

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE NINE MONTHS ENDED  
SEPTEMBER 30, 2009**

***Consolidated Income Statement***

**Change in Net Assets**

The Authority experienced increased net assets of \$46 million for the nine months ended September 30, 2009 compared with \$39 million (before the effects of the extraordinary loss of approximately \$4 million) for the nine months ended September 30, 2008. The main components of the variance are as follows:

**Revenue**

Revenue decreased approximately \$3 million due to the negative effects of weather totaling \$31 million and lower average customer usage totaling approximately \$26 million partially offset by higher net recoveries of power supply costs (discussed below) totaling \$54 million.

**Fuel and Purchased Power Costs**

Fuel and purchased power costs decreased \$157 million. LIPA experienced lower net commodity costs totaling \$368 million and lower consumption due to sales volumes totaling \$58 million. Offsetting those decreases was the impact of regulatory accounting items totaling \$269 million. A significant portion of the regulatory accounting items (\$236 million) relates to the collection of fuel and power supply costs in excess of actual costs incurred. Since LIPA's FPPCA tariff limits recovery to the actual power supply costs incurred, LIPA recorded a regulatory liability totaling \$236 million which represents amounts due to the customer as of September 30, 2009. This excess recovery is due to declining commodity costs during 2009. In order to begin returning the excess recovery to its customers, LIPA reduced its FPPCA, effective May 1, 2009. In addition, LIPA intends to issue customer bill credits over the next several months totaling \$144 million.

**Operations and Maintenance**

Operations and maintenance expense increased \$85 million due to higher Power Supply Agreement (PSA) billings totaling \$55 million in accordance with the Federal Energy Regulatory Commission (FERC) PSA reset proceeding (billings are subject to refund based upon the outcome of those proceedings), higher assessment charges totaling \$20 million due to the recently-enacted Temporary State Energy and Utility Service Conservation Assessment, higher charge-offs of bad debt accounts totaling \$6 million and higher clean energy costs totaling \$4 million. A summary of these variances is as follows:

<b><u>Operation and Maintenance Variances</u></b>	<b>(In Millions)</b>
Power Supply Agreement	\$55
Temporary State Energy & Utility Service Conservation Assessment	20
Higher charge-offs of bad debt accounts	6
Clean Energy Costs	4
<b>Total Variance</b>	<b>\$85</b>

**General and Administrative**

Increased \$3 million due to higher salary and benefit costs totaling \$1 million due to an updated actuarial report for OPEB related costs, higher consulting costs totaling \$1 million due to various new programs and higher consulting and advertising costs related to the Efficiency Long Island program.

**Depreciation and Amortization**

Increased \$6 million due to higher utility plant balances in 2009 compared to 2008.

**PILOTS - revenue based**

PILOTS - revenue based decreased \$1 million due to a tax settlement paid in 2008 as a result of an audit.

**PILOTS - property based**

PILOTS - property based increased approximately \$7 million due to increased town and school taxes.

**Other Income, Net**

Decreased \$34 million due primarily to lower investment earnings totaling \$19 million as a result of lower average cash balances and lower interest rates, lower sales of emissions allowance credits totaling \$3 million and higher miscellaneous expenses totaling \$5 million (due to the Board approved costs related to the Caithness community benefits package). In addition in 2008, LIPA recognized \$7 million of non-recurring income related to an interest rate swap that was terminated.

**Interest Charges**

Increased approximately \$14 million due to higher interest rates on fixed rate debt which refunded variable rate securities and higher debt balances outstanding.

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

	<b>Nine Months Ended September 30,</b>		<b>Variance</b>
	<b>2009 (unaudited)</b>	<b>2008</b>	
<b>Operating revenues - electric sales</b>	\$ 2,782,851	\$ 2,785,682	\$ (2,831)
<b>Operating expenses:</b>			
Operations - fuel and purchased power:			
Fuel and purchased power costs	1,253,179	1,680,151	(426,972)
2009 Fuel revenue recoveries in excess of costs incurred	236,296	-	236,296
Recovery of 2003 Excess Fuel Costs	26,727	27,668	(941)
Refund of Prior Year Excess Recovery of Fuel Costs	-	(82,877)	82,877
Amortization of KeySpan 2006 settlement credits	(76,321)	(27,611)	(48,710)
Total Fuel and Purchased Power Expense	<u>1,439,881</u>	<u>1,597,331</u>	<u>(157,450)</u>
Operations and maintenance	666,048	580,707	85,341
General and administrative	30,068	26,841	3,227
Depreciation and amortization	190,331	184,782	5,549
Payments in lieu of taxes - revenue based	44,104	45,757	(1,653)
Payments in lieu of taxes - property based	141,601	134,288	7,313
Total Operating Expenses	<u>2,512,033</u>	<u>2,569,706</u>	<u>(57,673)</u>
<b>Operating Income</b>	<u>270,818</u>	<u>215,976</u>	<u>54,842</u>
<b>Other income, net</b>	<u>23,351</u>	<u>57,603</u>	<u>(34,252)</u>
<b>Interest charges and (credits)</b>	<u>248,610</u>	<u>234,974</u>	<u>13,636</u>
<b>Change in net assets before extraordinary loss</b>	45,559	38,605	6,954
<b>Extraordinary loss on early extinguishment of debt</b>	-	(3,840)	3,840
<b>Change in net assets</b>	<u>45,559</u>	<u>34,765</u>	<u>10,794</u>
<b>Net assets</b>			
Total net assets, beginning of year	<u>289,178</u>	<u>262,836</u>	<u>26,342</u>
Total net assets, end of period	<u>\$ 334,737</u>	<u>\$ 297,601</u>	<u>\$ 37,136</u>

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

	<b>September 30, 2009 (unaudited)</b>	<b>December 31, 2008 (audited)</b>	<b>Variance</b>
<b>Current assets:</b>			
Cash and cash equivalents	\$ 565,576	\$ 225,158	\$ 340,418
Investments	8,018	32,562	(24,544)
Counterparty collateral - posted by the Authority	95,225	229,285	(134,060)
Accounts receivable (less allowance for doubtful accounts of \$21,501 and \$19,485, respectively)	367,519	275,755	91,764
Other accounts receivable	60,555	49,503	11,052
Fuel inventory	142,228	131,286	10,942
Material and supplies inventory	7,975	7,282	693
Interest receivable	30	275	(245)
Prepayments and other current assets	43,257	31,883	11,374
Total current assets	<u>1,290,383</u>	<u>982,989</u>	<u>307,394</u>
<b>Noncurrent assets:</b>			
Utility plant and property and equipment, net	6,484,024	5,725,010	759,014
Promissory Notes Receivable-KeySpan Energy	155,425	155,425	-
Nonutility Property and Other Investments	74,436	71,753	2,683
Other long - term receivables	67,085	80,276	(13,191)
Deferred loss - financial derivatives	213,977	386,462	(172,485)
Deferred Charges	124,343	117,622	6,721
Regulatory Assets			
Shoreham settlement	553,377	557,470	(4,093)
Fuel and purchased power costs	372,886	539,760	(166,874)
Acquisition Adjustment (net of accumulated amortization)	2,657,386	2,741,897	(84,511)
Total noncurrent assets	<u>10,702,939</u>	<u>10,375,675</u>	<u>327,264</u>
Total assets	<u>\$ 11,993,322</u>	<u>\$ 11,358,664</u>	<u>\$ 634,658</u>
<b>Current liabilities:</b>			
Short-term debt	\$ 200,000	\$ 200,000	\$ -
Current maturities of long-term debt	201,425	241,370	(39,945)
Current portion of capital lease obligation	126,066	102,844	23,222
Accounts payable and accrued expenses	343,661	366,897	(23,236)
Regulatory liability-fuel and purchased power costs	237,646	2,483	235,163
Accrued payments in lieu of taxes	32,356	37,708	(5,352)
Accrued interest	86,973	52,138	34,835
Customer deposits	28,192	28,049	143
Total current liabilities	<u>1,256,319</u>	<u>1,031,489</u>	<u>224,830</u>
<b>Noncurrent liabilities:</b>			
Long-term debt	6,515,180	6,394,364	120,816
Capital lease obligation	3,003,149	2,369,168	633,981
Asset retirement obligation	98,651	92,558	6,093
Deferred credits	217,747	299,072	(81,325)
Deferred credits - derivatives	537,952	854,805	(316,853)
Claims, damages and storm reserves	29,587	28,030	1,557
Total noncurrent liabilities	<u>10,402,266</u>	<u>10,037,997</u>	<u>364,269</u>
<b>Net assets:</b>			
Invested in capital assets net of related debt	(102,486)	(56,269)	(46,217)
Restricted	95,225	229,285	(134,060)
Unrestricted	341,998	116,162	225,836
Total net assets	<u>334,737</u>	<u>289,178</u>	<u>45,559</u>
Total liabilities and net assets	<u>\$ 11,993,322</u>	<u>\$ 11,358,664</u>	<u>\$ 634,658</u>

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

	<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
	<b>(unaudited)</b>	<b>(unaudited)</b>
<b>Cash flows from operating activities:</b>		
Received from customers for the system sales, net of refunds	\$ 2,708,268	\$ 2,700,088
Other operating revenues received	57,767	19,128
Paid to suppliers and employees		
Operations and maintenance	(737,366)	(606,163)
Fuel and purchased power	(1,222,851)	(1,636,488)
Payments in lieu of taxes	(274,317)	(267,496)
Margin calls on fuel derivative transactions, net	134,060	(7,272)
Net cash provided by operating activities	665,561	201,797
<b>Investing activities:</b>		
Redemption and sales of investment securities	27,600	657,829
Purchase of investment securities	(2,997)	(525,919)
Fair value adjustment - short term securities	91	385
Realized gains on short term securities	(150)	(7,021)
Earnings received on investments	2,438	18,342
Other	(4,181)	4,513
Net cash provided by (used in) investing activities	22,801	148,129
<b>Cash flows from capital and related financing activities:</b>		
Capital and nuclear fuel expenditures	(208,772)	(211,036)
Proceeds from KeySpan/National Grid promissory note	7,291	-
Proceeds from the issuance of bonds, net of discount	445,045	-
Bond issuance costs	(3,112)	(356)
Interest paid, net	(206,956)	(200,982)
Redemption of long-term debt	(381,440)	(339,370)
Net cash used in by capital and related financing activities	(347,944)	(751,744)
Net increase in cash and cash equivalents	340,418	(401,818)
Cash and cash equivalents at beginning of period	225,158	526,531
Cash and cash equivalents at end of period	\$ 565,576	\$ 124,713
<b>Reconciliation to net cash provided by operating activities:</b>		
Operating income	\$ 270,818	\$ 215,976
<b>Adjustments to reconcile operating income to net cash provided by operating activities:</b>		
Depreciation and amortization	190,332	184,782
Nuclear fuel burned	4,999	4,296
Shoreham surcharge recovery (credits)	27,692	28,100
Provision for claims and damages	23,836	23,375
Accretion of asset retirement obligation	4,006	4,112
Amortization of settlement benefits to ratepayers	(76,321)	(27,611)
Other	(1,385)	4,644
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable, net	(91,641)	(79,861)
Fuel and Material & supplies inventory	(11,635)	(69,166)
Fuel and purchased power costs, net	261,890	(55,209)
Counterparty collateral	134,060	(7,272)
Accounts payable and accrued expenses and other	(71,090)	(24,369)
Net cash provided by operating activities	\$ 665,561	\$ 201,797