

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF THE CONSOLIDATED RESULTS OF OPERATIONS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006**

Consolidated Results of Operations

The accompanying consolidated financial information reflects the operating results of the Authority and LIPA for the nine months ended September 30, 2006 and 2005.

Change in Net assets

The Authority generated revenue over expenses of \$157 million for the nine months ended September 30, 2006 compared with expenses over revenue of \$31 million for the nine months ended 2005.

Revenue

Revenue for the nine months ended September 30, 2006, increased approximately \$413 million. The increase is attributable to higher recoveries of excess fuel costs totaling approximately \$459 million, and higher average pricing of approximately \$12 million. These increases were offset by a reduction of load of approximately \$1 million, and the negative effects of weather estimated to be \$57 million as the nine months ended September 2006 was cooler than normal as compared to the nine months ended September 2005, which was warmer than normal.

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 to allow LIPA to recover in the period incurred fuel and purchased power costs. As a result of this modification, the FPPCA was designed to recover a sufficient amount of 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 would be reduced or increased accordingly. As a result of continuing increases in fuel and purchased power costs, the Authority increased the FPPCA in 2005 approximately \$45 million annually, effective June 8, and an additional \$133 million annually, effective October 8, 2005. 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 regarding this modification. Also in connection with the adoption of the 2006 Operating Budget in December 2005, the Authority decreased the FPPCA by approximately \$24 million annually effective January 1, 2006. In October 2006, the Authority announced that customer bills would decline approximately \$161 million, annually, or 4% of the typical residential bill, made possible by recent drops in the cost of for fuel and purchased power, and the prospect that these costs will remain lower going forward.

Fuel and purchased power costs for the nine months ended September 30, 2006, increased approximately \$210 million as compared to the same period in 2005. Commodity costs increased approximately \$83 million compared to 2005, partially offset by lower sales volumes totaling approximately \$38 million. In addition, in September 2006 the Authority recorded a \$148 million accrual to reflect a regulatory liability for excess fuel recoveries. The remaining variation was due to the application of customer credits totaling \$17 million in 2005,

which partially offset 2005 fuel and purchased power costs. In 2006, no such customer credits were applied.

Operations and maintenance

Operations and maintenance increased approximately \$22 million due to increased PSA capacity costs totaling \$22 million, higher storm cost accruals totaling approximately \$13 million, higher clean energy expenses totaling approximately \$2 million, higher bad debt expense totaling approximately \$3 million and the settlement of public works claims totaling approximately \$1 million. These increases were partially offset by lower MSA expenses totaling approximately \$19 million, due in part to the newly negotiated annual fee. The remaining change is due to the timing and type of work performed under the agreement.

General and administrative

General and administrative expenses decreased approximately \$2 million due to lower consulting costs, primarily as a result of costs incurred in 2005 related to the strategic assessment to evaluate LIPA's long-term organizational and business options.

Depreciation and amortization

Depreciation and amortization increased approximately \$5 million due to higher utility plant balances in 2006 when compared to 2005.

Payments in lieu of taxes

Payments in lieu of taxes increased approximately \$3 million due primarily to increased revenue taxes (due to higher fuel cost recoveries).

Other income

Other income increased approximately \$14 million due primarily to higher earnings of approximately \$9 million resulting from higher investment balances coupled with higher interest rates, and higher interest income related to New York Independent System Operator (NYISO) prior month's re-bills totaling approximately \$2 million, and higher emissions allowance income of approximately \$3 million.

Interest charges

Total interest charges increased approximately \$1 million. This increase was due to higher rates on variable rate debt resulting in an approximate \$3 million increase which was partially offset by higher allowance for borrowed funds used during construction totaling approximately \$2 million due to higher construction work in progress balances in 2006 compared to 2005.

Counterparty Collateral

The Authority uses derivative financial instruments to mitigate its exposure to fuel and purchased power commodity risk. In accordance with terms of the derivative agreements, counterparties are required to post collateral when their exposure to the Authority exceeds pre-determined boundaries. The Authority held \$0 and \$232 million of counterparty collateral at September 30, 2006 and December 31, 2005, respectively.

Other Significant Events

I. 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. This refunding produced approximately \$49 million net present value savings. The 2006A bonds have an average life of 16.5 years and an all in cost of 4.6%. The Authority also issued Series 2006B Electric System General Revenue Bonds, totaling approximately \$97 million to reimburse LIPA's treasury for capital expenditures for system improvements. The 2006B bonds have an average life of 29 years and an all-in cost of 4.8%.

In July 2006, the Authority issued Series 2006 C and 2006 D Electric System General Revenue Bonds. The Series 2006 C Bonds, of approximately \$198 million par value, was used to reimburse LIPA's treasury for capital expenditures for system improvements. The Series 2006 C Bonds have an average life of 29 years and an all-in cost of approximately 4.9%. The Series 2006 D Bonds, of approximately \$335 million par value, was used to refund approximately \$328 million of existing Authority debt including portions of Series 1998A, Series 1998B, Series 2001A and Series 2003C Bonds. The refunding will produce debt service savings of approximately \$11.6 million on a net present value basis. The average life of the Series 2006 D Bonds is approximately 11 years with an all-in cost of approximately 4.5%.

In September 2006, the Authority issued Series 2006E Electric System General Revenue Bonds, totaling approximately \$515 million par value to refund approximately \$526 million par value of certain Series 1998 bonds. This refunding produced approximately \$26 million net present value savings. The 2006E bonds have an average life of 13.7 years and an all-in cost of 4.4%.

II. 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 sought 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 asked the PSC to confirm the appropriateness of the actual costs that LIPA recovers through its fuel and purchased power cost adjustment clause. With respect to the first petition, the PSC, on June 20, 2006, issued a Declaratory Ruling which confirmed that the PSC permits the use of adjustment clauses to allow utilities to adjust their rates to reflect changes in fuel and other costs. With respect to the second petition, the PSC issued an Order on June 20, 2006, declining the Authority's request that it review the appropriateness of LIPA's recovery of fuel and purchased power costs through the FPPCA. The PSC noted that LIPA is not subject to PSC jurisdiction except in very limited circumstances unrelated to ratemaking, and LIPA's rates, services and practices are not governed by, and need not comply with, the provisions of the Public Service Law and the PSC's regulations. A Petition for Rehearing of the PSC's Order was filed on July 19, 2006. On November 13, 2006, the PSC issued an Order Denying Petition for Rehearing. The PSC stated in the Order that the relief sought by the Petition for Rehearing--full

review of LIPA's rates and practices-- is not within our [PSC's] jurisdiction, and authority to grant that relief has not been granted to us [PSC] by the legislature.

Suffolk County has initiated a lawsuit challenging the PSC's Order declining to review the appropriateness of LIPA's recovery of fuel and purchased power costs through the FPPCA.

In a separate letter to the Authority in June 2006, the Chairman of the PSC offered technical assistance to the Authority in procuring and overseeing an independent consultant to perform a review of the FPPCA, should the Authority choose to pursue that option. The Authority expects to retain an independent consultant to conduct such a review.

III. Rate Litigation

Lawsuits commenced as a proposed class action challenging the steps LIPA has taken to increase customer bills to reflect increases in its fuel and purchased power costs, have been dismissed by a State Supreme Court Justice. Among other allegations, the Plaintiffs contended that such increases violated certain conditions imposed on LIPA by the New York State Public Authorities Control Board in 1997. The lawsuits also repeated several criticisms directed at LIPA in a report issued by the New York State Comptroller in December 2005 which, among other things, took issue with the methodology used by LIPA in applying its FPPCA and criticized the increases in customer bills which have resulted from application of the FPPCA. The plaintiffs were seeking injunctive relief and an unspecified amount of damages on behalf of themselves and other class members. LIPA believes that its rate structure, including the FPPCA, complies with applicable legal requirements and that the methodology it uses to calculate the FPPCA is correct. Attorneys representing the plaintiffs said they will appeal the decision.

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

	Nine Months Ended September 30,	
	2006 (unaudited)	2005 (unaudited)
Operating revenues - electric sales	\$ 2,854,453	\$ 2,441,262
Operating expenses:		
Operations - fuel and purchased power		
Fuel and purchased power costs	1,527,186	1,315,714
Recovery of 2003 Excess Fuel Costs	27,571	29,217
	1,554,757	1,344,931
Operations and maintenance	567,222	545,337
General and administrative	29,521	31,989
Depreciation and amortization	181,620	176,732
Payments in lieu of taxes	170,593	167,484
Total Operating Expenses	2,503,713	2,266,473
Operating Income	350,740	174,789
Nonoperating revenues and expenses:		
Other income, net		
Investment income	20,790	11,476
Carrying charges on regulatory asset	24,363	24,218
Other	10,855	6,811
Total other income, net	56,008	42,505
Change in net assets before interest charges and (credits)	406,748	217,294
Interest charges and (credits):		
Interest on long-term debt, net	238,843	235,476
Other interest	14,190	14,251
Allowance for borrowed funds used during construction	(3,948)	(1,652)
Total interest charges	249,085	248,075
Change in net assets	157,663	(30,781)
Net assets		
Total net assets, beginning of year	51,620	31,620
Total net assets, end of period	\$ 209,283	\$ 839

Consolidated Balance Sheet
(Thousands of Dollars)

	September 30, 2006 (unaudited)	December 31, 2005 (audited)
Current assets:		
Cash and cash equivalents	\$ 556,591	\$ 454,414
Investments	186,308	16,466
Accounts receivable (less allowance for doubtful accounts of \$19,485)	410,103	343,673
Other accounts receivable	11,788	23,902
Fuel inventory	148,008	104,652
Material and supplies inventory	7,002	7,365
Interest receivable	598	153
Prepayments and other current assets	21,606	21,273
Total Current Assets	1,342,004	971,898
Noncurrent assets:		
Utility plant and property and equipment, net	4,068,936	4,004,646
Promissory Notes Receivable-KeySpan Energy	155,425	155,425
Nonutility Property and Other Investments	86,873	464,334
Deferred loss - financial derivatives	46,081	88,778
Deferred Charges	91,165	85,050
Regulatory Assets		
Shoreham settlement	565,090	568,316
Fuel and purchased power costs	146,928	323,110
Total Regulatory Assets	712,018	891,426
Acquisition Adjustment (net of accumulated amortization of \$1,100,083 and \$1,015,572, respectively)	2,995,428	3,079,939
Total assets	\$ 9,497,930	\$ 9,741,496
Current liabilities:		
Short-term debt	\$ 100,000	\$ 100,000
Current maturities of long-term debt	312,530	202,325
Current portion of capital lease obligation	121,611	121,813
Accounts payable and accrued expenses	336,241	332,008
Accrued payments in lieu of taxes	31,292	43,552
Accrued interest	64,298	44,780
Counterparty collateral	-	232,424
Customer deposits	24,398	23,224
Total current liabilities	990,370	1,100,126
Noncurrent liabilities:		
Long-term debt	6,851,676	6,686,136
Capital lease obligation	1,057,378	1,097,055
Asset retirement obligation	83,885	81,463
Deferred credits	73,547	68,601
Deferred credits - financial derivatives	176,275	222,996
Deferred gain - financial derivatives	6,547	6,339
Regulatory liability-fuel derivatives	21,235	400,579
Claims, damages and storm reserves	27,734	26,581
Total noncurrent liabilities	8,298,277	8,589,750
Net assets		
Invested in capital assets net of related debt	(803,051)	(475,991)
Unrestricted	1,012,334	527,611
Total net assets	209,283	51,620
Total liabilities and net assets	\$ 9,497,930	\$ 9,741,496

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

	Nine Months Ended September 30,	
	2006 (unaudited)	2005 (unaudited)
Cash flows from operating activities:		
Received from customers for the system sales, net of refunds	\$ 2,826,006	\$ 2,356,550
Other operating revenues received	27,418	20,407
Paid to suppliers and employees		
Operations and maintenance	(596,666)	(602,561)
Fuel and purchased power	(1,353,701)	(1,233,573)
Payments in lieu of taxes	(262,060)	(245,512)
Margin calls on fuel derivative transactions, net	(232,424)	408,140
Net cash provided by operating activities	408,573	703,451
Investing activities:		
Net purchases of investment securities	(169,842)	55,962
Earnings received on investments	19,188	10,230
Other	9,965	5,790
Net cash provided by investing activities	(140,689)	71,982
Cash flows from capital and related financing activities:		
Capital and nuclear fuel expenditures	(203,194)	(133,781)
Proceeds from the issuance of commercial paper notes and bonds	2,118,973	-
Bond issuance costs	(24,042)	-
Interest paid, net	(186,132)	(194,608)
Redemption of long-term debt	(1,871,312)	(83,800)
Net cash used in capital and related financing activities	(165,707)	(412,189)
Net increase in cash and cash equivalents	102,177	363,244
Cash and cash equivalents at beginning of period	454,414	335,068
Cash and cash equivalents at end of period	\$ 556,591	\$ 698,312
Reconciliation to net cash provided by operating activities:		
Operating income	\$ 350,740	\$ 174,789
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	181,620	176,732
Nuclear fuel burned	4,242	4,451
Shoreham surcharge recovery (credits)	27,589	27,655
Provision for claims and damages	18,713	10,361
Accretion of asset retirement obligation	3,498	3,074
Other	2,951	4,449
Changes in operating assets and liabilities:		
Accounts receivable, net	(54,316)	(149,362)
Fuel and Material & supplies inventory	(42,993)	(19,656)
Regulatory asset - Fuel and purchased power costs	176,181	29,217
Counterparty collateral	(232,424)	408,140
Accounts payable and accrued expenses and other	(27,228)	33,601
Net cash provided by operating activities	\$ 408,573	\$ 703,451