,716
Paid to suppliers and employees		
Operations and maintenance	(404,605)	(386,860)
Fuel and purchased power	(951,292)	(833,111)
Payments in lieu of taxes	(192,830)	(193,777)
Margin calls on fuel derivative transactions, net	926,375	-
Net cash provided by operating activities	<u>1,036,663</u>	<u>242,528</u>
Investing activities:		
Net sales (purchases) of investment securities	(54,352)	66,644
Earnings received on investments	14,178	17,709
Other	3,073	4,482
Net cash provided by investing activities	<u>(37,101)</u>	<u>88,835</u>
Cash flows from capital and related financing activities:		
Capital and nuclear fuel expenditures	(134,653)	(148,473)
Bond issuance costs	(341)	(430)
Interest paid, net	(151,409)	(148,815)
Redemption of long-term debt	(338,755)	(134,825)
Net cash used in by capital and related financing activities	<u>(625,158)</u>	<u>(432,543)</u>
Net increase (decrease) in cash and cash equivalents	374,404	(101,180)
Cash and cash equivalents at beginning of period	526,531	501,244
Cash and cash equivalents at end of period	<u>\$ 900,935</u>	<u>\$ 400,064</u>
Reconciliation to net cash provided by operating activities:		
Operating income	\$ 22,941	\$ 123,634
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	123,023	122,630
Nuclear fuel burned	2,602	2,768
Shoreham surcharge recovery (credits)	15,798	15,584
Provision for claims and damages	13,917	13,026
Accretion of asset retirement obligation	2,758	2,541
Other	(12,281)	1,566
Changes in operating assets and liabilities:		
Accounts receivable, net	(21,254)	2,482
Fuel and Material & supplies inventory	(42,795)	2,240
Fuel and purchased power costs, net	(29,115)	(38,868)
Counterparty collateral	926,375	-
Accounts payable and accrued expenses and other	34,694	(5,075)
Net cash provided by operating activities	<u>\$ 1,036,663</u>	<u>\$ 242,528</u>