

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF THE CONSOLIDATED RESULTS OF OPERATIONS
FOR THE NINE MONTHS ENDED
SEPTEMBER 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 nine months ended September 30, 2008 and 2007.

Change in Net Assets

The Authority generated revenues over expenses of approximately \$35 million for the nine months ended September 30, 2008 compared with approximately \$161 million for the nine months ended September 30, 2007.

Revenue

Revenue for the nine months ended September 30, 2008 increased approximately \$59 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 \$84 million partially offset by the sales mix and lower average customer usage, (primarily in the Commercial & Industrial segment), totaling approximately \$24 million and the negative effects of weather totaling approximately \$1 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 nine months ended September 30, 2008, increased approximately \$220 million. Approximately \$232 million is attributable to higher commodity costs offset by approximately \$12 million as a result of lower sales. In addition, fuel and purchased power costs decreased approximately \$30 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 decreased approximately \$4 million as a result of lower clean energy costs totaling approximately \$4 million, lower MSA costs totaling approximately \$3 million and other various items totaling \$2 million. These decreases were partially offset by higher storm cost accruals totaling approximately \$4 million and higher PSA costs totaling approximately \$1 million.

PILOTs

PILOTs increased approximately \$10 million as a result of higher Nassau and Suffolk County school and town taxes totaling approximately \$8 million and higher revenue taxes totaling approximately \$2 million which is attributable to a settlement of prior years' taxes.

Prior Service Cost- OPEBs

In 2007, the Authority adopted the provisions of GASB No. 45, *Accounting and Financial Reporting for Post Employment Benefits Other than Pensions*, which required LIPA to recognize the unfunded actuarial accrued liability related to periods prior to the adoption of this pronouncement totaling approximately \$11 million. The current period expense for providing health benefits to employees upon their retirement is included in G&A.

Other Income, Net

Other income decreased approximately \$1 million. This is due to lower investment earnings totaling approximately \$7 million as a result of lower rates and lower sales of emissions allowance credits totaling approximately \$7 million. Offsetting these decreases was 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, and lower costs in 2008 related to the community benefits package associated with the Caithness generating station.

Interest Charges

Total interest charges decreased approximately \$5 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.

Finance Activities

In May 2008, in response to the market-wide disruption in the Auction Rate Securities market, the Authority converted \$293.6 million of its Electric System General Revenue Bonds Series I through O from Auction Rate mode to weekly variable rate demand notes.

In October 2008, the Authority issued approximately \$605 million Electric System General Revenue Bonds, Series 2008A. The proceeds of these fixed rate bonds, net of discount and cost of issuance, will be used to replenish the treasury for funds used to finance the Authority's on-going capital program with the remainder used to redeem \$375 million of the Authority's insured auction rate securities in November 2008.

Other significant events

Cross Sound Cable—Effective July 1, 2008, the Cross Sound Cable began operating under the terms of a Firm Transmission Capacity Supply Agreement as amended in December 2004. The agreement is for a 24 year period and has been capitalized in accordance with FAS No. 13 Accounting for Leases.

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

	Nine Months Ended September 30,	
	2008 (unaudited)	2007 (unaudited)
Operating revenues - electric sales	\$ 2,785,682	\$ 2,726,901
Operating expenses:		
Operations - fuel and purchased power		
Fuel and purchased power costs	1,652,540	1,528,943
Recovery of 2003 Excess Fuel Costs	27,668	27,969
Refund of Prior Year Excess Recovery of Fuel Costs	(82,877)	(150,015)
	1,597,331	1,406,897
Operations and maintenance	580,707	585,101
General and administrative	26,840	26,864
Depreciation and amortization	184,782	184,702
Payments in lieu of taxes	180,045	170,481
Prior service cost-OPEB's	-	10,918
Total Operating Expenses	2,569,705	2,384,963
Operating Income	215,977	341,938
Nonoperating revenues and expenses:		
Other income, net		
Investment income	20,839	27,582
Carrying charges on regulatory asset	23,923	24,176
Other	12,840	7,304
Total other income, net	57,602	59,062
Change in net assets before interest charges and (credits)	273,579	401,000
Interest charges and (credits):		
Interest on long-term debt, net	228,945	235,999
Other interest	12,121	9,879
Allowance for borrowed funds used during construction	(6,092)	(6,216)
Total interest charges	234,974	239,662
Change in net assets before extraordinary loss	38,605	161,338
Extraordinary loss on early extinguishment of debt	(3,840)	-
Change in net assets	34,765	161,338
Net assets		
Total net assets, beginning of year	262,836	169,790
Total net assets, end of period	\$ 297,601	\$ 331,128

Consolidated Balance Sheet
(Thousands of Dollars)

	September 30, 2008 (unaudited)	December 31, 2007 (audited)
Current assets:		
Cash and cash equivalents	\$ 185,637	\$ 526,531
Investments	101,683	287,881
Counterparty collateral, net	4,372	-
Accounts receivable (less allowance for doubtful accounts of \$19,485)	379,379	272,666
Other accounts receivable	73,636	101,146
Fuel inventory	212,187	143,206
Fuel derivatives	-	155,153
Material and supplies inventory	6,905	6,720
Interest receivable	214	690
Prepayments and other current assets	22,666	16,532
Total current assets	<u>986,679</u>	<u>1,510,525</u>
Noncurrent assets:		
Utility plant and property and equipment, net	5,654,255	5,320,740
Promissory notes receivable-KeySpan Energy	155,425	155,425
Nonutility property and other investments	67,249	70,979
Other long - term receivables	91,611	90,953
Deferred loss - financial derivatives	134,152	71,599
Deferred charges	85,507	82,208
Regulatory assets		
Shoreham settlement	558,035	562,212
Fuel and purchased power costs	230,917	218,655
Acquisition adjustment (net of accumulated amortization of \$1,325,445 and \$1,240,934, respectively)	2,770,067	2,854,578
Total noncurrent assets	<u>9,747,218</u>	<u>9,427,349</u>
Total assets	<u>\$ 10,733,897</u>	<u>\$ 10,937,874</u>
Current liabilities:		
Short-term debt	\$ 100,000	\$ 100,000
Current maturities of long-term debt	212,580	426,570
Current portion of capital lease obligation	97,527	90,761
Accounts payable and accrued expenses	543,313	518,687
Regulatory liability-fuel and purchased power costs	31,533	269,476
Accrued payments in lieu of taxes	27,405	38,237
Accrued interest	64,875	43,330
Counterparty collateral	-	2,900
Customer deposits	27,738	26,977
Total current liabilities	<u>1,104,971</u>	<u>1,516,938</u>
Noncurrent liabilities:		
Long-term debt	6,296,282	6,402,713
Capital lease obligation	2,344,426	2,130,236
Asset retirement obligation	90,000	91,541
Deferred credits	279,852	298,857
Deferred credits - derivatives	286,644	195,500
Claims, damages and storm reserves	34,121	39,253
Total noncurrent liabilities	<u>9,331,325</u>	<u>9,158,100</u>
Total net assets	<u>297,601</u>	<u>262,836</u>
Total liabilities and net assets	<u>\$ 10,733,897</u>	<u>\$ 10,937,874</u>

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

	Nine Months Ended September 30,	
	2008 (unaudited)	2007 (unaudited)
Cash flows from operating activities:		
Received from customers for the system sales, net of refunds	\$ 2,700,088	\$ 2,646,582
Other operating revenues received	19,128	33,930
Paid to suppliers and employees		
Operations and maintenance	(606,163)	(562,657)
Fuel and purchased power	(1,636,488)	(1,346,043)
Payments in lieu of taxes	(267,496)	(266,850)
Margin calls on fuel derivative transactions, net	(7,272)	-
Net cash provided by operating activities	201,797	504,962
Investing activities:		
Net sales (purchases) of investment securities	186,195	(7,735)
Earnings received on investments	18,342	25,889
Other	4,516	11,168
Net cash provided by used in investing activities	209,053	29,322
Cash flows from capital and related financing activities:		
Capital and nuclear fuel expenditures	(211,036)	(207,116)
Proceeds from the issuance of commercial paper notes and bonds	-	-
Bond issuance costs	(356)	(430)
Interest paid, net	(200,982)	(207,846)
Redemption of long-term debt	(339,370)	(135,415)
Net cash used in capital and related financing activities	(751,744)	(550,807)
Net decrease in cash and cash equivalents	(340,894)	(16,523)
Cash and cash equivalents at beginning of period	526,531	501,244
Cash and cash equivalents at end of period	\$ 185,637	\$ 484,721
Reconciliation to net cash provided by operating activities:		
Operating income	\$ 215,976	\$ 341,938
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	184,782	184,702
Nuclear fuel burned	4,296	4,229
Shoreham surcharge recovery (credits)	28,100	27,143
Provision for claims and damages	23,375	19,539
Accretion of asset retirement obligation	4,112	3,811
Other	(22,967)	2,348
Changes in operating assets and liabilities:		
Accounts receivable, net	(79,861)	(128,539)
Fuel and Material & supplies inventory	(69,166)	14,716
Regulatory asset - Fuel and purchased power costs	(55,209)	(53,431)
Counterparty collateral	(7,272)	-
Accounts payable and accrued expenses and other	(24,369)	88,506
Net cash provided by operating activities	\$ 201,797	\$ 504,962