

**MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE NINE MONTHS ENDED
SEPTEMBER 30, 2011 VERSUS 2010**

Change in Net Assets

The change in net assets for the nine months ended September 30, 2011 reflects a gain of \$64 million as compared with the prior year gain of \$132 million for the nine months ended September 30, 2010. The details of the \$68 million variance are as follows:

Revenues

Revenue decreased approximately \$123 million. Approximately \$61 million of the decrease was due to year over year operations that resulted in lower booked power supply costs recovery totaling \$110 million due to a reduction in the power supply rate and lower sales totaling \$7 million, partially offset by increased rates associated with Efficiency Long Island totaling approximately \$19 million, increased delivery charge rates totaling \$33 million and increased late payment charges totaling \$4 million. The remaining \$62 million resulted from a new methodology related to accrued sales that was adopted in 2010.

Fuel and Purchased Power Costs

Fuel and purchased power costs decreased \$69 million. The decrease is due to lower net commodity prices totaling \$70 million and lower sales impacting fuel costs by \$5 million. This was partially offset by lower amortization of KeySpan settlement credits of \$6 million.

Operations and Maintenance

Operations and maintenance expense increased \$27 million due to higher Efficiency LI costs totaling \$11 million, higher scheduled costs under the Power Supply Agreement (PSA) totaling \$8 million, higher Management Services Agreement costs totaling \$2 million, and higher bad debt expense totaling \$3 million.

A summary of the O&M variances are as follows:

<i>Operation and Maintenance Variances</i>	<i>(In Millions)</i>
Energy efficiency costs	\$ 11
Higher PSA costs	8
Higher MSA costs	2
Higher bad debt expense	3
Other various items	3
Total Variance	\$ 27

Storm restoration

The increase totaling \$30 million is primarily due to the costs associated with Tropical Storm Irene (\$177 million) resulting in year-to-date storm restoration costs totaling \$220 million. As of September 30, 2010, storm restoration costs totaled \$190 million which included the March 2010 Nor'easter (\$69 million) and Hurricane Earle (\$36 million).

General and Administrative

Increased approximately \$2 million due to increased consulting costs and increased personnel expenses.

Depreciation and Amortization

The increase totaling approximately \$15 million was due to (i) increased transmission and distribution plant balances resulting in a depreciation expense increase of \$5 million expense and (ii) a \$10 million reduction to the accumulated amortization of the acquisition adjustment recorded in 2010 resulting from the adoption of a revised accrued sales methodology.

PILOTS – revenue based

Revenue based PILOTS decreased approximately \$4 million due to lower revenues billed and an adjustment related to the power for jobs program.

PILOTS - property based

Increased approximately \$19 million due to increased town and school taxes.

Grant Income

Grant income increased approximately \$83 million due primarily to the expected FEMA reimbursements related to the Tropical Storm Irene which are approximated to be \$133 million compared with the prior year for the March 2010 Nor'easter which totaled \$53 million.

Also, in May 2010, LIPA issued taxable Build America Bonds for which LIPA receives an interest subsidy from the federal government equal to 35 percent of the interest paid. As of September 30, 2011, LIPA recognized approximately \$2 million more than the prior year due to the mid-year issuance date.

Interest Charges

Interest charges increased approximately \$6 million due to approximately \$5 million related to higher average interest rates on bonds and approximately \$1 million for higher interest paid to customers (related to incorrect billings).

Consolidated Balance Sheet
(Thousands of Dollars)

	September 30, 2011 (unaudited)	December 31, 2010 (audited)
Current assets and deferred outflows:		
Cash and cash equivalents	\$ 505,121	\$ 363,319
Investments	20,997	115,707
Counterparty collateral - posted by the Authority	-	365
Accounts receivable (less allowance for doubtful accounts of \$32,519, respectively)	693,246	565,339
Other accounts receivable	208,979	80,617
Fuel inventory	153,865	167,630
Material and supplies inventory	8,077	7,432
Deferred charges	-	2,744
Deferred outflow - commodity derivatives	9,934	90,341
Prepayments and other current assets	9,743	13,489
	<u>1,609,962</u>	<u>1,406,983</u>
Noncurrent assets and deferred outflows:		
Utility plant and property and equipment, net	6,391,732	6,431,896
Promissory Notes Receivable-KeySpan Energy	155,425	155,425
Nonutility Property and Other Investments	81,387	80,703
Other long - term receivables	44,378	65,145
Deferred outflow - commodity derivatives	47,970	24,098
Deferred outflow - financial derivatives	202,803	81,729
Deferred Charges	118,808	114,668
Regulatory Assets		
Shoreham settlement	535,950	542,798
Fuel and purchased power costs	122,133	150,674
New York State assessment	30,387	27,788
Southampton visual benefit assessment	11,706	11,900
Deferred transition costs	10,346	12,734
Acquisition Adjustment (net of accumulated amortization)	2,403,835	2,487,366
Total noncurrent assets and deferred outflows	<u>10,156,860</u>	<u>10,186,924</u>
Total assets and deferred outflows	<u>\$ 11,766,822</u>	<u>\$ 11,593,907</u>
Current liabilities:		
Short-term debt	\$ 200,000	\$ 200,000
Current maturities of long-term debt	189,495	238,100
Current portion of capital lease obligation	142,372	135,710
Accounts payable and accrued expenses	373,165	362,820
Regulatory liabilities		
Fuel and purchased power costs	103,165	255,969
Efficiency Long Island budget variations	34,988	11,108
Commodity derivative instruments	9,934	93,086
Accrued payments in lieu of taxes	30,587	46,389
Accrued interest	87,025	53,616
Customer deposits	33,989	28,701
Claims and damages due within one year	200,061	55,102
Total current liabilities	<u>1,404,781</u>	<u>1,480,601</u>
Noncurrent liabilities:		
Long-term debt	6,548,395	6,363,244
Borrowings	106,764	110,297
Capital lease obligation	2,727,054	2,834,416
Asset retirement obligation	76,495	73,675
Deferred credits	92,406	133,024
Commodity derivative instruments	47,970	29,712
Financial derivative instruments	300,359	170,121
Claims and damages reserves	21,482	21,648
Total noncurrent liabilities	<u>9,920,925</u>	<u>9,736,137</u>
Invested in capital assets net of related debt	(257,154)	(87,016)
Restricted	-	365
Unrestricted	698,270	463,820
Total net assets	<u>441,116</u>	<u>377,169</u>
Total liabilities and net assets	<u>\$ 11,766,822</u>	<u>\$ 11,593,907</u>

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

	Nine Months Ended September 30, 2011 2010 (unaudited)	
Operating revenues - electric sales	\$ 2,912,037	\$ 3,034,940
Operating expenses:		
Fuel and Purchased Power	1,388,517	1,457,532
Operations and maintenance	711,563	684,376
Storm restoration	219,647	189,854
General and administrative	31,616	29,274
Depreciation and amortization	200,467	184,990
Payments in lieu of taxes - revenue based	46,050	50,269
Payments in lieu of taxes - property based	175,177	155,831
Total Operating Expenses	2,773,037	2,752,126
Operating Income	139,000	282,814
 Other income and deductions, net	 27,650	 29,428
Grant Income	144,369	61,561
 Interest charges and (credits)	 247,072	 241,403
 Change in net assets	 63,947	 132,400
Net assets		
Total net assets, beginning of year	377,169	325,815
Total net assets, end of period	\$ 441,116	\$ 458,215

Statement of Cash Flows
(Thousands of Dollars)

	Nine Months Ended September 30,	
	2011 (unaudited)	2010 (unaudited)
Cash flows from operating activities:		
Received from customers for the system sales, net of refunds	\$ 2,694,656	\$ 2,759,689
Other operating revenues received	46,547	41,510
Paid to suppliers and employees		
Operations and maintenance	(782,350)	(786,157)
Fuel and purchased power	(1,332,256)	(1,382,569)
Payments in lieu of taxes	(313,283)	(301,369)
Margin calls on fuel derivative transactions, net	365	31,435
Net cash provided by operating activities	313,679	362,539
Cash flows from investing activities:		
Sales of investment securities	203,808	295,994
Purchase of investment securities	(108,883)	(234,424)
Fair value adjustment - short term securities	17	5
Realized gains on short term securities	(233)	(267)
Earnings received on investments	472	522
Other	2,397	1,292
Net cash provided by investing activities	97,578	63,122
Cash flows from noncapital financing related activities:		
Grant proceeds	19,580	48,257
Net cash provided by noncapital activities	19,580	48,257
Cash flows from capital and related financing activities:		
Capital and nuclear fuel expenditures	(203,364)	(185,185)
Proceeds from KeySpan/National Grid promissory note	8,075	7,291
Proceeds from the issuance of bonds, net of discount	261,693	421,759
Bond issuance costs	(1,742)	(2,215)
Interest paid, net	(203,797)	(194,529)
Redemption of long-term debt	(149,900)	(353,220)
Net cash used in by capital and related financing activities	(289,035)	(306,099)
Net (decrease) increase in cash and cash equivalents	141,802	167,819
Cash and cash equivalents at beginning of period	363,319	371,264
Cash and cash equivalents at end of period	\$ 505,121	\$ 539,083
Reconciliation to net cash provided by operating activities:		
Operating income	\$ 139,000	\$ 282,814
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	200,467	184,990
Nuclear fuel burned	6,427	5,256
Shoreham surcharge recovery (credits)	29,613	31,770
Provision for claims and damages	220,616	191,110
Accretion of asset retirement obligation	3,439	4,333
Amortization of settlement benefits to ratepayers	(30,255)	(36,698)
Other	(7,328)	(7,251)
Changes in operating assets and liabilities:		
Accounts receivable, net	(108,685)	(426,214)
Adjustment to acquisition adjustment	-	45,551
Fuel and Material & supplies inventory	13,120	18,395
Fuel and purchased power costs deferred, net	(124,205)	126,519
Counterparty collateral	365	31,435
Claims, damages and storm restoration	(75,823)	(111,620)
Accounts payable and accrued expenses and other	46,928	22,149
Net cash provided by operating activities	\$ 313,679	\$ 362,539