

Long Island Power Authority

**Biennial Report
of the
Consulting Engineer and Rate Consultant
for the Period
January 1, 2006 through December 31, 2007**

August 31, 2008

NAVIGANT CONSULTING, INC.



August 31, 2008

Long Island Power Authority
Board of Trustees
333 Earle Ovington Boulevard
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Chairman and Members of the Board of Trustees:

Navigant Consulting, Inc. ("Navigant Consulting") has been retained by the Long Island Power Authority (the "Authority") as the Authority's Consulting Engineer and Rate Consultant (as such terms are defined in the General Bond Resolution and the General Subordinated Resolution) for the purpose of an examination of, and preparation of a report on, the properties and operations of the System. This report (the "Biennial Report") is to be prepared no less frequently than every other Fiscal Year, commencing with Fiscal Year 1999 (the 12 months ended December 31, 1999) pursuant to Section 702(b) of the General Bond Resolution and Section 7.02 of the General Subordinated Resolution. Navigant Consulting submits this Biennial Report for the Fiscal-Year 2006 through 2007 period (the "Historical Period") presenting the results of its review and investigations.

In preparation of the Biennial Report, Navigant Consulting has reviewed the operation, maintenance, and repair of the System for the Historical Period and estimated results for the two Fiscal Years ending December 31, 2009. Navigant Consulting has also reviewed the rates, fees, rents, charges, and surcharges of the Authority. For purposes of this assignment, Navigant Consulting has conducted investigations and analyses, held discussions with staff and representatives of the Authority and KeySpan Corporation, d/b/a "KeySpan", and its successor in interest National Grid USA, among others, and performed examinations of reports and projections prepared by consultants and advisors to the Authority, which Navigant Consulting deemed necessary and appropriate to reach its conclusions.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Patrick S. Hurley".

Patrick S. Hurley
Managing Director

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SECTION 1

INTRODUCTION

The Long Island Power Authority (the "Authority") is a corporate municipal instrumentality and political subdivision of the State of New York authorized under the Long Island Power Authority Act (the "Act"). The Authority became the retail supplier of electric service in most of Nassau and Suffolk Counties and the Rockaway Peninsula of Queens County (the "Service Area") on May 28, 1998 by acquiring the Long Island Lighting Company ("LILCO") as a wholly owned subsidiary of the Authority through a merger (the "LIPA/LILCO Merger"). Since the LIPA/LILCO Merger, LILCO has done business under the name "LIPA". Before the LIPA/LILCO Merger, LILCO was a publicly traded, shareholder-owned corporation that, since the early 1900's, was the sole supplier of both retail electric and gas service in the Service Area. LIPA (LILCO) no longer provides gas service in the Service Area. For the period prior to the LIPA/LILCO Merger, LILCO is referred to herein as "LILCO" and, for the subsequent period, is referred to herein as "LIPA."

The Authority, through LIPA, owns, among others, the following assets: (i) an electric transmission and distribution system (the "T&D System") serving most of Nassau and Suffolk Counties and the Rockaway Peninsula of Queens County, including assets, facilities, equipment, and contractual arrangements used to provide the transmission and distribution of electrical capacity and energy to electric customers within the Service Area; (ii) an 18 percent ownership interest in the Nine Mile Point 2 Nuclear Power Station ("NMP2") located in upstate New York; and (iii) certain other intangible assets resulting from the LIPA/LILCO Merger. These assets, together with all other assets of the Authority and LIPA used in the furnishing of electric service, are referred to as the "System."

As part of the LIPA/LILCO Merger, the remainder of LILCO's electric service assets (including all of its then-existing fossil-fueled generating units), and its entire gas supply system, were transferred to certain wholly-owned subsidiaries of KeySpan Corporation which does business under the name KeySpan Energy ("KeySpan"). In August 2007, KeySpan was acquired by National Grid plc ("National Grid"), a company organized under the laws of England and Wales (see Section 3 for additional information on the acquisition by National Grid).

LIPA provides retail electric service to approximately 1.1 million customers within the Service Area. During 2007, the maximum annual peak demand experienced by LIPA totaled approximately 5,247 megawatts ("MW"), inclusive of sales for resale. During this period, LIPA's total annual revenues approximated \$3.54 billion, of which over \$3.52 billion was derived from retail electric sales.

PURPOSE OF THE REPORT

The Authority had a total of approximately \$6.926 billion of senior lien, subordinate lien, and subsidiary debt outstanding as of December 31, 2007. As of such date, approximately \$5.791 billion of senior lien bonds issued under the Authority's Electric System General Revenue Bond Resolution (the "General Bond Resolution") were outstanding. The Authority also had outstanding approximately \$880 million of subordinate lien bonds, issued under the Authority's Electric System General Subordinated Revenue Bond Resolution (the "General Subordinated Resolution"), \$100 million of commercial paper issued under the Authority's Supplemental Bond Resolution, and approximately \$155 million of New York State Energy Research and Development Authority Financing Notes for which it is primarily responsible, and for which

LIPA holds a Promissory Note from KeySpan for an equivalent amount. The General Bond Resolution and General Subordinated Resolution contain certain covenants that require the Authority to undertake certain actions on an annual or periodic basis. One such action involves the performance by the Authority's Consulting Engineer and Rate Consultant (as such terms are defined in the General Bond Resolution and the General Subordinated Resolution) of an examination of, and preparation of a report on, the properties and operations of the System. This report (the "Biennial Report") is to be prepared no less frequently than every other Fiscal Year, commencing with Fiscal Year 1999 (the 12 months ended December 31, 1999).

Pursuant to Section 702(b) of the General Bond Resolution and Section 7.02 of the General Subordinated Resolution, the Biennial Report is to set forth the following:

- (i) "The Consulting Engineer's advice and recommendations as to the proper operation, maintenance, and repair of the System during the ensuing two Fiscal Years, and an estimate of the amounts of money necessary for such purposes;
- (ii) The Consulting Engineer's advice and recommendations as to improvements which should be made during the ensuing two Fiscal Years, and an estimate of the amounts of money necessary for such purposes, showing the amount projected to be expended during such Fiscal Years from the proceeds of Bonds and Subordinated Indebtedness issued under or pursuant to the Resolution;
- (iii) The Rate Consultant's recommendation as to any necessary or advisable revisions of rates, fees, rents, charges and surcharges and such other advice and recommendation as it may deem desirable; and
- (iv) The Consulting Engineer's findings as to whether the System has been maintained in good repair and sound operating condition, and its estimate of the amount, if any, required to be expended to place such properties in such condition and the details of such expenditures and the approximate time required therefore."

Navigant Consulting, Inc. ("Navigant Consulting") has been retained by the Authority to serve as the Consulting Engineer and the Rate Consultant to perform the examination of the properties and operations of the System, as required by the General Bond Resolution and General Subordinated Resolution, and to render its findings with respect to the above subject matter. This Biennial Report covers the Fiscal-Year 2006 through 2007 period (the "Historical Period") and the Fiscal-Year 2008 through 2009 forecast period (the "Forecast Period"). Information presented herein with respect to LIPA's historical operations is limited to financial and operating results known to have occurred as of December 31, 2007, except as otherwise noted. Additional information and items of a material nature have been included in this Biennial Report based on information available to Navigant Consulting through the date of this Biennial Report. Navigant Consulting's findings with respect to Section 702(b) of the General Bond Resolution and Section 7.02 of the General Subordinated Resolution can be found in Section 7 of this Biennial Report.

NAVIGANT CONSULTING, INC.

Navigant Consulting is an internationally recognized firm of engineers, economists, regulatory specialists, and management consultants headquartered in Chicago, Illinois. Navigant Consulting's professionals provide services to various industries, including electric and gas utilities, power producers, fuel suppliers, and power marketers. Typical services include power marketing analysis, transmission and distribution system planning, generation facilities evaluation, rate and pricing studies, environmental assessments, conservation and demand-side

management program development and evaluation, strategic planning, marketing studies, and related services.

In addition to serving as the Authority's Consulting Engineer and Rate Consultant, Navigant Consulting provides day-to-day assistance to the Authority on various issues, including operations, management, and expansion of its facilities, power supply resource development, rates and charges, environmental compliance, financial forecasting, and budget review and development, among other areas.

SECTION 2

DESCRIPTION OF THE SYSTEM

The Service Area encompasses the bulk of Long Island in New York State, and is comprised of Nassau and Suffolk Counties and the Rockaway Peninsula of Queens County, an area of approximately 1,230 square miles, excluding areas served by three municipal utilities: the villages of Freeport, Greenport, and Rockville Centre. Suffolk County is the easternmost county within the Service Area and covers an area of approximately 911 square miles, followed by Nassau County with a 287 square mile area, and the Rockaway Peninsula with an area of approximately 32 square miles. The Service Area is bounded by the Atlantic Ocean on the south and east, by the Long Island Sound on the north, and by portions of New York City on the west. LIPA estimates the population of the Service Area was approximately 2.98 million people as of December 31, 2007.

CLIMATIC FACTORS

Long Island experiences seasonal conditions typical of the northeast United States. Summers are usually hot with high temperatures in excess of 90°F, accompanied by high levels of humidity. Winters include snow and icing conditions that can be damaging to overhead power lines. In addition, the Service Area experiences severe storms, including “nor’easters” and hurricanes, which can be particularly damaging due to Long Island’s coastal location. In response to these conditions, the T&D System has been constructed and maintained to minimize damage from high winds and icing and LIPA has adopted storm response procedures that are designed to restore service expeditiously.

CUSTOMER BASE

Approximately 98 percent of LIPA’s total revenues are derived from electric sales to retail customers. As of December 31, 2007, LIPA served approximately 1.1 million retail electric customers, of whom approximately 89 percent were residential users. During the year ending December 31, 2007, residential customers provided approximately 52 percent of LIPA’s annual retail electric revenues and commercial and industrial customers provided approximately 45 percent of annual retail electric revenues. The balance of retail electric revenues is derived from electric sales for public lighting and sales to public authorities.

Although commercial and industrial customers provide a significant portion of annual electric sales revenues, these customers account for only 10 percent of the retail electric customers served by LIPA. In general, individual commercial and industrial customers are relatively small; with approximately 93 percent of these customers having peak demands less than 75 kilowatts (“kW”). Furthermore, the Service Area contains little traditional “industrial” loads, and customers served under this rate classification are primarily large commercial customers. The single largest customer in the Service Area (the Long Island Rail Road) accounted for less than two percent of total electric sales during 2007 and less than two percent of total retail electric revenues during the same period. Overall, the 20 largest electric customers, in aggregate, accounted for approximately eight percent and seven percent of total retail energy sales and total retail revenues, respectively, during 2007.

LIPA also provides electric transmission service to the New York Power Authority (“NYPA”) for the delivery of NYPA capacity and energy to the three municipal utilities and other NYPA-power recipients on Long Island, including the Suffolk County Electrical Agency (“SCEA”) and the Nassau County Public Utility Agency (“NCPUA”).

Table 1 provides summary information on annual retail energy sales and retail electric revenues within the Service Area during the 2003 through 2007 period. Included in Table 1 is information on numbers of retail electric customers for this period, as well as annual peak demand for electricity and annual energy requirements.

**TABLE 1
HISTORICAL STATISTICS¹**

	2003	2004	2005	2006	2007
Peak Demand (MW)	4,794	4,581	5,115	5,667	5,247
Energy (MWh) ²					
Residential	9,010,295	9,182,524	9,705,752	9,278,210	9,508,341
Commercial and Industrial.....	9,593,552	9,904,543	10,106,947	9,887,704	10,131,849
Other.....	426,059	439,120	437,367	430,148	452,717
Total Sales.....	19,029,906	19,526,187	20,250,066	19,596,062	20,092,907
Lost and Unaccounted For ³	1,448,646	1,466,420	1,529,151	1,481,405	1,516,368
Total Energy Requirements...	20,478,552	20,992,607	21,779,217	21,077,467	21,609,275
System Load Factor (Percent).....	48.8	52.3	48.6	42.5	47.0
Customers ⁴					
Residential	970,746	975,656	981,532	986,477	989,727
Commercial and Industrial.....	112,343	112,817	114,014	114,476	115,121
Other.....	5,023	5,097	5,256	5,253	5,055
Total Customers.....	1,088,112	1,093,570	1,100,802	1,106,206	1,109,903
Retail Electric Revenues (\$000) ⁵	\$2,563,542	\$2,834,948	\$3,257,144	\$3,610,091	\$3,497,480

¹ Provided by LIPA. Amounts may not total due to rounding.

² Megawatt-hour or MWh. Excludes Sales for Resale.

³ Includes Company service.

⁴ Numbers of meters at year-end.

⁵ Excludes Sales for Resale. Includes fuel and purchased power adjustment clause revenues.

TRANSMISSION AND DISTRIBUTION SYSTEM

The T&D System is an integrated electric system consisting of overhead and underground facilities, vehicles, equipment, land parcels, easements, contractual arrangements, and other assets used to provide the transmission and distribution of electric capacity and energy to and within the Service Area. The T&D System includes seven transmission interconnections that link the T&D System to utilities outside the Service Area. These transmission interconnections are owned in part or under contract to LIPA. A more complete description of the T&D System is provided in Section 4 of this Biennial Report.

SECTION 3

MANAGEMENT AND OPERATION OF THE SYSTEM

The Authority manages the operations, performance, and costs of the System with a senior management team comprised of engineering, legal, financial, accounting and management professionals. The organization and performance of this senior management team is described below. This section also includes a discussion of the responsibilities of KeySpan Corporation ("KeySpan") under the terms of certain key outsourcing agreements.

AUTHORITY MANAGEMENT AND ORGANIZATION

The Authority and LIPA are parties to an Administrative Services Agreement (the "Administrative Services Agreement"), which sets forth the terms and conditions under which the Authority provides personnel, personnel-related services, and other services (including management, supervisory, payroll and other services) necessary for LIPA to provide electric service in the Service Area. Except for services of the type and nature provided to LIPA by outside independent agents, attorneys, and consultants, and for any other services provided under agreements approved by the Authority, LIPA meets its personnel and personnel-related needs exclusively through the Administrative Services Agreement. The Administrative Services Agreement may be amended from time to time to reflect the changing needs of the Authority and LIPA.

Under the Administrative Services Agreement, the services provided by the Authority include, but are not limited to: (i) performance of LIPA's duties and obligations and enforcing its rights under any existing and future contracts between LIPA and any other person; (ii) coordination of services for which LIPA contracts; (iii) coordination of negotiations and studies authorized by LIPA for any project for the supply of power and energy or the provision of transmission capacity to LIPA; (iv) reviewing invoices; (v) disbursement of all funds of LIPA; (vi) preparation of construction and operating budgets on behalf of LIPA; (vii) provision or coordination of all other accounting matters and preparation of billings to, and collection from, LIPA's customers; (viii) coordination of all other matters arising under any agreements relating to any project that LIPA might undertake; (ix) securing information from any persons required to fulfill LIPA's obligations under any agreements arising from the Administrative Services Agreement, the agreements referred to in clauses (i) and (viii), and any project LIPA might undertake; (x) provision or coordination of rate matters; and (xi) provision or coordination of such other services as LIPA determines are required to carry out its business in an economical and efficient manner.

The day-to-day operation of the System, including LIPA's ownership interest in NMP2, is outsourced principally to KeySpan through the Management Services Agreement (the "MSA"), the Power Supply Agreement (the "PSA"), and the Energy Management Agreement (the "EMA") (collectively, the "Operating Agreements"), using primarily management and other personnel previously performing these functions for LILCO. As discussed below, the MSA and the PSA expire on December 31, 2013 and May 28, 2013, respectively. Portions of the EMA expire on December 31, 2009, with the remainder of the agreement expiring on May 28, 2013. Summaries of these services and agreements are described more fully in the appendices to this Biennial Report.

The Authority uses a combination of: (i) a core group of senior managers; (ii) internal professional and administrative support staff; and (iii) outsourced services by specialists to meet the wide variety of skills and experience required to guide the management of the electric utility.

The Authority has adopted an organization which includes the following senior management positions: (i) Chief Executive Officer; (ii) President; (iii) Senior Vice President and Chief Financial Officer; (iv) General Counsel and Secretary of the Authority; (v) Vice President of Environmental Affairs; (vi) Vice President of Government Relations; (vii) Vice President of Communications; (viii) Vice President of Retail Services; (ix) Vice President of Operations; and (x) Controller. The Authority employs experienced support personnel to assist the senior management team in its day-to-day activities.

The Authority is governed by a fifteen-member board of Trustees who are required under the Act to be residents of the Service Area. The Governor appoints nine of the Trustees. Of the six remaining, three are appointed by the Majority Leader of the New York State Senate, and three are appointed by the Speaker of the New York State Assembly. A chairman of the Trustees is also appointed by and serves at the pleasure of the Governor. Each Trustee serves for a staggered term of four years. A Trustee whose term expires continues to serve until his or her successor is appointed. Pursuant to the Act, the Trustees and the officers of the Authority are not subject to any personal or civil liability resulting from the exercise, carrying out, or advocacy of any of the Authority's purposes or powers. Trustees are entitled to reimbursement for reasonable expenses in the performance of their duties. The By-laws and other instruments of the Authority and LIPA provide for the indemnification of the Trustees, officers and employees of the Authority and the directors, officers and employees of LIPA.

The Public Authorities Accountability Act of 2005 (the "PAAA") was signed into law by the Governor in January 2006. The PAAA addresses a wide range of matters pertaining to many public authorities in the State, including the Authority. Among other things, the PAAA increases requirements applicable to public authorities' annual reports; sets forth requirements relating to independent audits and audit reports of public authorities; sets forth roles and responsibilities of public authority board members and establishes certain restrictions on such board members; prohibits any board member, including the chairman, from serving as the chief executive officer; establishes certain rules regarding the board membership, including financial disclosure requirements; sets forth requirements pertaining to public authorities' disposition of real and personal property; and creates a State Authority Budget Office and a State Inspector General's Office.

The Authority oversees the operation of the System and manages the Operating Agreements with a staff of approximately 90 and through the support of outside financial, engineering, accounting, and legal advisors and consultants. Day-to-day operations and maintenance during the terms of the Operating Agreements are being performed by the KeySpan's workforce.

A wide variety of skills and experience are required by the Authority to establish policy, evaluate System needs, and assess System operations and related matters. These requirements are periodic and vary in the level of effort required. Outsourcing some of these services enables the Authority to have the skills needed without the expense of committing to full-time positions. The Authority employs several outside consultants to assist it in managing the System.

SERVICES PROVIDED BY KEYSpan

At the time of the LIPA/LILCO Merger, the Authority entered into the Operating Agreements to assist LIPA with the production, acquisition, and delivery of electricity in the Service Area. The Authority entered into the Operating Agreements with separate wholly owned subsidiaries of KeySpan (the "KeySpan Subs") and assigned them to LIPA. The performance of each such KeySpan Sub under the respective Operating Agreement, as well as any payment obligations it

may have under such Operating Agreement, are guaranteed by KeySpan. The purpose of the Operating Agreements is to provide the Authority and LIPA with the operating personnel and power supply resources necessary for LIPA to continue to provide electric service in the Service Area.

CHANGES TO THE AGREEMENTS

The day-to-day operation of the T&D System is provided by KeySpan under the terms of the MSA, which was to expire December 31, 2008. In January 2006, the Authority entered into definitive agreements to amend the MSA (the "Amended and Restated MSA") as well as certain of the other Agreements, subject to certain governmental approvals and other conditions. The Amended and Restated MSA will expire December 31, 2013. The Amended and Restated MSA (i) provides a simpler "fee for service" contract and (ii) establishes 18 service level metrics which KeySpan must achieve or be subject to penalties. The Authority also entered into a Settlement Agreement, dated January 1, 2006 (the "2006 Settlement Agreement") with KeySpan and certain of the KeySpan subsidiaries to resolve certain outstanding disputes. Under the 2006 Settlement Agreement, KeySpan agreed to provide LIPA approximately \$120 million in payments or credits for certain outstanding items. The New York State Comptroller approved these agreements in 2007.

The Authority also announced it entered into an option agreement (the "2006 Option Agreement") with KeySpan Generation LLC ("GENCO") which provided the Authority with an option (the "2006 Purchase Option"), exercisable not later than December 31, 2006, to acquire the Barrett and Far Rockaway plants (as defined in such agreement) from GENCO. In the event the Authority acquired either or both such plants, the Authority and KeySpan agreed that KeySpan, acting through a subsidiary to be designated, would operate and maintain such plants. Additionally, the Authority indicated that if it exercised the 2006 Purchase Option, the Authority and KeySpan agreed to amend the EMA and PSA in various respects to reflect the fact that such generating unit or units were no longer owned by GENCO. The Authority subsequently chose not to exercise the 2006 Purchase Option.

The Authority and KeySpan announced they also amended the EMA. The EMA provides for a KeySpan subsidiary to (i) procure and manage fuel supplies for LIPA to fuel the GENCO generating facilities, (ii) perform off-system capacity and energy purchases on a least-cost basis to meet LIPA's needs, and (iii) make off-system sales of energy, capacity, and other ancillary services from the GENCO generating facilities and other power supplies either owned or under contract to LIPA. The term for the service provided in (i) above expires May 28, 2013. The term for the service provided in (ii) and (iii) currently expires May 28, 2006, but an amendment that provides for extension of the EMA up to December 31, 2009 has been executed by the parties. LIPA undertook a competitive procurement process for the services provided in (ii) and (iii) above and selected ConEdison Solutions to provide these services commencing January 1, 2010.

ACQUISITION OF KEYSpan BY NATIONAL GRID

On February 27, 2006, KeySpan announced a definitive agreement under which KeySpan would be acquired in early 2007 by an affiliate of National Grid. The transaction was subject to the approval of the shareholders of both companies and to various regulatory approvals. The Authority evaluated the acquisition of KeySpan by National Grid and its effect on the Authority's agreements with KeySpan and the potential benefits to LIPA's customers of the acquisition. On August 24, 2007, National Grid completed the acquisition of KeySpan for \$11.8 billion.

National Grid is an international energy delivery company. In the United States, National Grid delivers electricity to approximately 3.3 million customers in Massachusetts, New Hampshire, New York, and Rhode Island, and manages the electricity network on Long Island under the Operating Agreements. National Grid is the largest power producer in New York State, owning and operating approximately 6,650 MW of electric generating capacity, a portion of which is sold to LIPA. On March 31, 2008, National Grid entered into an agreement with TransCanada to sell 100 percent of its ownership interest in the Ravenswood generating station, a 2,480 MW plant that provides approximately 21 percent of the electricity needs of New York City. National Grid is also the largest distributor of natural gas in the northeastern United States, serving approximately 3.4 million customers in New York, Massachusetts, New Hampshire, and Rhode Island.

In consideration of LIPA's waiver of its rights under change of control provisions in the Operating Agreements associated with National Grid's acquisition of KeySpan, LIPA and National Grid reached an agreement under which National Grid agreed to pay LIPA approximately \$91 million over a period of seven years representing LIPA's guaranteed share of the synergy savings resulting from National Grid's acquisition of KeySpan. In addition, National Grid agreed to provide LIPA \$25 million in incremental consideration, to be used for various matters.

SECTION 4

TRANSMISSION AND DISTRIBUTION SYSTEM

The T&D System is an integrated electric system consisting of overhead and underground facilities, vehicles, equipment, land parcels, easements, contractual arrangements and other assets used to provide the transmission and distribution of electric capacity and energy to and within the Service Area. Key components of the T&D System are summarized below.

TRANSMISSION INTERCONNECTIONS

Electricity is transmitted to and from the Service Area over seven transmission interconnections that are owned in part or are under contract to LIPA. These interconnections link the T&D System to other utilities and enable delivery of: (i) capacity and energy produced by NMP2; (ii) additional off-system capacity resources needed to meet the peak demands of the electric customers; (iii) favorably-priced energy to supplement or displace generation from on-island generating resources; and (iv) excess generation from on-island generating facilities to off-island purchasers when conditions merit. Table 2 provides summary information on the transmission interconnections.

**TABLE 2
SERVICE AREA TRANSMISSION INTERCONNECTIONS**

Name	Off System Terminal Locations	Interconnecting Utility ¹	Voltage Level ²	AC/DC ³
Dunwoodie to Shore Road.....	Westchester County, NY	Con Edison	345 kV	AC
East Garden City to Sprainbrook	Westchester County, NY	NYPA ⁴	345 kV	AC
Northport to Norwalk Harbor.....	Norwalk, CT	CL&P ⁵	138 kV	AC
Shoreham to New Haven ⁶	New Haven, CT	UI ⁷	150 kV	DC
Jamaica to Lake Success.....	Queens, NY	Con Edison	138 kV	AC
Jamaica to Valley Stream.....	Queens, NY	Con Edison	138 kV	AC
Sayreville to Newbridge Road.....	Sayreville, NJ	JCP&L ⁸	138 kV	DC

¹ These utilities own the portion of the interconnections not owned by LIPA, except for the interconnection with NYPA, which is entirely owned by NYPA.

² Kilovolt or “kV.”

³ AC = Alternating Current. DC = Direct Current.

⁴ NYPA = New York Power Authority.

⁵ CL&P = Connecticut Light and Power. CL&P is a wholly owned subsidiary of Northeast Utilities.

⁶ This cable is a +/-150 kV bi-directional high voltage direct current system. Electricity is converted to 138 kV alternating current at LIPA’s Shoreham substation for transmission and delivery to LIPA’s customers.

⁷ UI = United Illuminating.

⁸ JCP&L = Jersey Central Power & Light. JCP&L is a wholly-owned subsidiary of First Energy.

Four submarine cables installed under Long Island Sound form part of the interconnection between the T&D System and other utility systems in upstate New York and Connecticut: (i) Dunwoodie to Shore Road; (ii) East Garden City to Sprainbrook; (iii) Northport to Norwalk Harbor; and (iv) Shoreham to New Haven. A fifth submarine cable (Sayreville to Newbridge Road) connects LIPA’s service area with New Jersey and allows for energy and capacity purchases from the Pennsylvania-New Jersey-Maryland interconnection (“PJM”).

The Dunwoodie to Shore Road line, an 18-mile 345-kilovolt (“kV”) cable designated as the “Y-50” line and placed in operation in August 1978, is jointly owned with Consolidated Edison Company of New York, Inc. (“Con Edison”). This cable is of pipe-type construction in which dielectric fluid is circulated to cool the conductors and maintain the electrical insulation. The cable operates at full capacity with a rating of 599 MW. On peak load days, the system operator may choose to operate Y-50 in a forced oil circulation mode to increase its capability. Under these conditions, the cable operates with a normal rating of 653 MW and an emergency rating of 914 MW.

The East Garden City to Sprainbrook 345 kV interconnection (“Y-49”) was installed in 1991 and is approximately 23 miles long. This tie is comprised of a submarine portion and a land-based portion. The submarine portion is constructed of self-contained dielectric fluid-filled cables that operate under high pressure, while the land-based portion is of conventional pipe-type construction. This line is owned entirely by NYPA and is used by LIPA under the terms of a contract with NYPA. LIPA’s agreement for use of Y-49 provides that LIPA will reimburse NYPA for the costs it incurs in connection with the line, including, but not limited to, debt service, reserves, and operation and maintenance expenses. LIPA is contractually obligated to pay such costs based on the full capacity of Y-49; however, to the extent that NYPA allocates capacity to other parties, LIPA’s payment obligations are proportionately reduced. The Y-49 Cable has generally performed well with only a few instances of outages due to terminal equipment failures and one interruption due to an anchor dragging across the submerged cable.

The Northport to Norwalk Harbor line is a double circuit 138 kV submarine cable. This tie extends approximately 12 miles under the Long Island Sound from the Northport Electric Generating Station (“Northport”) in Suffolk County, New York to Norwalk Harbor, Connecticut. LIPA owns that portion of the line from Northport to the New York-Connecticut state boundary, at which ownership is held by Connecticut Light and Power (“CL&P”), a wholly-owned subsidiary of Northeast Utilities. Due to repeated damage suffered by the original cable over the years from barges and ships operating in the Long Island Sound, LIPA and CL&P undertook the replacement of the cable in accordance with an implementation plan that was approved by all required regulatory and other agencies. Cable-laying and embedment activities commenced early in 2008 and commercial operation of the new cable is expected before year-end. Originally designated the “NUSCO Cable,” the new cable has been re-designated the Northport-Norwalk Cable (“NNC”). As a result of recent upgrades to the Connecticut electric system, LIPA expects to regularly schedule imports and exports of power on the NNC once it returns to service.

The Shoreham to New Haven line (referred to as the “Cross Sound Cable”) is a 24-mile, +/- 150 kV bi-directional high voltage direct current system utilizing voltage source converter technology with a capability of 330 MW. The Cross Sound Cable is connected between the converter stations installed adjacent to United Illuminating’s 345 kV East Shore substation in Connecticut and at LIPA’s Shoreham 138 kV substation. Construction of this line began in 2000 pursuant to a lease entered into between LIPA and Cross Sound Cable Company, LLC (“CSC LLC”) pursuant to which LIPA agreed to purchase up to 330 MW of transmission capacity (the “CSC Agreement”).

The Cross Sound Cable began operation in 2005. Since CSC LLC had not yet received all necessary permits in final form necessary to satisfy the CSC Agreement, CSC LLC was providing transmission service to LIPA pursuant to a temporary Bridge Period Firm Transmission Capacity Purchase Agreement (the “Bridge Agreement”), dated June 27, 2004. Pursuant to a February 27, 2006 Agreement and Consent signed by LIPA, CSC LLC, and other related parties, the Bridge

Agreement was extended to June 30, 2008, by which time all permits were received in final form, and the Date of Initial Commercial Operation was deemed to be July 1, 2008. The CSC Agreement provides for up to 330 MW of firm transmission capacity and expires in 2031.

In September 2005, LIPA entered into a 20 year contract with Neptune Regional Transmission System LLC ("Neptune") that permits LIPA to import power from New Jersey over an undersea high-voltage direct current transmission cable constructed by Neptune (the "Neptune Cable"). The Neptune Cable is capable of carrying 660 MWs of electricity and runs from Sayreville, New Jersey, under the Atlantic Ocean and connects with LIPA at its Newbridge Road substation in Levittown. The Neptune cable became operational in July 2007.

The two remaining Service Area transmission interconnections are linked to the Con Edison transmission system in Queens County, New York. LIPA owns these facilities to the border of Nassau and Queens Counties, at which point ownership transfers to Con Edison. These ties are employed primarily for the delivery of power to Con Edison from its portion of energy flowing across Y-50.

TRANSMISSION FACILITIES

The transmission facilities provide for the delivery of capacity and energy from the transmission interconnections and the on-Island generating stations to LIPA's electric distribution system. As of December 31, 2007, LIPA reported the transmission system consisted of approximately 1,309 miles of overhead and underground lines, with voltage levels ranging from 23 kV to 345 kV. This transmission system has been constructed following standards similar to those employed by other major electric utilities in the Northeast and includes wood poles, steel poles, and lattice steel towers. Many of the existing transmission structures support distribution circuits and/or connections for telephone, cable television, or fiber optics.

The transmission system includes transformation equipment at 17 generating sites that is used to step up the generation voltage to transmission voltage levels. With the exception of certain facilities (e.g., auxiliary and starting transformers) at generating facilities previously owned by LILCO and now under contract to LIPA, transformation equipment at these sites is owned by LIPA.

DISTRIBUTION FACILITIES

LIPA reports the distribution system included approximately 13,215 primary circuit miles of overhead and underground line (8,950 miles of overhead line and 4,265 miles of underground line) at December 31, 2007. As of December 31, 2007, there were 147 substations providing service to load via distribution transformers connected to the 138kV and 69kV buses. Approximately 41.5 percent of the poles on which LIPA's distribution facilities have been installed are owned by Verizon and used by LIPA pursuant to a joint-use agreement.

MANAGEMENT SERVICES AGREEMENT

LIPA relies on KeySpan (as Manager under the Amended and Restated MSA) to operate and maintain the T&D System in accordance with all applicable laws, prudent utility practices, and the policies and procedures established by the Authority. The Manager's responsibilities include, but are not limited to: (i) the day-to-day operation and maintenance of the T&D System, including emergency repairs, customer service, billings, and meter readings; (ii) routine facility additions and improvements, including customer connections, procurement of goods and services from third parties, and inventory management; (iii) preparing and monitoring budgets, developing load and energy forecasts, and acquisition, maintenance and use of power resource

models and plans; and (iv) maintaining an operation and maintenance manual for the T&D System.

The Authority is responsible for, among other things, (i) setting rates and charges; (ii) establishing line extension policies; (iii) developing service rules and regulations; (iv) approving long-term strategic plans; (v) developing customer service programs; (vi) approving annual operating and capital budgets; (vii) approving the Manager's load forecast and power resource models and plans; (viii) determining all energy efficiency, conservation and load management policies and plans; (ix) managing governmental relations and reporting; (x) managing overall legal responsibilities; (xi) overseeing the Manager's operations and performance; and (xii) managing community and public relations. The Authority also has the right to approve the appointment of key personnel of the Manager.

The Amended and Restated MSA provides the Authority a reduction in costs of approximately \$34 million per year on a net present value basis from the amount paid for such services in 2005 under the original MSA. The Amended and Restated MSA provides for payment to KeySpan based on a fixed rate per kilowatt-hour ("kWh") of retail electric sales, which is subject to an inflation factor, as well as a floor and a cap. This fixed rate per kWh replaces a fixed direct fee, the variable payment, the cost incentive fee, and the non-cost performance component contained in the original MSA. "Pass through expenditures" which include both direct and third party costs, such as capital expenditures and storm restoration costs, continue to be passed through to LIPA on an actual cost basis. The Amended and Restated MSA also eliminates cost and performance incentives and provides only for penalties for failure by KeySpan to perform within 18 specified performance metrics. Total financial penalties payable by KeySpan for failure to meet the performance metrics can reach \$7 million per year.

For a more complete description of the Manager's responsibilities under the Amended and Restated MSA please see Appendix A.

THE MANAGER'S PERFORMANCE UNDER THE MSA

The following sections provide a summary of the Manager's performance in key areas during the Historical Period.

Reliability

LIPA is continuing a program to maintain and, where necessary, improve the reliability and quality of electric service within the Service Area. For the distribution system, this program is focused on three major areas: (i) circuit reconfiguration and reinforcement; (ii) pole replacement; and (iii) circuit conversion and reinforcement projects to serve new customer loads. For the transmission system, the improvement program is focused on: (i) transmission system reliability; (ii) substation reliability improvements; (iii) transmission breaker replacements; and (iv) structure inspection program. These program elements are a key part of LIPA's efforts to achieve reductions in both the frequency and duration of customer outages.

Two standard industry criteria for measuring transmission and distribution system reliability are: (i) System Average Interruption Frequency Index ("SAIFI"), which is a measure of the number of times the average customer's service is interrupted in a year; and (ii) Customer Average Interruption Duration Index ("CAIDI"), which is a measure of the average number of minutes required to restore service to a customer whose service has been interrupted. For both SAIFI and CAIDI, a low value is favorable. A low SAIFI value indicates a longer time period between service interruptions, and a low CAIDI value indicates a shorter average duration, less

elapsed time, associated with the outages that have occurred. The MSA establishes incentive measures for the Manager to maintain SAIFI and CAIDI indices for the T&D system within prescribed levels. Information on these incentives may be found in Appendix A.

For 2006, the system-wide SAIFI index was 0.746 (or 16.1 months between interruptions), and the CAIDI index was 82 minutes. For 2007, the system-wide SAIFI index was 0.903 (or 13.3 months between interruptions), and the CAIDI index was 72 minutes. The composition of these reliability indices by LIPA operating district is provided in Table 3.

**TABLE 3
T&D SYSTEM RELIABILITY^{1,2}**

	MSA Penalty Trigger	Calendar Year	
		2006	2007
SAIFI³			
Queens.....		0.644	0.638
Central.....		0.836	1.166
W. Suffolk.....		0.743	0.836
E. Suffolk.....		0.736	0.905
System Average.....	1.00	0.746	0.903
CAIDI⁴			
Queens.....		71	60
Central.....		106	81
W. Suffolk.....		74	70
E. Suffolk.....		71	68
System Average.....	76	82	72

¹ Excludes interruptions of less than five minutes and during major storms.

² Lower values are more favorable.

³ System Average Interruption Frequency Index.

⁴ Customer Average Interruption Duration Index.

Over the five-year period 2003 through 2007, LIPA's customers experienced an average of 14.2 months between interruptions and average interruption times of 58 minutes. For all New York State utilities (other than Con Edison, whose system is predominately underground), the average time between interruptions during this five-year period was 11.4 months and the average duration of an interruption was 119 minutes.

As of December 31, 2007, LIPA had the second best SAIFI value of all the utilities in New York State operating overhead distribution systems. Through December 31, 2007, the average LIPA customer experienced 0.903 outages per year compared to an average of 1.091 outages per year for the other utilities. As of December 31, 2007, LIPA also had the best CAIDI value for all the overhead utilities in New York State. Through December 31, 2007, the average LIPA customer interruption was 72 minutes compared to an average of 120 minutes for the other utilities.

Maintenance

The Manager's substation maintenance group is responsible for the operation and maintenance of the transmission and distribution substations throughout the Service Area. The preventive maintenance program calls for the inspection and major maintenance of over 2,000

individual pieces of substation equipment annually. During the Historical Period, the substation maintenance group completed approximately 99 percent of the scheduled preventive maintenance each year. A completion rate over 90 percent falls within the range of that achieved by other similarly situated utilities.

The Manager uses a computerized maintenance inspection and record-keeping system, known as Maximo, for the substation group. This maintenance system is used for work order management, planning and scheduling, asset management and tracking, resource management, reports and analysis, and integration with the Manager’s financial system. The system considers equipment criticality, load, number of operations, age, and test diagnostics, LIPA expects the computerized maintenance system to provide for more targeted maintenance programs in the future.

Storm Restoration

The Manager is responsible for storm response and storm restoration programs. During these restoration efforts, the Manager utilizes, as necessary, appropriately trained personnel not normally assigned to field duties, as well as gas and generation department personnel when storm severity warrants , in order to perform electric distribution emergency restoration services. In addition, the Manager may utilize tree trimming or construction vendors to assist in storm restoration and rebuild activities. This utilization of personnel increases the availability of local field forces to restore service to customers affected by the storm damage. The Manager, on behalf of LIPA, also relies on the upstate resources of National Grid and standard electric utility industry mutual aid programs wherein neighboring and regional utilities provide emergency assistance to one another in the event of widespread outages due to major storms. Table 4 below provides a summary of the total cost of storm damage within the Service Area for the 2003 through 2007 period. Depending on the extent of storm damage, the Authority could be eligible for funds from the Federal Emergency Management Agency.

**TABLE 4
HISTORICAL STORM EXPENDITURES
FOR THE T&D SYSTEM**

Year	\$000
2003	\$12,917
2004	6,582
2005	14,802
2006	38,442 ¹
2007	31,305 ¹

¹ Estimated pending resolution of disputed costs.

Increases in storm expenditures indicated in Table 4 for 2006 and 2007 are a result, in part, of changes in the method of accounting for such expenditures adopted in the Amended and Restated MSA. Pre-2006, LIPA was responsible for incremental storm costs, and under the Amended and Restated MSA, LIPA is responsible for full storm costs. These increases also reflect an increase in the number of storm events on Long Island during this period.

Since the inception of the MSA, LIPA and the Manager have experienced a number of disagreements with respect to the storm billings. In March 2005, LIPA executed an agreement

with the Manager, "Clarification of MSA Incremental Storm Billing Procedures," which clarified certain provisions in the original MSA relative to the record keeping, accounting, and billing for incremental costs incurred due to major storms and extreme weather. While this letter agreement did not attempt to resolve those disagreements for storms occurring prior to January 1, 2005, it did identify the procedures and provisions for invoicing incremental costs for all storms occurring after December 31, 2004. Provisions identified in this letter agreement were carried into the Amended and Restated MSA. The Manager continued to experience anomalies in substantiation and allocation of storm costs during the Historical Period. It is anticipated that through internal Manager audits, which were implemented in early 2008, these errors will decrease over time.

Condition of the Facilities

During the January 2006 through May 2008 period, Navigant Consulting conducted periodic on-site observations of principal and representative facilities comprising the T&D System. These observations consisted of visual examinations of facilities that Navigant Consulting deemed adequate to allow it to assess the general condition of the facilities. In addition to field observations, Navigant Consulting reviewed historical operation and maintenance records for the T&D System to assess past performance levels and examined written maintenance procedures to evaluate the adequacy of existing maintenance practices. Navigant Consulting did not identify any material deficiencies in the condition of the T&D System as a result of these observations or review of historical records.

Capital Expenditures

During the 2003 through 2007 period, LIPA reported that an average of approximately \$236 million per year was spent on T&D System capital additions and improvements. Such expenditures included interconnection costs associated with new generating stations on Long Island, interconnection facilities related to the undersea transmission cables, reliability enhancements, capability expansion, new customer connections, facility replacements and public works. LIPA reports that T&D System capital expenditures for 2006 and 2007 were approximately \$263 million and \$275 million, respectively. The variation in capital expenditure levels during the Historical Period was due primarily to differences in the amounts incurred by LIPA for transmission interconnection projects associated with new generating and transmission resources. In 2006, system upgrades to support the Neptune cable project were \$79 million. In 2007, capital expenditures for NUSCO replacement and upgrades to support the interconnection for Neptune, amounted to approximately \$57 million. T&D System capital expenditures for 2008 and 2009 are estimated by LIPA to total approximately \$282 million and \$242 million, respectively. The 2008 and 2009 capital expenditure programs provide for a continuation of the historical programs to improve reliability, quality of electric service, capacity expansion, and new customer connections, as well as specific expenditures to reinforce or the system against severe storms and Category 3 hurricanes and to replace the NUSCO cable.

Amounts reported above for T&D System capital expenditures do not include expenditures for NMP2 or for the Authority's internal administrative and general purposes. NMP2 capital expenditures are discussed in Section 5 of this Biennial Report. The Authority's internal administrative and general capital expenditures have averaged approximately \$2 million per year during the 2003 through 2007 period. During 2008, LIPA estimates capital expenditures for administrative and general purposes will increase to approximately \$15 million to fund new computer facilities, but will return to a level of \$2 million per year beginning in 2009.

T&D System capital expenditures will continue to be subject to the Authority's annual approval process under the terms of the Amended and Restated MSA. LIPA employs a capital planning and review process that takes into account the priority and benefits of individual capital projects relative to alternative investments. This capital planning process allows LIPA to identify, rank, fund, and manage capital investments. The process involves three phases: (i) selection, in which capital projects are screened, ranked, and selected; (ii) control, whereby an ongoing monitoring process manages selected capital projects to ensure that each investment continues to be required and is completed on schedule and within budget; and (iii) evaluation, wherein projects are reviewed upon completion to determine if the capital investment realized its expected mission and business performance goals, and provide feedback to continually improve the capital planning and execution process. The 2008 capital budget was reviewed and approved using an industry-accepted process of ranking projects according to the probability of the occurrence of an outage, the number of customers that would be affected by the outage, and the outage's duration. By utilizing this process, capital investments may be targeted to the most critical projects which provide for the most reliability benefit.

Adequacy of Performance

Operation of the T&D System during the Historical Period was generally consistent with past experience, and no materially adverse conditions or occurrences were noted. Such results reflect the relative success of the Manager in operating and maintaining the T&D System under the original MSA and the Amended and Restated MSA. Many of the past issues experienced by LIPA with the performance of the Manager, including (i) resolution of certain reporting and information issues; (ii) enhanced capital budgeting and system planning procedures; (iii) improvements in LIPA's customer billing system; and (iv) increased attention to prospective conflicts of interest, were directly addressed in the Amended and Restated MSA. LIPA believes such improvements will provide for continued enhanced operation and management of the T&D System.

SECTION 5

NINE MILE POINT NUCLEAR POWER STATION, UNIT 2

Nine Mile Point, Unit 2 (“NMP2”) is part of a two-unit nuclear power station (“Nine Mile Point”) located on the south shore of Lake Ontario near the Town of Scriba, New York. NMP2 uses a boiling water reactor (“BWR”) and turbine generator supplied by General Electric Corporation. The plant has a rated capacity of 1,148 MW.

NMP2 is the second of two units at the Nine Mile Point site. Unit 1 (“NMP1”) began commercial operation in 1969. NMP2 began commercial operation in April 1988 under a Nuclear Regulatory Commission (“NRC”) license that was set to expire in 2026. The NRC recently approved a request by Constellation Nuclear LLC (“Constellation”), the majority owner of Nine Mile Point, to extend the operating license of NMP2 by 20 years to October 31, 2046.

NMP2 OWNERSHIP AND MANAGEMENT

NMP1 and NMP2 are operated under different ownership interests. LIPA’s ownership interest is limited to NMP2, in which LIPA has an undivided 18 percent interest. Constellation owns 100 percent of NMP1 and 82 percent of NMP2. LIPA’s share of the rated capability of NMP2 is approximately 207 MW.

LIPA has entered into an operating agreement with Constellation for NMP2. Among other things, the agreement provides for a management committee comprised of representatives from LIPA and Constellation, who meet regularly on plant matters. Constellation controls the operating and maintenance decisions of NMP2 in its role as operator. The annual NMP2 business plan and the operating and capital budgets are developed by Constellation and submitted to LIPA for review and approval. LIPA receives electric generation from NMP2 and is responsible for operating and capital costs in proportion to its ownership interest. In addition to its involvement through the management committee, LIPA engages KeySpan personnel to provide on-site support to protect its interests.

NMP2 PERFORMANCE

Table 4 sets forth capacity factors and generation levels associated with LIPA’s 18 percent share of NMP2 for the period 2003 through 2007. This table also presents comparative industry data for all nuclear generating units in the United States.

Constellation’s goal for NMP2’s 2006 capacity factor was 92 percent, considering a scheduled refueling outage. The actual capacity factor for 2006 was 90.6. The target was not achieved because of a forced outage resulting from a loss of condenser vacuum. There was no refueling outage in 2007, although the plant did have a planned outage in November 2007 to remove a failed fuel bundle, remove foreign material from a jet pump, and repair a recirculation pump isolation valve. The outage was planned for 15 days, but was accomplished in 12.5 days. The annual capacity factor for 2007 was 92.1 percent.

Historical generation statistics for NMP2 are shown in Table 4 below.

**TABLE 4
HISTORICAL NMP2 PERFORMANCE**

Calendar Year	Annual Net Generation (MWh) ^{1,2}	Annual Net Capacity Factor ^{1,3}	Three-Year Average Net Capacity Factor ^{1,4}	Industry Average Net Capacity Factor ⁵
2003.....	1,722,036	95.2	89.0	89.6
2004.....	1,555,826	85.8	88.3	90.1
2005.....	1,793,014	99.1	93.4	89.4
2006.....	1,639,805	90.6	91.8	89.6
2007.....	1,665,023	92.1	93.9	91.5

¹ Source: KeySpan. *Note: Data for NMP2 net generation and Capacity Factor was obtained through Constellation’s Generation Availability Data System (“GADS”). The metering point for such data is at the revenue meter and annual net capacity is 1,147.4 MW. These numbers may be slightly different from those recorded by other sources.*

² LIPA’s 18 percent share of NMP2 net output.

³ Net capacity factor is a measure of the utilization of NMP2’s theoretical maximum annual output.

⁴ The three-year average smoothes the effects of refueling outages.

⁵ Source: Energy Information Administration. *Includes all nuclear plants operating during the respective year.*

NMP2 Maintenance Programs and Condition

The NRC uses a Reactor Oversight Process to evaluate plant performance in eighteen areas or “Performance Indicators.” Performance is graded “Green”, “White”, “Yellow”, or “Red”. Green signifies satisfactory performance requiring minimal NRC resources for oversight. At the opposite end, Red signifies unsatisfactory performance requiring the most NRC resources for oversight. In 2006 and 2007, both Nine Mile Point units were graded as Green in all areas and the NRC stated that Nine Mile Point had “operated in a manner that preserved public health and safety, and fully met all cornerstone objectives.”

The Institute of Nuclear Power Operations (“INPO”) is a nuclear industry self-assessment and support organization. In 2004, INPO identified areas needing improvement at Nine Mile Point, and, based on historically flat trends in several of these areas, INPO placed Nine Mile Point into its Policy 14 program, which is designed to help plants improve in certain programmatic and process areas. The Policy 14 program involves increased assistance from INPO and peer personnel and is monitored by INPO management on a regular basis. Based on an evaluation performed in June 2008, INPO’s rating of Nine Mile Point was raised. As a result, Nine Mile Point is no longer on the Policy 14 program.

Quarterly Quality Performance Assessments (“QPA”) were conducted by Constellation during the 2006 and 2007. This is an ongoing self-improvement program wherein processes associated with ten areas of plant performance are reviewed (Operations, Maintenance, Engineering, Work Management, Radiation Protection, Chemistry, Emergency Preparedness, Security, Training, and the Corrective Action Program). When the QPA program identifies potential areas for improvement, action plans are implemented by management. In 2007, action plans were implemented in the areas of human performance, foreign material exclusion, equipment reliability and training. Overall, the QPA reports indicate improvement during the Historical Period.

Capital Expenditures

NMP2's historical capital expenditure levels vary with the schedule of refueling and maintenance outages for the facility. Major maintenance activities, including replacement of major plant components and facility improvements, are undertaken concurrent with the refueling outages. Nuclear fuel purchases are capitalized and subsequently expensed based on expended heat content of the fuel rods.

During the 2003 through 2007 period, LIPA reported an average of approximately \$12 million per year was spent for its 18 percent share of NMP2 nuclear fuel, capital additions, and improvements. NMP2 capital expenditures for 2006 and 2007 were reported by LIPA to be approximately \$6 million and \$18 million, respectively. Current (June 2008) estimates for LIPA's share of 2008 and 2009 NMP2 capital expenditures are approximately \$5.3 million and \$29 million, respectively. The 2007 actual expenditures and 2009 projections are higher than other years due to nuclear fuel purchases for the subsequent refueling outages in 2008 and 2010. In 2007, \$13.2 million of the total capital expenditure of \$18 million was attributable to nuclear fuel purchases. The nuclear fuel estimate for 2009 is \$22.2 million, an increase over 2007 due primarily to uranium price increases.

NMP2 Decommissioning Funding

LIPA is providing for decommissioning costs for NMP2 based on a site-specific study performed in 1995. LIPA's share of the total decommissioning costs for both the contaminated and non-contaminated portions of NMP2 is estimated to be approximately \$145 million in 1996 dollars. LIPA maintains a trust fund for its share of the decommissioning costs of the contaminated portion of NMP2, which at December 31, 2007, had an approximate value of \$59.7 million. LIPA established a separate decommissioning fund for its share of the non-contaminated portion of NMP2, which had a value at December 31, 2007, of approximately \$11.2 million. Extensive federal government delays in establishing a national repository for long term storage of spent fuel has prompted a revision to the overall decommissioning schedule in order to accommodate longer term on-site storage. Therefore, the period during which decommissioning funds will be spent has been extended, resulting in a change in annual deposit requirements. Through continued deposits and investment returns on these trusts, LIPA believes that the value of these trusts will, in 2046, be sufficient to meet LIPA's decommissioning obligations for NMP2.

SECTION 6

ADEQUACY OF RATES AND CHARGES

The Authority's retail rates generally reflect traditional rate designs and include fixed customer charges for all customer classes, seasonal energy rates for all customer classes except lighting, and seasonally differentiated demand charges for the non-residential customer classes (greater than seven kW). Voluntary time-of-use rates are available to all residential and nonresidential customers. Mandatory time-of-use rates apply to nonresidential customers with demands in excess of 145 kW in the summer or 500 kW in the non-summer months. The summer months are May through September, inclusive. Economic development and load retention incentives are provided to a small number of commercial customers.

In addition to the base retail rates, the LIPA Tariff for Electric Service ("Tariff") includes the following adjustments and riders.

FUEL AND PURCHASED POWER COST ADJUSTMENT CLAUSE

LIPA's Tariff includes a fuel recovery provision – the Fuel and Purchased Power Cost Adjustment Clause ("FPPCA") that is applicable to all Service Classifications. The FPPCA mechanism is designed to allow LIPA to recover from or return to customers all current year fuel and purchased power costs, including certain load reduction program costs, up to an amount sufficient to achieve a targeted level of net income for each year.

Prior to April 2006, the FPPCA mechanism was designed to achieve a targeted financial reserve of \$20 million per year. If the projected financial reserve was expected to fall below this level, the FPPCA was adjusted upward to achieve the targeted financial reserve level. A corresponding downward adjustment was made in the FPPCA if the projected financial reserve was expected to exceed \$20 million.

Effective April 2006, the FPPCA mechanism was modified to achieve a targeted financial reserve of \$75 million per year, with a deadband of \$50 million around this target. The purpose of the deadband is to create some degree of rate stability within the calendar year. So long as the projected financial reserve is greater than \$25 million and less than \$125 million, the FPPCA will remain unchanged and LIPA's projected financial reserve will be impacted accordingly. If the projected financial reserve falls outside the deadband, the FPPCA will be increased or decreased so that the financial reserve will fall within the deadband. Since the lower limit of the financial reserve deadband is now \$25 million, LIPA's financial health is improved compared to the previous targeted financial reserve of \$20 million.

On June 22, 2006, the Board of Trustees approved a revision to LIPA's base schedule of rates to move substantially all elements of the fuel and purchased power costs previously recovered through base electric rates to the FPPCA. This change was effective for all bills issued on and after July 5, 2006, and substantially consolidates fuel and purchased power costs in the FPPCA. While this restructuring will not affect the level of revenues collected from its customers, LIPA believes the change will provide a clearer indication of the costs incurred to meet the power supply needs of ratepayers in the Service Area.

In 2003, the Authority authorized the deferred recovery of approximately \$365 million in fuel and purchased power costs. These deferred costs are being amortized over ten years and recovered through the FPPCA in equal annual amounts.

To protect its customers from significant market price fluctuations for the purchase of fuel oil, natural gas and electricity, LIPA uses derivative financial instruments which are recorded at their market value. Any unrealized gains and losses derived from these derivatives are deferred as a regulatory asset (or regulatory liability) until realized, at which time they are included in current period results as a component of fuel and purchased power expenses.

SHOREHAM PROPERTY TAX SETTLEMENT RIDER

The Authority and certain taxing jurisdictions in Suffolk County previously reached an agreement settling various matters related to prior property tax assessments on Shoreham (the "Settlement"). The Settlement results in a rate differential between non-Suffolk County ratepayers (Nassau County and Rockaway Peninsula) and ratepayers in Suffolk County. Under the Settlement, all ratepayers initially received a credit on their monthly electric bills relating to the property tax settlement, with ratepayers in Nassau County and Rockaway Peninsula receiving a greater credit than ratepayers in Suffolk County. Beginning in June 2003, the billing credits were eliminated for all ratepayers and a surcharge was added to electric bills for Suffolk County ratepayers.

LIPA's rates include a rider that implements the Settlement. The rider describes the calculation of percentage factors to be applied to bills, including the FPPCA portion thereof. Under this rider, LIPA expects to collect approximately \$35 to \$40 million during each 12-month period for the remaining years of the Settlement from customers residing in Suffolk County. No revenues will be recovered from customers residing in Nassau County and the Rockaway Peninsula under the terms of the Settlement.

PILOT PAYMENT RECOVERY RIDER

The Authority is obligated to make payments in lieu of taxes ("PILOTs") to municipalities and school districts equal to the property taxes that would have been received by each such jurisdiction from LILCO if the acquisition by the Authority had not occurred, and to make PILOTs for certain State taxes (including gross receipts taxes) and local taxes (including temporary transit station maintenance surcharges charged by the Metropolitan Transportation Authority of New York (the "MTA")) which would otherwise have been imposed on LILCO. LIPA's rates include a PILOT payments recovery rider that allows the Authority to recover the applicable gross receipts tax PILOTs from each ratepayer. This rider also allows for the recovery of the MTA surcharge from each ratepayer. All other PILOTs are recovered in the Authority's base electric rates.

ADEQUACY OF LIPA RETAIL RATES AND CHARGES

As discussed below, LIPA's currently effective rates and charges, including adjustments and riders, provide for adequate revenue recovery to meet its annual revenue requirements and to satisfy the debt service coverage requirements set forth in the General Bond Resolution, absent the approval of waivers limiting cost recovery.

Legislation was unanimously passed by the New York State Legislature in June, 2008 which would amend the Act and the State Public Service Law to require the approval by the New York Public Service Commission ("NYPSC") of an increase in LIPA's average customer rates exceeding 2.5 percent over a 12 month period or the extension or re-establishment any portion of a temporary rate increase exceeding 2.5 percent. Were such legislation to become law, LIPA would have to notify the NYPSC of any proposed rate increase, extension or re-establishment exceeding 2.5 percent over a 12-month period, and an approval of any such LIPA request by the NYPSC

would require a full evidentiary hearing. The proposed legislation was vetoed on September 4, 2008, by the Governor and has not been enacted into law. If, on a second vote, both houses of the State Legislature were to override the Governor's veto by approving the bill by at least a two-thirds majority during the current term (which will end no later than December 31, 2008), the bill would be enacted into law despite the Governor's veto. The Authority cannot predict whether the Legislature will seek to override such legislation or whether other similar legislation may be introduced and acted upon in the future.

The restructuring of LIPA's rates in July 2006 (described earlier) had no net impact on LIPA's revenue recovery or rate levels. The base rates and the FPPCA were adjusted by exactly the same amount (in cents per kWh) to maintain rate neutrality and bill neutrality. The restructured rates are, however, more consistent with the rest of the utilities in New York State, which have unbundled their rates and present power supply charges separately from delivery service charges.

Although most other electric utilities in the state have done so, LIPA has not adopted a systems benefit charge to recover the costs of public policy programs that target energy efficiency, research and development, and the low income sector. The costs of LIPA's public policy programs are recovered through base rates. Similarly, LIPA has not instituted a Renewable Portfolio Standard ("RPS") recovery rider. Presently, any costs for compliance with RPS initiatives are recoverable as a cost of fuel and purchased power through the FPPCA mechanism.

LIPA has announced that it will be expanding its energy efficiency programs as part of its contribution toward meeting the statewide energy efficiency goals established by the Governor. As part of this announcement, LIPA stated it would propose an energy efficiency cost recovery rider to recoup its expenditures on the energy efficiency programs along with the lost revenues expected from the energy efficiency programs. This cost recovery will occur in the same year that the cost or revenue impacts are projected to occur. Such a change would bring LIPA's rate structure more in line with the regulated electric utilities in the State, since the proposed cost recovery rider would combine the Systems Benefits Charge already existing for the regulated utilities and a revenue decoupling mechanism the NYPSC has ordered each of the regulated utilities to develop. If the energy efficiency cost recovery mechanism is approved by the Trustees as proposed, LIPA's rates will be better structured to ensure the recovery of its costs as it promotes even greater levels of energy efficiency for its customers.

In 2008, legislation was passed in New York requiring the regulated electric utilities to expand the size limits of net metering for renewable generation on residential installations and extend net metering for renewable generation to commercial customers. The same legislation enabled LIPA to make similar modifications to its Tariff. Acting voluntarily, the Trustees decided to match the requirements of the State legislation in the following ways:

- Residential customers can be net metered for solar photovoltaic or wind generation up to 27.5 kW.
- Farm Service customers can be net metered for wind generation up to 500 kW.
- Commercial customers can be net metered for solar photovoltaic or wind generation equal to their highest billing demand in the past 12 months, not to exceed 2 MW. Smaller commercial customers can install an additional 10 percent, for generation up to 27.5 kW.

The Authority also adopted aggregate limits of 51.2 MW for solar photovoltaic generation and 15.3 MW for wind generation, which is consistent with the amounts specified in the new legislation as a fraction of LIPA's system peak load. Expansion of net metering for renewable

generation has the potential for reducing LIPA's base rate revenues beyond the level currently anticipated in LIPA's revenue projections. The potential loss in base rate revenue has been estimated to be between \$6.5 million and \$8.3 million per year, if the entire increase in allowed net generation is enrolled.

OPEN ACCESS TRANSMISSION TARIFF

On May 13, 1998, the Authority adopted an open access transmission tariff consistent with regulations issued by FERC. On November 18, 1999, the New York Independent System Operator ("NYISO") officially assumed control of the New York State bulk power system. The NYISO is responsible for the safe and reliable operation of the New York State electric power system and for providing transmission service on a comparable and non-discriminatory basis. In its role as transmission service provider, the NYISO has adopted an open access transmission tariff ("OATT") for use of the New York State transmission system. Except in the case of "grandfathered" contracts, the NYISO OATT supersedes the transmission tariff adopted by LIPA.

LIPA's participation does not limit its ability to recover its transmission costs from wholesale customers that use the system. Under the NYISO OATT, LIPA has specified the Transmission Service Charge ("TSC") based on LIPA's determination of its transmission revenue requirements. The TSC applies to all wholesale customers that are located in the Service Area, and is not substantially different from the charge that LIPA adopted previously under its own open access transmission tariff. Additional NYISO OATT charges are designed to compensate LIPA for other usage of its transmission system, including interconnections with adjoining service territories.

In 2003, the LIPA Trustees approved a modification to the Open Access Transmission Tariff to authorize the use of a formula rate to update the TSC. As modified, LIPA staff is authorized to update the TSC calculation each year using verifiable financial information. LIPA expects the automatic adjustment process to reduce the administrative burden of the TSC and better match LIPA's revenues to current expense levels.

UNBILLED SERVICE

The financing agreement ("Financing Agreement") between the Authority and LIPA Acquisition Corp., a subsidiary of the Authority formed in connection with the acquisition of LILCO, generally prohibits LIPA from providing services of the System without reasonable compensation. Through discussions with LIPA, Navigant Consulting has identified situations where LIPA is providing electric service to KeySpan at rates below retail tariff levels. These situations occur at certain KeySpan facilities that are jointly used to support LIPA operations and KeySpan's natural gas operations and other business activities.

Electric service at these KeySpan locations is metered (or estimated) and billed to KeySpan at a rate of 4.6 cents per kWh (plus an allowance for county-specific taxes). KeySpan's payments for electric service to support their operations on behalf of LIPA, however, are recoverable from LIPA under the MSA. Therefore, by charging the lower rate to KeySpan for this usage, the charges that LIPA pays to KeySpan under the MSA are reduced, and LIPA's ratepayers are kept whole. This arrangement is not believed to be contrary to the intent of the Financing Agreement since all LIPA retail customers bear the cost of electricity used in LIPA's operations. However, the discounted cost of electricity that accrues to KeySpan's gas customers and other business practices is not consistent with the intent of the Financing Agreement. Navigant Consulting has brought this issue to LIPA's attention and LIPA has taken it under consideration.

FINANCIAL RESULTS – REASONABLENESS OF RATES

Section 702(b)(iii) of the General Bond Resolution sets forth the duties of the Rate Consultant in preparing its respective portion of the Biennial Report. Specifically, this Section states such report shall contain:

“(iii) the Rate Consultant’s recommendation as to any necessary or advisable revisions of rates, fees, rents, charges and surcharges and such other advise and recommendation as it may deem desirable;”

The General Bond Resolution itself however is silent regarding the criteria or standards upon which the recommendations of the Rate Consultant are to be based. As a general matter, Navigant Consulting believes there are many quantitative and qualitative factors to consider when assessing rates, fees, charges, and surcharges including: adequacy of total revenue produced to cover all costs; each rate’s (service classification’s) ability to produce revenue sufficient to cover an appropriate portion of total costs; timeliness of cost recovery; regional competitiveness, understandability; stability; and predictability. Among these, the Navigant Consulting believes the single most important factor is whether the Tariff will produce revenues that are adequate to cover all costs reasonably expected to be incurred. This is predominately a forward-looking test.

For purposes of the Biennial Report, Navigant Consulting refers to Article VII, Sections 701 and 702 of the General Bond Resolution, which set forth both a minimum standard for assessing the adequacy of Tariff revenue in total and an expectation that the Rate Consultant will, in the preparation of the Biennial Report, make a determination as to whether that minimum standard is satisfied. Furthermore, Navigant Consulting believes that the determinations required by these sections of the General Bond Resolution as to the satisfaction of the minimum standard along with the findings and recommendations of the Rate Consultant are to be measured on both a historical and forward-looking basis. Section 701(a) of the General Bond Resolution states, in part:

“The Authority shall establish and maintain System fees, rates, rents, charges and surcharges sufficient in each Fiscal Year so that Revenues reasonably expected to be produced in such Fiscal Year, will be at least equal to the sum of (i) 120% (except, after the Authority shall have retired, other than from proceeds of Bonds or Subordinated Indebtedness, an amount equal to 25% of the Acquisition Debt net of the then outstanding balance of the Promissory Notes, 100%) of Debt Service, and amounts under all Parity Contract Obligations, payable by the Authority in such Fiscal Year, (ii) 100% of the Operating Expenses payable in such Fiscal Year, (iii) 100% of the amount necessary to pay all PILOTS payable in such Fiscal Year, and (iv) 100% of the amount necessary to pay other Required Deposits, all other payments required pursuant to the Resolution and the Financing Agreement, and all other payments required for the System, for such Fiscal Year; ...”

During 2005, the Authority’s cumulative retirement of Acquisition Debt (as defined in the General Bond Resolution) exceeded 25 percent of the original issued amounts. Pursuant to the provision cited above, the Authority’s requirement to establish and set rates equal, among other requirements, to 120 percent of Debt Service has been reduced to 100 percent of Debt Service.

With reference to the expectation that the Rate Consultant will make a determination regarding the requirements of Section 701(a), Section 701(b) states, in part:

“If ...the report of the Rate Consultant pursuant to Section 702 [Biennial Report], indicates that the rates, fees, rents, charges and surcharges are, or will be, insufficient to meet the requirements of this Section 701 ...”

For purposes of preparing this portion of the Biennial Report relating to the adequacy of the currently effective system of rates and surcharges, Navigant Consulting, as Rate Consultant, utilized the provisions established in the aforementioned Section 701(a) as the basis of its determinations. Specifically, the test was whether the requirements (minimum standards or Rate Covenants) set forth in Section 701(a) of the General Bond Resolution have been satisfied for the Historical Period and can reasonably be expected to be satisfied for the Forecast Period. In conducting this test, Navigant Consulting utilized the currently effective Tariff in developing the level of estimated revenues each year of the Forecast Period. To the extent the Trustees have approved waivers of certain provisions of the Tariff during the Historical Period, the effect of these waivers on the reported results and related findings have been recognized in the appropriate year. Navigant Consulting's analysis for the Forecast Period is based upon the assumption that no provision of the currently effective Tariff will be waived. To the extent the Trustees approve any waiver of the Tariff that would impact either the amount or timing of the recovery of any incurred expense during the Forecast Period, such waiver would have a direct effect on the results of the revenue adequacy test and the related advice and recommendations derived therefrom. The results of the analyses for the Historical Period and Forecast Period are shown on Exhibits 1 and 2, respectively.

Exhibit 1 sets forth the Authority's annual Statement of Operations for the Historical Period. In accordance with the Authority's accounting practices, annual operating results shown in Exhibit 1 are presented on an accrual basis and include operating expenses, depreciation and amortization, interest income, PILOTs and interest charges, among other expenses.

As shown in Exhibit 1, the actual level of revenues recovered through the Authority's retail electric rates were sufficient during the Historical Period to meet the Authority's operating expenses, PILOTs, and other financial obligations as well as provide debt service coverage levels in excess of 180 percent of debt service payments on outstanding senior lien bonds, parity reimbursement obligations and parity contract obligations.

In conjunction with the preparation of this Biennial Report, Navigant Consulting has prepared an estimate of the Authority's annual operating results for the Forecast Period, which is included in Exhibit 2. These estimates are based on numerous assumptions with respect to the Authority's future operations and activities. These assumptions are summarized below.

1. KeySpan and its subsidiaries will carry out their obligations in accordance with the terms of the Agreements.
2. LIPA will fund repairs, renewals, and replacements to the T&D System, and the Manager will make such repairs, renewals, and replacements in accordance with prudent utility practices and the Amended MSA, as may be required, to continue the safe and reliable operation of the T&D System.
3. The Authority will retain staff, advisors, and consultants, as necessary, to carry out its responsibilities for financing, contract administration, planning, public relations, and

other matters in connection with the ownership, operation, and maintenance of the System.

4. The Authority will approve capital expenditures by GENCO, and GENCO will make repairs, renewals, and replacements in accordance with prudent utility practice and the PSA, as may be required to continue the reliable operation of GENCO's generating facilities.
5. LIPA and Constellation will provide operating and capital funds in a timely manner as needed and required by contract to maintain the reliable, cost effective operation of NMP2 and to meet applicable regulations, including environmental and safety standards.
6. LIPA will establish an energy efficiency cost recovery mechanism that will provide for the recovery, in the same year, of its expenditures on its energy efficiency program and the reduction, if any, in base rate revenues caused by the energy efficiency program.
7. If any changes in State legislation require LIPA to expand the provisions of net metering for renewable resources, LIPA will modify its tariffs to allow for the recovery of the associated reduction in base rate revenues through other means.
8. The resetting of the charges associated with the PSA scheduled to become effective on January 1, 2009, will be accomplished on the same terms as the current PSA.
9. The Trustees will not waive any provision of the Tariff that would impact the recovery of incurred expenses during the Forecast Period.
10. In the event the legislation requiring evidentiary hearings before the NYPSC is signed into law by the Governor, LIPA will be able to recover its base rate expenses through the existing base rates, and its costs for fuel and purchased power through either the current FPPCA mechanism or a similar mechanism, as is allowed for the regulated electric utilities in the State.
11. Natural gas transportation facilities to deliver gas to and within the Service Area will, during the Forecast Period, be maintained, improved, and expanded to enable operation of the on-island generating facilities as forecast by the Manager in its resource planning calculations as well as for the operation of other power supply resources under contract or available to LIPA.
12. LIPA will incur fuel and purchased power expenses as set forth in Exhibit 2.
13. Third party costs, PILOTs, incentive payments, and escalation rates for labor and other costs, as applicable, associated with the Amended MSA, PSA, and EMA will be as reflected in Exhibit 2.
14. LIPA's share of NMP2 decommissioning costs will increase from estimated 1996 costs at an average rate of no more than 3.0 percent per year and will be funded through annual deposits by LIPA of approximately \$2.7 million and \$1.3 million for the contaminated and non-contaminated portions, respectively, of NMP2. Annual earnings on the decommissioning funds held by or on-behalf of LIPA will average 6.0 percent LIPA will maintain a Rate Stabilization Fund at the levels shown in Exhibit 2 of this Report.
15. The Rate Stabilization Fund will be used for the purposes and in the amounts shown in Exhibit 2 of this Report for the Forecast Period.
16. LIPA will realize earnings on its invested funds as reflected in Exhibit 2.

17. There will be no changes in applicable federal, State, or local laws that will establish new limits on the operation and maintenance of the generating facilities under contract to LIPA during the Forecast Period.
18. The Authority will maintain regulations, policies, procedures, and rates and charges that will preclude the undue shifting of fixed costs among retail customers or rate classes as a result of individual customers or groups of customers electing to select power suppliers other than LIPA.
19. There will be no changes in regulations or policies of federal, State, or local agencies with jurisdiction over NMP2 that will cause new capital additions or operation and maintenance costs to exceed the estimated amounts of such costs reflected in Exhibit 2 of this Biennial Report.
20. All NMP2 generic issues will continue to be successfully addressed within the NMP2 plant modification budget forecast.
21. NMP2's regulatory performance will be sufficient to make increased NRC regulation of NMP2 unnecessary.
22. Any legislation enacted by the federal government that provides for the restructuring of the electric utility industry will not preclude the use of tax-exempt debt by the Authority for the funding of capital improvements or for other purposes contemplated during the Forecast Period and will not preclude LIPA from owning or operating the System as contemplated in this Biennial Report.]

As shown on Exhibit 2, the level of revenue estimated to be recovered through the Authority's retail rates are estimated to be sufficient during the Forecast Period to meet the Authority's estimated operating expenses, PILOTs, and other financial obligations and provide debt service coverage levels in excess of 100 percent of debt service payments on outstanding senior lien bonds, parity reimbursement obligations, and parity contract obligations.

SECTION 7 FINDINGS

The results of the analyses performed in the preparation of this Biennial Report and the findings presented herein are predicated upon the general condition that the assumptions presented herein are reasonable and will continue, as stated, for the period covered by the analyses, without major modification or change except as noted herein. Although Navigant Consulting believes the assumptions made are reasonable, Navigant Consulting makes no representation that the assumed conditions will, in fact, occur. In addition, Navigant Consulting was not permitted to review the INPO plant evaluation reports for NMP2 and therefore offers no assurances as to the conclusions and recommendations contained therein. Furthermore, the waiver of any provision of the Tariff by the Trustees that would impact the recovery of incurred expenses during the Forecast Period could impact the adequacy of LIPA's revenue recovery and, therefore, LIPA's ability to satisfy the requirements of Article VII, Sections 701 and 702 of the General Bond Resolution. Navigant Consulting's studies, analyses, investigations, and projections have been based upon its understanding of certain documents and information provided to Navigant Consulting by the Authority, the Authority's legal, financial, and accounting advisors, KeySpan, and others. While Navigant Consulting believes these sources to be reliable, they have not been independently verified for either accuracy or validity, and no assurances are offered with respect thereto. To the best of Navigant Consulting's knowledge, the data and summaries presented herein accurately reflect the information furnished to Navigant Consulting by the Authority, the Authority's legal, financial, and accounting advisors, KeySpan, and others. Further, Navigant Consulting has assumed that all contracts, agreements, or ordinances that have been relied upon in the conduct of its investigations will be fully enforceable in accordance with their terms and conditions. Navigant Consulting makes no representations or warranties, and provides no opinion concerning the enforceability or legal interpretations of such contractual and legal requirements.

Pursuant to Section 702(b) of the General Bond Resolution and Section 7.02 of the General Subordinated Resolution, Navigant Consulting's findings are as follows:

OPERATION, MAINTENANCE, AND REPAIR OF THE SYSTEM

1. The Manager has provided services adequate for the operation, maintenance, and repair of the System during the Historical Period.
2. During the Forecast Period, it is reasonable to expect the Manager will provide services adequate for the operation, maintenance, and repair of the System consistent with that experienced during the Historical Period.
3. The amounts included in Exhibit 2 to this Biennial Report for operation, maintenance, and repair expense are expected to be adequate to properly operate, maintain, and repair the System during the Forecast Period.

IMPROVEMENTS TO THE SYSTEM

1. During the Historical Period, LIPA's capital improvement programs: (i) maintained system reliability and quality of service at or near the best ratings in New York State; and (ii) provided reasonable levels of expenditures for capability expansion, new customer connections, and public works projects.

2. LIPA has approved capital expenditure programs for 2008 (and is expected to approve capital programs for 2009) intended to: (i) maintain system reliability and quality of service; and (ii) provide adequate levels of expenditures for capability expansion, new customer connections, facility replacement, and public works projects.
3. The amounts included in Exhibit 2 and estimated to be available from the proceeds of Bonds during the Forecast Period, together with funds estimated to be available from net revenues of the System, are reasonably expected to be adequate to fund LIPA's identified capital expenditure programs during the Forecast Period.

RATES, FEES, CHARGES, AND SURCHARGES

1. As of the date of this Biennial Report, LIPA's currently effective system of rates and surcharges (if applied without waiver) are expected to be adequate without change to satisfy during the Forecast Period the requirements of Section 701(a) of the General Bond Resolution and Section 7.01 of the General Subordinated Resolution, which provide that the Authority will establish and maintain rates sufficient to produce revenues at least equal to (i) 100 percent of its annual operating expenses, PILOTs, and other financial obligations; and (ii) 100 percent of annual debt service payments on outstanding senior lien bonds, parity reimbursement obligations, and parity contract obligations.

CONDITION OF THE SYSTEM

1. As of the date of this Biennial Report, the System is in good repair and sound operating condition to reliably deliver capacity and energy to LIPA's customers.

EXHIBIT 1
ACTUAL OPERATING RESULTS
STATEMENT OF OPERATIONS ¹
(\$000)

	<u>2006</u>	<u>2007</u>
Retail Sales of Electricity (MWh).....	21,077,467	21,609,275
Electric Revenues	\$3,664,976	\$3,542,555
Operating Expenses		
Fuel and Purchased Power Costs.....	\$2,024,811	\$1,838,495
Operations and Maintenance	765,569	847,963
General and Administrative ²	43,082	37,978
Prior Service Costs-OPEBs ²	-	10,912
Operating Taxes/Payments In-Lieu of Taxes.....	225,077	231,490
Depreciation and Amortization	242,206	245,632
Total Operating Expenses	<u>\$3,300,745</u>	<u>\$3,212,470</u>
Operating Income	\$364,231	\$330,085
Other Income and Deductions, Net	<u>85,853</u>	<u>82,374</u>
Excess of Revenues Over Expenses Before Interest Expense	\$450,084	\$412,459
Interest Expense	<u>331,914</u>	<u>319,413</u>
Excess of Revenues Over Expenses	<u><u>\$118,170</u></u>	<u><u>\$93,046</u></u>
Debt Service Coverage:		
Senior Lien Debt Service	2.77	2.33
Senior Lien and Subordinate Debt Service	2.56	2.16
Total Debt Service	2.52	2.12

¹ Source: LIPA. Sums may not add due to rounding.

² LIPA adopted the provisions of GASB No. 45 which requires the recognition, as a current period expense, the costs for providing health benefits to employees upon their retirement. This amount is included in General and Administrative costs for 2007. LIPA also recognized the amount incurred in the periods prior to the adoption of this pronouncement, which totaled approximately \$11 million.

EXHIBIT 2
ESTIMATED OPERATING RESULTS
STATEMENT OF OPERATIONS ¹
(\$000)

	<u>2008</u>	<u>2009</u>
Retail Sales of Electricity (MWh) ²	20,063,589	20,617,363
Electric Revenues ³	\$3,644,863	\$3,958,665
Operating Expenses		
Fuel and Purchased Power Costs ⁴	\$2,058,216	\$2,239,169
Operations and Maintenance ⁵	779,166	821,350
General and Administrative ⁶	36,393	38,073
Revenue Taxes ⁷	59,559	62,664
Payments In-Lieu of Taxes ⁸	179,715	187,933
Depreciation and Amortization ⁹	247,823	267,401
Total Operating Expenses	<u>\$3,360,872</u>	<u>\$3,616,590</u>
Operating Income	\$ 283,991	\$ 342,075
Other Income and Deductions, Net ¹⁰	<u>66,195</u>	<u>68,465</u>
Excess of Revenues Over Expenses Before Interest Expense	\$ 350,186	\$ 410,540
Interest Expense		
Debt Service Interest Expense ¹¹	\$ 319,390	\$ 335,168
Other Interest Expense and Fees ¹²	<u>7,887</u>	<u>8,447</u>
Subtotal Interest Expense	\$ 327,277	\$ 343,615
Promissory Notes Receipts ¹³	<u>(8,075)</u>	<u>(8,075)</u>
Net Interest Expense	<u>\$ 319,202</u>	<u>\$ 335,540</u>
Excess of Revenues Over Expenses ¹⁴	<u>\$ 30,984</u>	<u>\$ 75,000</u>

EXHIBIT 2
ESTIMATED OPERATING RESULTS
STATEMENT OF OPERATIONS ¹
(CONTINUED)
(\$000)

	2008	2009
CALCULATION OF CASH AVAILABLE FOR DEBT SERVICE		
Excess of Revenues Over Expenses ¹⁵	\$ 30,984	\$ 75,000
Plus (Minus) Non-Cash Items:		
Amortization of 2007 Excess Fuel Cost Recovery ¹⁶	\$ (113,106)	\$ -
Utilization of Settlement Benefits ¹⁷	(36,000)	(100,000)
Amortization of Deferred Shoreham Property Tax Settlement		
Credits ¹⁸	36,390	37,335
Carrying Charges on Deferred Shoreham Property Tax		
Settlement Costs ¹⁹	(31,829)	(31,383)
Deferred Fuel Cost Reconciliation ²⁰	36,336	36,500
NMP2 Amortized Nuclear Fuel Expense ²¹	6,257	8,038
Amortization of Prepaid NMP2 Refueling Outage Costs ²²	2,799	2,408
Amortization and Prepaid Hedging Costs ²³	11,988	13,065
O&M Asset Accretion-Asset Retirement Obligation		
(FASB 143) ²⁴	4,984	5,175
Depreciation and Amortization ⁹	247,823	267,401
PSA Plant and Property Tax True-Ups-Accruals ²⁵	12,419	12,515
Other ²⁶	(537)	10,806
Interest Expense ²⁷	319,202	335,540
Subtotal	\$ 527,710	\$ 672,400
Less:		
Prepaid Fuel Hedging Program Costs ²⁸	\$ 20,000	\$ 14,925
Prepaid NMP2 Refueling Outage Costs ²⁹	5,657	205
Funding for NMP2 Decommissioning ³⁰	1,000	1,000
Bank and Related Fees ³¹	7,887	9,944
Capitalized MSA Management Fees ³²	10,000	10,000
PSA Plant and Property Tax True-Up Payments ³³	22,600	14,895
NMP2 Cash Fuel Expense ³⁴	44	22,384
Subtotal	\$ 67,188	\$ 73,353
Operating Cash Available for Debt Service Coverage	\$ 460,522	\$ 599,047

EXHIBIT 2
ESTIMATED OPERATING RESULTS
STATEMENT OF OPERATIONS ¹
(CONTINUED)
(\$000)

	<u>2008</u>	<u>2009</u>
DEBT SERVICE COVERAGE RATIO ³⁵		
Operating Cash Available for Debt Service and Coverage ³⁶.....	\$ 460,522	\$ 599,047
Plus:		
Taxes ³⁷	\$ 239,274	\$ 250,597
Capitalized Leases ³⁸	215,612	271,219
Total Cash Available for Debt Service and Coverage Based on Priority of Payments.....	<u>\$ 915,408</u>	<u>\$1,120,863</u>
 Senior Lien Debt Service ³⁹	 \$ 479,261	 \$ 451,908
Coverage on Senior Lien Debt Service	1.91x	2.48x
 Senior Lien and Subordinate Debt Service ^{39,40}	 \$ 514,671	 \$ 542,872
Coverage on Senior Lien and Subordinate Debt Service	1.78x	2.06x
 Total Debt Service ^{39,40,41}	 \$ 522,747	 \$ 550,947
Coverage on Total Debt Service.....	1.75x	2.03x

EXHIBIT 2
ESTIMATED OPERATING RESULTS
STATEMENT OF OPERATIONS ¹
(CONTINUED)
(\$000)

	2008	2009
FUNDS PROVIDED FROM:		
Excess of Revenues Over Expenses ⁴²	\$ 30,984	\$ 75,000
Plus (Minus):		
Accrual/(Amortization) of 2006 Excess Fuel Cost Recovery ¹⁶	\$ (113,106)	\$ -
Utilization of Settlement Benefits ¹⁷	(36,000)	(100,000)
Amortization of Deferred Shoreham Property Tax Settlement		
Credits ¹⁸	36,390	37,335
Carrying Charges on Deferred Shoreham Property Tax		
Settlement Costs ¹⁹	(31,829)	(31,383)
Deferred Fuel Cost Reconciliation ²⁰	36,336	36,500
NMP2 Amortized Nuclear Fuel Expense ²¹	6,257	8,038
Amortization of Prepaid NMP2 Refueling Outage Costs ²²	2,799	2,408
Amortization and Prepaid Hedging Costs ²³	11,988	13,065
O&M Asset Accretion-Asset Retirement Obligation		
(FASB 143) ²⁴	4,984	5,175
Depreciation and Amortization ⁹	247,823	267,401
PSA Plant and Property Tax True-Ups-Accruals ²⁵	12,419	12,515
Other ⁴³	(535)	10,808
Interest Expense ²⁷	319,202	335,540
Proceeds of Bonds, Notes, and Swaps ⁴⁴	205,000	85,000
Total Sources of Funds	\$ 732,712	\$ 757,402
FUNDS USED FOR:		
Prepaid Fuel Hedging Program Costs ²⁸	\$ 20,000	\$ 14,925
Prepaid NMP2 Refueling Outage Costs ²⁹	5,657	205
Funding for NMP2 Decommissioning ³⁰	1,000	1,000
Bank and Related Fees ³¹	7,887	9,944
Debt Service Payments and Accelerated Debt Retirement ⁴⁵	722,747	550,947
Capital Expenditures ⁴⁶	306,983	245,207
Capitalized MSA Management Fees ³²	10,000	10,000
PSA Plant and Property Tax True-Up Payments ³³	22,600	14,895
NMP2 Cash Fuel Expense ³⁴	44	22,384
Change in Cash Position Due to Operating, Financing, and		
Investing Activities ⁴⁷	(364,206)	(112,105)
Total Uses of Funds	\$ 732,712	\$ 757,402

EXHIBIT 2
ESTIMATED OPERATING RESULTS
STATEMENT OF OPERATIONS ¹
(CONTINUED)
(\$000)

	2008	2009
CASH ACCOUNT: FUNDS AVAILABLE FOR OPTIONAL DEFEASED/TENDERED DEBT, WORKING CAPITAL, CAPITAL IMPROVEMENTS, AND OTHER PURPOSES		
Beginning Balance	\$ 564,412	\$ 200,206
Change in Cash Position Due to Operating, Financing, and Investing Activities ⁴⁷	(364,206)	(112,105)
Withdrawals from Rate Stabilization Fund	-	-
(Deposits to) Rate Stabilization Fund	-	-
Ending Balance	\$ 200,206	\$ 88,101
 RATE STABILIZATION FUND		
Beginning Balance	\$ 250,000	\$ 250,000
(Withdrawals From)	-	-
Deposits to	-	-
Ending Balance	\$ 250,000	\$ 250,000
 TOTAL FUNDS		
Beginning Balance ⁴⁸	\$ 814,412	\$ 450,206
Transfers In (Out) ⁴⁹	(364,206)	(112,105)
Ending Balance	\$ 450,206	\$ 338,101
 CAPITAL EXPENDITURE FUNDING		
Internal Funding ⁵⁰	\$ 127,147	\$ 189,913
Bond Proceeds ⁵¹	205,000	85,000
Total Capital Expenditures ⁴⁶	\$ 332,147	\$ 274,913

EXHIBIT 2
ESTIMATED OPERATING RESULTS
STATEMENT OF OPERATIONS ¹
(CONTINUED)
(\$000)

FOOTNOTES:

- ¹ Sums may not add due to rounding.
- ² Includes bundled and Long Island Choice electric sales. Developed by KeySpan.
- ³ Includes revenues from bundled services, Long Island Choice services, Shoreham property tax settlement surcharge, and recoverable fuel and purchased power costs. Also includes revenues from sales for resale, transmission of electricity for others (“wheeling”), pole attachment fees, late payment charges, service activation charges, and other miscellaneous revenues. Please see LIPA’s 2007 Audited Financial Statement for additional information on the Shoreham property tax settlement surcharge and associated regulatory asset.
- ⁴ Includes LIPA’s cost for fossil and nuclear fuel, cost of purchased capacity and energy, wheeling charges, independent system operator charges, hedging costs, and deferred fuel cost recovery. Developed based on information provided by KeySpan.
- ⁵ Includes costs in accordance with the MSA and PSA, NMP2 operation and maintenance expenses and accretion of the asset retirement obligation, Clean Energy and Energy Efficiency Programs costs, assessments, research and development, storm damage reserve, uncollectible accounts, customer service economic development, postage-paid envelopes, and other miscellaneous expenses.
- ⁶ Includes employee salaries and benefits, utilities, rent, legal and consulting fees, and similar administrative and general costs.
- ⁷ Payments for gross receipts taxes.
- ⁸ Includes payments in lieu of property taxes to various taxing jurisdictions for NMP2, the T&D System, and merchant power plants.
- ⁹ Consists of amortization of the acquisition adjustment and depreciation of plant-in-service.
- ¹⁰ Includes interest earned on investments from available cash balances and the Nuclear Decommissioning Trust Fund. Also includes carrying charges related to the Shoreham property tax settlement regulatory asset and income from the sales of emission credits.
- ¹¹ Interest expense on Senior Lien Bonds, subordinate indebtedness, commercial paper, debentures, and certain financing notes. Includes accretion of capital appreciation bonds and amortized interest expense. Also includes amortization of upfront swap payments on derivative financial transactions.
- ¹² Bank and letter of credit fees, debt administration costs, interest on customer deposits, amortization of costs associated with bond issuance and redemptions, and reduction for capitalized interest.
- ¹³ Receipts from KeySpan for certain promissory notes held by LIPA for repayment of certain assumed debt. LIPA’s Audited Financial Statements reflect these receipts as an offset to interest expense.
- ¹⁴ LIPA’s FPPCA mechanism will set recoveries of fuel costs so that LIPA achieves \$75 million of revenues in excess of expenses for each calendar year, plus or minus \$50 million. The fuel recovery will not exceed the fuel cost recovery allowance calculated according to FPPCA rider to LIPA’s tariffs.
- ¹⁵ From Exhibit 2, Page 1.
- ¹⁶ During 2007, LIPA recovered more fuel costs than it incurred. This entry returns the excess cost recovery.
- ¹⁷ Utilization of benefits resulting from the settlement of significant outstanding contractual issues between LIPA and KeySpan/National Grid to mitigate the level of the Power Supply Charge.
- ¹⁸ Equal to the Shoreham property tax settlement surcharge.
- ¹⁹ Annual carrying charges recorded on the Shoreham property tax settlement regulatory asset.

EXHIBIT 2
ESTIMATED OPERATING RESULTS
STATEMENT OF OPERATIONS ¹
(CONTINUED)
(\$000)

FOOTNOTES:

- ²⁰ Recognition of deferred fuel costs as an expense in the year during which the corresponding fuel and purchased power costs are billed to retail customers. Equals deferred fuel and purchased power costs from 2003 amortized over a 10-year period.
- ²¹ Amortization of prepaid NMP2 fuel costs based on NMP2 generation during the year.
- ²² Amortization of non-fuel and capital costs incurred during refueling outages.
- ²³ Amortization of fuel hedging costs in the year of the contract's settlement date.
- ²⁴ Accretion of the asset retirement obligation.
- ²⁵ Accrual for the difference between the estimated cost of removal of plant equipment as reflected in the PSA and the amount expected to be achieved in the current year. Also accounts for property tax assessments are on a one year lag. The prior year's property taxes are used for the current budget estimate. This entry accrues the difference in property tax levels.
- ²⁶ Includes true-ups and adjustments to reserve accounts.
- ²⁷ Debt Service Interest Expense (Note 11), Other Interest Expense (Note 12), and Promissory Notes Receipts (Note 13).
- ²⁸ Cash outlays for hedging contracts.
- ²⁹ Operating and maintenance costs attributable to refueling outages, other than nuclear fuel and capital projects. Includes costs of specialty contractors, skilled craft outside labor, incremental onsite labor associated with the outage, materials and supplies, and benefits and taxes.
- ³⁰ Deposits to the NMP2 decommissioning fund.
- ³¹ Bank fees, letter of credit fees, bond administration costs, and interest on customer deposits.
- ³² MSA administration and support costs associated with capital projects.
- ³³ Payments of actual true-ups for PSA plant and property taxes that were accrued in the prior year.
- ³⁴ Cash outlays for NMP2 nuclear fuel.
- ³⁵ The General Bond Resolution requires rates to be set to produce revenues at least sufficient to provide Debt Service Coverage equal to 20 percent of Senior Lien Bond principal and interest payments. At such time that LIPA retires 25 percent of the Acquisition Debt net of the then outstanding balance of KeySpan Promissory Notes, the Debt Service Coverage requirement is eliminated. LIPA achieved the 25 percent retirement level during 2005; therefore the 20 percent coverage requirement is no longer applicable. Please see the General Bond Resolution for additional information related to the Debt Service Coverage requirement, including the meaning of the above defined terms.
- ³⁶ From Exhibit 2, Page 2.
- ³⁷ Revenue Taxes and Payments In-Lieu of Taxes. From Exhibit 2, Page 1. See Notes 7 and 8.
- ³⁸ Capacity payments for power supply agreements that satisfy the conditions for capital leases.
- ³⁹ Debt service on Senior Lien Bonds.
- ⁴⁰ Debt service on subordinated indebtedness. Subordinated indebtedness consists of variable rate debt and commercial paper.
- ⁴¹ Debt service on debentures and certain financing notes.
- ⁴² From Exhibit 2, Page 1.
- ⁴³ Includes true-ups and adjustments to reserve accounts, plus the non-cash add back for OPEBS.
- ⁴⁴ Proceeds of bonds and notes for capital projects and up-front payments for swap transactions.
- ⁴⁵ Senior Lien Debt Service (Note 39), Subordinate Lien Debt Service (Note 40), and Subsidiary Unsecured Debt Service (Note 41), plus early retirement of \$200 million of Senior Lien Debt during 2008.
- ⁴⁶ Total amount expended for capital improvements.
- ⁴⁷ Changes in LIPA's cash position.
- ⁴⁸ Beginning balance in Cash Account plus beginning balance in Rate Stabilization Fund.

EXHIBIT 2
ESTIMATED OPERATING RESULTS
STATEMENT OF OPERATIONS
(CONTINUED)
(\$000)

FOOTNOTES:

⁴⁹ Change in Cash Position plus change in Rate Stabilization fund.

⁵⁰ Internal LIPA funds used for capital improvements.

⁵¹ Proceeds of bonds and notes, net of financing costs, used for capital improvements.

Appendix A

SUMMARY OF CERTAIN PROVISIONS OF THE AMENDED AND RESTATED MANAGEMENT SERVICES AGREEMENT

The following is a brief summary of certain provisions of the Amended and Restated Management Services Agreement, as amended (the “MSA” or the “Agreement”). The summary does not purport to be complete or definitive and is qualified in its entirety by reference to the Agreement, a copy of which is on file with the Trustee.

General

The Authority (acting through LIPA) and National Grid Electric Services LLC (the “Manager”) have entered into an Amended and Restated Management Services Agreement (the “Agreement”), which becomes effective pending the approval of the New York State Attorney General (as to form) and the approval of the New York State Comptroller.

The Amended and Restated Management Services Agreement establishes the terms and conditions under which the Authority has contracted with the Manager for the purpose of providing the Operation and Maintenance Services and the Construction Work relating to the T&D System in a manner consistent with policies established by LIPA in order to assure the continued delivery of electric energy to the customers of the T&D System.

Ownership of the T&D System

The Agreement provides that the Manager does not and will not have any ownership or leasehold interest in the T&D System. LIPA has engaged the Manager as an independent contractor to furnish the services described in the Agreement.

The Agreement provides that the Manager will not, without LIPA’s prior written consent, create or permit to be created or to remain, and will promptly discharge at its expense, any Encumbrance on the T&D System, other than (1) Encumbrances existing as of the date of the Agreement, or (2) any Lien affecting the T&D System (i) resulting solely from any action or failure to act by LIPA or anyone claiming by, through or under LIPA; or (ii) created by Subcontractors that are promptly discharged or bonded against by the Manager. The Agreement provides that nothing in the Agreement will be deemed to create any Lien or Encumbrance in favor of the Manager on any asset of LIPA as security for the obligations of LIPA under the Agreement.

The Agreement provides that the Manager will provide LIPA with unrestricted access to the T&D System. The Manager will provide LIPA and its consultants and designees with a dedicated on-site office space located at the Manager’s current headquarters building or another mutually agreed site and a separate work space adequate to enable LIPA to exercise its oversight rights and responsibilities under the Agreement. LIPA has the right to designate up to four LIPA employees (each a “LIPA Designee”) to be located at the Manager’s offices. One such LIPA Designee will fully participate with the senior executives of the Manager and its Affiliates who are responsible for the provision of electric service, up to two LIPA Designees will fully participate with the senior management of the Manager’s Electric Planning Organization for the T&D System and with respect to electric resource planning work performed by such organization, and one such LIPA Designee will fully participate with the Manager’s combined Electric Sales and Marketing Organization.

Operation of the T&D System

General. The Agreement provides that the Manager will not transmit or distribute Power and Energy other than Power and Energy obtained by, on behalf of, or with the approval of LIPA, and will not use the T&D System for any purpose other than, the purposes contemplated by the Agreement or to serve or benefit any person other than LIPA and its customers in the Service Area.

Operation and Maintenance. The Agreement provides that the Manager will provide Operation and Maintenance Services and Construction Work for the T&D System on behalf of LIPA at all times in accordance with the Contract Standards (the "Scope of Services"). The Scope of Services to be provided by the Manager is subject to modification during the Term of the Agreement to reflect changes in Prevalent Utility Services. The Manager will be responsible for all electric transmission, distribution, and load serving activities the safe and reliable operation and maintenance of the T&D System, management and/or performance of construction of improvements thereto and delivery of Power and Energy to LIPA's customers and will be responsible for the following tasks and services, among others: (a) day-to-day operation and maintenance of the T&D System; (b) engineering activities; (c) asset management; (d) identification and assistance in the development and administration of third-party research and development; (e) contract administration of third party generation and transmission and interface with daily operation; (f) preparation of recommended, and monitoring of the approved, Capital Plan and Budget, load and energy forecasts and long and short range system and strategic plans; (g) preparation of long and short range transmission and distribution planning analyses and forecasts; (h) monitoring the regulatory environment for changes or trends that could impact LIPA and recommending appropriate courses of action; (i) performance of accounting, tax and payment in lieu of tax reporting functions; (j) representation of LIPA before FERC, NYSPSC, NERC, NYISO, NY State Reliability Council, ISO-NE, NPCC, PJM and North American Energy Standard Board or such other regulatory or governmental group or entity as the parties any mutually agree is appropriate and any working groups or committees of the foregoing; (k) administration and management, at the direction of LIPA, of LIPA's interest in NMP2; (l) billing and collection, in accordance with LIPA's direction, of all fees and charges in connection with the use or availability of the T&D System for wheeling services; (m) under LIPA's direction, assistance in the administration, development and/or implementation of energy conservation and load management programs for the T&D System and its customers; (n) performance of Capital Improvements including customer connections and disconnections and supervision; (o) repair or modification activities required due to Public Works Improvements; (p) reasonable cooperation with third parties providing services to LIPA with respect to the provision of electric service; (q) other activities necessary, appropriate or advisable to safely, reliably and efficiently operate and maintain the T&D System in accordance with the Contract Standards and Prevalent Utility Services.

The Manager will be responsible for implementation of customer service functions related to the provision of electric service, including, but not limited to, the following: (a) maintaining customer contact through call centers with toll free service numbers, customer offices, authorized payment centers, maintaining and overseeing customer portion of LIPA's Web Site, co-management of customer loyalty and satisfaction programs, customer services field operations, and customer care and institutional communications and responding to customer inquiries regarding LIPA provided services; (b) development and maintenance of all necessary information and accounting systems and controls relating to the provision and reporting of

customer services, and updating customer records in the financial and customer information system; (c) marketing and sales for retail system expansion, retail customer retention, and customer care and service programs, including all aspects of marketing, promotion and communications; market research; account relationship management; economic development, field sales; trade ally relations; demand response programs; and participating in and complying with LIPA's clean energy initiatives; (d) planning and managing the design of customer meter reading and billing systems, reading of customer meters, issuance of accurate and timely customer bills, and collection of customer payments and timely investigation of customer bill inquiries, all in accordance with the Contract Standards and unusual or unmetered usage, unbilled revenues and theft of services; (e) auditing, on a timely basis, of adjustments for billing errors, and seeking refunds and interest payments from customers; (f) collection of reliability, meter reading, call answering, collection and customer satisfaction performance data; (g) inclusion of communications to customers requested and approved by LIPA in customer bills; (h) identification, assistance in the development of, and administration of third party produced research and development to provide solutions to fulfill customer needs and expectations, renewable technologies and clean energy initiatives; and (i) other activities necessary, appropriate or advisable to implement LIPA's customer service programs in accordance with the Contract Standards and Prevalent Utility Services.

The Manager is responsible for (a) the preparation of recommended revenue requirements for the management of the T&D System; (b) the preparation of recommended rate classification and designs for the T&D System; (c) at LIPA's request, public presentation of recommended rate and capital expenditure adjustments at LIPA rate hearings; (d) cost of service and planning; (e) tariff development, administration, and enforcement; (f) regulatory monitoring; and (vii) load research and forecasting.

The Manager is responsible for the following other activities with respect to the provision of electric service to customers of the T&D System: (a) assisting LIPA in developing and maintaining System Policies and Procedures and training the Manager's work force in accordance therewith; (b) assigning and supervising the Manager's and its Subcontractor's work force consistent with the day-to-day requirements of the Agreement; (c) assigning and allocating physical resources consistent with the day-to-day operational requirements of the Agreement; (d) recruiting, retaining, deploying, and supervising subcontract labor and resources; (e) determining, acquiring, deploying, and maintaining tools, equipment, and information systems necessary to perform all activities under the Agreement; (f) preparing and delivering cost and budget input data for LIPA's annual budgeting processes; (g) accounting for and documenting the costs and revenues resulting from the Manager's performance under the Agreement in accordance with GAAP, GASB, FERC and /or NYSPSC requirements as necessary; (h) developing safety programs, safety reports, and written procedures and practices for the Manager's staff; (i) producing and delivering information as may be necessary to determine the Manager's performance under the Agreement; (j) contracting for and maintaining services, including utilities, communication systems, and internet and intranet services, necessary for the Manager's office facilities and to fulfill the Manager's obligations under the Agreement; (k) monitoring industry advancements and technological changes in the provision of transmission and distribution services by electric utilities and recommending improvements in current programs and practices for LIPA's consideration; (l) in accordance with current practices of the Manager, staffing public events and presenting workshops, seminars, and similar activities during normal business hours, evenings, weekends, and holidays, as may be required from time to time by LIPA; and (m) providing vehicle and refueling operations.

The Manager is responsible for developing and implementing business continuity, disaster recovery and emergency response plans, and all necessary emergency response and reporting relating to the T&D System, and coordinating such plans with LIPA's plans and the plans of LIPA's other service providers for business continuity and disaster recovery.

If requested by LIPA, the Manager will perform additional services reasonably related to the T&D System and not included within the Manager's scope of services based upon terms and conditions (including compensation) agreed to by the parties. The Manager's scope of services does not include (a) operation, maintenance and repair of transmission or distribution facilities which are owned in whole or in part by third parties, other than certain specified cables or (b) operation, maintenance and repair of transmission or distribution facilities located outside of the Long Island Control Area owned by LIPA which are constructed or acquired after the date of delivery of the Agreement (the "Contract Date").

The Manager's responsibilities under the Agreement include the representation of LIPA before FERC, NYISO, NY State Reliability Council and ISO-NE among others, or such other regulatory or governmental group or entity as the parties may mutually agree is appropriate and any working groups or committee meetings of the foregoing. The employees of the Manager or its Affiliates acting on behalf of LIPA in such capacity are referred to herein as "LIPA Regulatory Representatives." LIPA Regulatory Representatives shall at all times comply with the rules and regulations of the FERC, NYISO, NY State Reliability Council and ISO-NE, among others, and LIPA's Standard of Conduct and Code of Conduct as in effect from time to time. Within a reasonable time after each working group or committee meeting, LIPA Regulatory Representatives present and representing LIPA at such working group or committee meeting will provide LIPA with summaries of the issues addressed and matters discussed at each working group or committee meeting and the outcome thereof. Prior to working group or committee meetings, LIPA Regulatory Representatives will coordinate with the appropriate LIPA representative with regard to the positions to be taken and the decisions and/or votes to be made on behalf of LIPA at such working group or committee meetings. No LIPA Regulatory Representative may represent the Manager or any of its Affiliates as long as the LIPA Regulatory Representative is representing LIPA.

Maintenance and Repair of T&D System. The Agreement provides that the Manager will maintain the T&D System, the T&D System Site and the Common Facilities in good working order and repair and in a neat and orderly condition, and will conduct periodic, corrective, and preventive maintenance and repair of the T&D System consistent with the Contract Standards for the purpose of, among other things, mitigating and preventing abnormal wear, tear and usage.

All additions to the T&D System purchased in conjunction or for the use with any part of the T&D System during the term of the Agreement shall be the property of LIPA, except those which are leased or constitute part of the Common Facilities.

Performance Metrics. The Agreement provides that the Manager will monitor and report to LIPA with respect to the Manager's performance during each month under the following operational and customer service performance metrics: Actual Meter Read Rate, Billing Accuracy, Customer Satisfaction Index, Days Sales Outstanding, Bad Debt Ratio, Expanded Electronic Transactions, Call Answer Rate & Average Speed of Call Answer, First Call Resolution, Workplan Completion Index, Capital Cost Per Customer, Multiple Customer Outages, System Average Interruption Duration Index, System Average Interruption Frequency Index, Customer Average Interruption Duration Index, Storm Customer Average Interruption Duration Index,

Worker Safety, Planned Substation Maintenance, and Primary Cable Faults, as set forth in Appendix 5 to the Agreement (the "Performance Metrics"). The Manager's performance in meeting the Performance Metrics will determine the extent, if any, to which the Manager will be assessed performance penalties, which penalties shall in no event exceed either (i) Seven Million Dollars (\$7,000,000) in the aggregate during any one Contract Year for such Performance Metrics, or (ii) an amount which would result in the Manager receiving less than the Minimum Compensation amount for such Contract Year. The deviation from the agreed upon level of performance with respect to the metrics, and the associated penalty amount, are set forth in Appendix 5 to the Agreement.

The Agreement establishes a Clean Energy Initiative ("CEI") performance metric with a maximum one million dollar per year penalty or performance bonus. The CEI performance metric has three parts: budget, cost-effectiveness, and collaboration.

Rights and Responsibilities of LIPA. The Agreement provides that LIPA will retain the ultimate authority and control over the assets and operations of the T&D System and the right, consistent with Applicable Law, Prudent Utility Practices, Prevalent Utility Services, subject to the Agreement, to direct the Manager, in connection with the performance of the Manager's obligations under the Agreement. Without limiting the generality of the foregoing, LIPA's specific rights and responsibilities with respect to the T&D System include: (a) the right to determine all T&D System rates and charges, line extension policies and service rules and regulations applicable to the T&D System and System Power Supply; (b) the right to determine and to change from time to time, in its sole discretion, all policies and procedures for the T&D System; (c) the right to review, amend as appropriate and approve the annual Capital Plan and Budget pursuant to the procedures outlined in the Agreement and approve or in its discretion, develop, all long-range strategic plans for the T&D System and System Power Supply; and (d) to the extent the Manager acts as the representative of LIPA in connection with the FERC, NERC, NPCC, the NYISO, the NY State Reliability Council, the NYSPSC, the ISO-NE, PJM, the North American Energy Standards Board and any other similar institutions or organizations, the right to direct the Manager's actions with respect thereto.

Customer Services, Rates and Rules of Service. The Agreement provides that the Manager will perform normal and customary customer services, including, but not limited to: customer account service and maintenance; service restorations account inquiry work; customer assistance, credit and collection services; cashiering; account connection and disconnection; and conservation advice.

The Agreement provides that the Manager will, unless otherwise directed, by LIPA, read the meters of electric commercial, "industrial", residential heating and residential multiple rate period customers on a monthly basis and all other electric customer meters on a bi-monthly basis. The Manager will, according to the schedule of rates, tariffs and policies (the "Schedule of Rates") then in effect, render bills to all T&D System customers in the name of LIPA for electric service delivered on behalf of LIPA and in the formal determined by LIPA. To the extent directed by LIPA, such bills will also reflect electric services provided to T&D System customers by other parties. LIPA may implement changes to such rates, rules of service, regulations and procedures by giving written notice to the Manager not later than sixty (60) days prior to the effective date of such change to the extent practicable given the nature of the change. The Manager will maintain customer bills and records as LIPA reasonably requests.

The Manager will use best efforts to collect on a timely basis (1) all amounts due LIPA for service provided to customers, and for other services; in accordance with the Schedule of Rates for the periods in which services were provided, and (2) other monies owed to LIPA pursuant to the operation of the T&D System. The Manager's responsibilities will also include the institution of legal proceedings in LIPA's name to collect utility, billings and other monies owed LIPA related to the T&D System. All monies collected by the Manager or its Subcontractors will be the property of LIPA and will be deposited by the Manager daily in an account or LIPA specified pursuant to the Agreement. In collecting such monies, the Manager and any Subcontractor will act solely as an agent for LIPA and will have no right or Claim to such moneys and, without limiting the generality of the foregoing, will have no right to assert a claim of set-off, recoupment, abatement, counterclaim or deduction for any amounts which may be owed to the Manager under the Agreement or with respect to any other matter in dispute thereunder.

To the extent moneys are collected for any power supply services provided by any unrelated party, amounts collected will be allocated in accordance with the directions of LIPA.

Licenses, Permits and Approvals. The Manager will identify for LIPA, prepare, and with LIPA approval, make and prosecute all filings, applications and reports necessary to obtain and maintain all permits, licenses and approvals required to be made, obtained or maintained by each under Applicable Law in order to operate the T&D System.

Operating Period Insurance. During the term of the Agreement, the Manager will obtain and maintain certain insurance policies relating to the Manager's duties (the "Required Operating Period Insurance") to the extent that such insurance remains available on commercially reasonable terms. If, as a result of material changes in the market for insurance products, one or more Required Operating Period Insurance policies is or are not generally available or available only on terms not considered to be commercially reasonable, the Manager will so notify LIPA. If such insurance is not generally available, LIPA will be entitled to an equitable adjustment in the Minimum Compensation for the Scope of Services. If such insurance is available, but only at a cost that Manager considers to be commercially unreasonable, Manager will advise LIPA of such cost. If, after consultation, the parties are unable to agree on whether the Manager should procure such insurance at such additional cost, LIPA may either obtain such insurance at its own cost or determine to forego such insurance coverage. In either event, LIPA will be entitled to an equitable reduction in the Minimum Compensation for the Scope of Services. LIPA has the right, upon ninety days' notice to the Manager, at any time at its expense to cancel or replace and obtain independently all or any portion of the Required Operating Period Insurance, in which case LIPA will be entitled to an equitable reduction in the Minimum Compensation for the Scope of Services. If the Manager obtains additional insurance not set forth in the Agreement at LIPA's request, LIPA will reimburse the Manager for the costs thereof as an Additional Service.

Manager's Reporting Requirements

Monthly Reports. The Manager will provide LIPA and the Consulting Engineer with monthly reports no later than 15 Business Days after the end of each month (except for (i) item (1) below, which will be provided no later than 20 Business Days after the end of each month, provided that Manager agrees, not later than six months after the Contract Date, it will examine its reporting practices with an objective of accelerating the reporting of item (1) below so it can be provided no later than 15 Business Days after the end of each month, and (ii) item (3) below, which will be provided no later than 30 Business Days after the end of each month), including the following data: (1) on a monthly and year-to-date basis, the actual Capital Costs, pensions and

OPEBs, and Storm Events (collectively, "Reported Costs") versus the budget for Reported Costs, with variance explanations, and the prior year's Reported Costs at such time; (2) a capital budget adjustment report; (3) a System Operating Report substantially in the form provided by the Manager as of the Contract Date, together with a report of the Manager's performance with respect to the Performance Metrics; (4) a reasonably detailed list of the results of any environmental or other tests or monitoring procedure conducted by or at the direction of any federal, State or local environmental or other regulatory agency during the prior monthly period, and at LIPA's request copies thereof and copies of any reports or other submittals made to or received from any such agency (it being understood that LIPA will in any event have complete access to the foregoing); (5) a description of partial or total shutdowns for maintenance and repairs during the prior month and anticipated during the current month, any known or anticipated adverse conditions which may be expected to arise during the next 30 day period that may affect the ability of the Manager to transmit and distribute Power and Energy, the results of any regulatory or insurance inspections or tests conducted during the prior month, and identification of those costs which are classified as Capital Costs versus operating in sufficient detail in order to allow LIPA to determine which costs qualify for bonding under the Bond Resolution and which are to be recovered through T&D System rates; and (6) any other documents, reports, data, and other information or statement which LIPA may reasonably request (as to time and format) and which may be reasonably produced from records maintained by the Manager hereunder or pursuant to the original MSA in the normal course of business consistent with the provisions of the Agreement with respect to record retention.

The Manager will provide LIPA on a monthly basis updated year-end projections of Pass-Through Expenditures beginning in April of each Contract Year.

Annual Reports. The Manager will furnish LIPA and the Consulting Engineer with an annual settlement reconciling actual costs for Reported Costs and the budget for Reported Costs, certified by the Manager and the Guarantor's internal auditor and chief financial officer. The Manager will continue to have its independent auditors certify the Manager's internal controls in accordance with Section 404 of the Sarbanes-Oxley Act.

Books and Records. The Manager will prepare and maintain and make available to LIPA upon its reasonable (as to time and format) request, distinct, proper, accurate and complete books, records, and accounts regarding the operations and financial or other transactions related to the T&D System to the extent necessary: (1) to enable LIPA to prepare financial statements, regarding the operations of the T&D System, certified in accordance with GAAP and GASB, (2) to verify data with respect to any operations or transactions in which LIPA has a financial or other material interest hereunder, (3) to prepare periodic performance reports and statements of the T&D System, which will be submitted by the Manager to LIPA, and (4) as may be required by Applicable Law or applicable regulatory authority.

MGP Reports. Not later than 25 Business Days following the end of each Contract Year quarter, KeySpan shall furnish or Cause to be furnished to LIPA, a written report providing in reasonably sufficient detail, the status of KeySpan's performance with respect to certain environmental remediation activities.

Fiscal Affairs, Accounting and Record Keeping. The Manager will maintain possession of operating equipment, buildings, materials and supplies, maps, plans, specifications, and customer billing records during the term of the Agreement in accordance with the Manager's customary practices or in such manner as LIPA may reasonably require. The Manager also will

maintain LIPA's fixed asset books and records for those activities performed by the Manager in general conformity with municipal electric utility accounting standards or such other standards as reasonably requested by LIPA.

All cash held by the Manager for the account of LIPA and all cash collected by the Manager for the account of LIPA will be deposited on each business day in bank accounts in such bank as LIPA may direct and upon such terms and conditions as may be specified by LIPA.

Purchase of Equipment, Materials and Services. The Agreement provides that the Manager will arrange for the purchase or rental for the account of LIPA of equipment, materials, and supplies and services which are not purchased directly by LIPA or other items necessary to properly operate and maintain the T&D System and to maintain the records of LIPA, and to make such additions and extensions to the T&D System, all as may be required by LIPA. Subcontractors will be subject to approval by LIPA in accordance with the Agreement.

Other Services. The Manager will timely pay all bills related to the T&D System which are proper, appropriate and not otherwise disputed and which it has authority to pay and will assure that, to the extent within the Manager's control, no mechanic's or similar liens are filed against any portion of the T&D System.

CEI/DSM Consulting Services. During the term of the Agreement, if requested by LIPA, the Manager will devote 100 hours to reviewing LIPA's energy efficiency programs in order to (i) identify potential enhancements to LIPA's energy efficiency programs, (ii) suggest new program and service options related to enhancing residential and commercial or industrial energy efficiency, (iii) explore the applicability and usefulness of retro-commissioning buildings, the national advanced buildings program, and the engagement of a project expeditor to LIPA, and (iv) review and recommend certain improvements to LIPA's energy efficiency evaluation practices (the services in items (i) through (iv) above, collectively, the "CEI/DSM Consulting Services"). All CEI/DSM Consulting Services shall be within the Scope of Services.

Capital Improvements

Capital Improvements Generally. From time to time it will be necessary to make repairs and replacements to the T&D System which do not constitute routine maintenance and it will be necessary or desirable from time to time during the term of the Agreement to modify, alter or improve the T&D System from its then current condition. All such projects which constitute Capital Improvements will be made in accordance with the Agreement and will be owned by LIPA. The Manager will not make a Capital Improvement without notifying LIPA and receiving written consent from LIPA unless such Capital Improvement is included in the then current annual Capital Plan and Budget. LIPA will have the right, when the Manager has materially exceeded the Capital Plan and Budget as of an interim date, to require the Manager to defer specific Capital Improvements planned for the remainder of the year.

Capital Plan and Budget. The Manager is obligated to prepare a proposed annual, two and five year Capital Plan and Budget concerning planned Capital Improvement projects.

The annual Capital Plan and Budget will be approved by LIPA prior to or contemporaneously with the adoption of any rate adjustment by LIPA, provided that in the event the Capital Plan and Budget has not been adopted by LIPA as of the beginning of a Contract Year, the Manager may undertake such Capital Improvements as reasonably approved by LIPA on a project-by-project basis.

Cost Determination. Capital Improvements will be performed at the cost of the service without any multiplier fee or mark-up. With respect to any Capital Improvement estimated to cost in excess of \$2,000,000, after conferring with the Manager, LIPA, at its sole discretion, may (a) conduct an independent procurement, (b) direct the Manager to competitively bid the Capital Improvement, or (c) direct the Manager to complete the work. In that regard, LIPA will give due consideration to the efficient utilization of the Manager's workforce.

Capital Improvements for which Manager is Responsible. If the T&D System is damaged or destroyed by reason of circumstances for which the Manager is responsible, described below under the heading "Allocation of Risks of Certain Costs and Liabilities", the Manager will promptly proceed to make or cause to be made all Capital Improvements reasonably necessary to permit the Manager to perform its obligations under the Agreement. All such Capital Improvements for which the Manager is responsible as described under the heading "Allocation of Risks of Certain Costs and Liabilities" will be made at the Manager's sole cost and expense, and the Manager will not be entitled to any compensation from LIPA as a result thereof.

Compensation and Budgets

Manager Compensation. Commencing with the first Contract Year and for each Contract Year during the term of the Agreement, LIPA will pay the Manager a fee for the Scope of Services provided by the Manager under the terms of the Agreement in an amount equal to the lesser of (i) the Minimum Compensation plus the Variable Compensation and (ii) the Minimum Compensation divided by 80%.

"Minimum Compensation" is equal to Two Hundred Twenty Four Million Dollars (\$224,000,000.00) for the first three Contract Years. For each subsequent Contract Year, Minimum Compensation will be equal to the prior Contract Year Minimum Compensation multiplied by 1.017, multiplied by the change in the Consumer Price Index (all Urban Consumers) for the New York-Northern New Jersey-Long Island region (Series ID #CUURA101SA0) as published by the United States Department of Labor Bureau of Labor Statistics ("New York Region CPI") for the twelve month period ending September 30th of the prior Contract Year.

"Variable Compensation" is equal to the total kilowatt hours of LIPA's billed sales for the Contract Year less "Base Kilowatt Hours," multiplied by the "Variable Price Per KWh" for the Contract Year.

"Base Kilowatt Hours" is equal to 16,558,000,000 kilowatt hours for the Initial Contract Year. For each subsequent Contract Year, Base Kilowatt Hours will be set at the prior Contract Year's Base Kilowatt Hours multiplied by 1.017.

"Variable Price Per KWh" is equal to 1.3377 cents per kilowatt hour (\$0.013377/KWh) for the Initial Contract Year. For the second Contract Year, the Variable Price Per KWh will be equal to 1.2870 cents per kilowatt hour (\$0.012870/KWh) multiplied by the change in the New York Region CPI for the twelve month period ending September 30, 2006 as compared to September 30, 2005. For the third Contract Year, the Variable Price Per KWh will be equal to 1.2363 cents per kilowatt hour (\$0.012363/KWh) multiplied by the change in the New York Region CPI for the twelve month period ended September 30, 2006 multiplied by the change in the New York Region CPI for the twelve month period ended September 30, 2007. For each subsequent Contract Year, the Variable Price Per KWh will be set at the Variable Price Per KWh for the prior Contract Year multiplied by the change in the New York Region CPI for the twelve month period ended on September 30th of the prior Contract Year.

Payment Schedule. LIPA will pay to the Manager the Minimum Compensation in monthly installments based on LIPA's forecasted sales pattern as set forth below:

January	8.4%
February	7.4%
March	7.9%
April	7.0%
May	7.6%
June	9.0%
July	10.5%
August	10.4%
September	8.5%
October	7.7%
November	7.4%
December	8.2%

Pass-Through Expenditures. The Agreement provides that LIPA will reimburse the Manager for all Pass-Through Expenditures in the manner set forth therein. "Pass-Through Expenditures" are those expenditures incurred by the Manager with respect to the following items: (1) Capital Costs; (2) claims, lawsuits, litigations, losses, costs and expenses, judgments, liens, settlement, disbursements and similar expense (including, without limitation, external attorney's fees) (collectively, "Claims"), incurred in connection with each such Claim or related Claims which exceeds \$25,000 in the aggregate; (3) Storm Events; (4) LIPA's return postage; (5) real property taxes, special franchise taxes, other taxes and any payments in lieu of taxes (PILOTS) related to LIPA-owned assets or revenues (collectively, "Taxes"); (6) customer refunds; (7) completion of repairs and remediation related to E.F. Barrett to Valley Stream 138kV cable leak (circuit no 138-291) identified in the fall of 2005; (8) incremental substation maintenance for Contract Year 2006, in an amount up to \$2,000,000; (9) third party conservation and third party research and development costs; (10) repair costs for any damage to the submerged portion of any marine cable; (11) increases in the annual cost of Long Island Railroad easements above \$1,265,000 (which amount will be escalated annually by 1.017 multiplied by the change in the New York Region CPI for the twelve month period ending September 30th of the prior Contract Year) and (12) for Contract Years 2008 through 2013, LIPA-approved incremental funding or allocation of Capital Costs for storm hardening that exceed \$1,000,000.

Exogenous Cost Adjustments. The Agreement provides that LIPA will reimburse the Manager. The Manager is required to credit to LIPA's account any Exogenous Costs which the Manager incurs during a Contract Year to the extent that the Manager incurs net Exogenous Costs for that Contract Year in excess of \$3,000,000 in the aggregate. "Exogenous Costs" are those costs which result in either a positive or negative change in the Manager's costs of providing services hereunder within the Scope of Services which are (i) outside of the Manager's control and (ii) not otherwise reflected in the New York Region CPI, and which directly result from one or more of the following: (1) Change in Law (including tax law, except with respect to the Manager's income tax), regulation or GAAP, but only if and to the extent that such changes are applicable to electric utilities operating in New York State, (2) change in the New York Public Service Law or NYSPSC regulation, but only if and to the extent that such change relates to the safety and reliability of the operation of the T&D System and are adopted as part of the System Policies and Procedures and (3) acts of terrorism.

Storm Costs. LIPA will reimburse the Manager, as a Pass-Through Expenditure, for costs incurred by the Manager in connection with a Storm Event. Such costs will be charged against the Storm Reserve which LIPA will establish and replenish from time to time in the amounts and in the manner set forth in the Agreement.

Mutual Aid Costs. The Manager must obtain authorization from LIPA prior to the release of any internal or third-party crews to assist a utility either within or outside New York State for storm recovery (“Mutual Aid”). The Manager will track all costs related to such Mutual Aid on a segregated basis and will prepare the documentation necessary for cost reimbursement by LIPA. Any and all reimbursement which the Manager receives from the Mutual Aid recipient or third party for such Mutual Aid assistance will accrue to LIPA’s account.

LIPA Non-Performance. If due to the occurrence of an event for which LIPA is responsible for as discussed below under the heading “Allocation of Risk of Certain Costs and Liabilities,” there will be an increase in the Manager’s cost of Construction Work or Operation and Maintenance Services, the amount of any such incremental cost increase will be borne by LIPA to the extent it is responsible therefor.

If at any time the T&D System is damaged or destroyed due to an event for which LIPA is responsible for as discussed below under the heading “Allocation of Risks of Certain Costs and Liabilities,” LIPA will pay all Capital Improvement Costs and adjustments as are required to be made by LIPA pursuant to applicable provisions of the Agreement.

Manager Non-Performance. If due to an event for which the Manager is responsible as discussed below under the heading “Allocation of Risk of Certain Costs and Liabilities;” there will be an increase in the Manager’s cost of Construction Work or Operation and Maintenance Services, or in LIPA’s costs associated with performing obligations under the Agreement, the amount of any such incremental cost increase will be borne by the Manager to the extent it is responsible therefor.

LIPA’s Payment Obligations. The Agreement provides that amounts payable to the Manager under the Agreement will be paid from T&D System revenues and other funds of LIPA available for such purposes in accordance with the terms of the Resolution.

The Agreement contemplates that if any billing disputes cannot be resolved within 30 days, either party may refer such dispute for resolution as discussed below under the heading “Non-Binding Mediation; Arbitration.”

Allocation of Risks of Certain Costs and Liabilities. The Agreement provides that except to the extent due to LIPA Fault (as determined by either a final non-appealable order or judgment of a court of competent jurisdiction (including administrative tribunals) or a final non-appealable binding arbitration decision), the Manager will be responsible and liable to LIPA for, and will not be entitled to reimbursement from LIPA for any Loss-and-Expense incurred by the Manager or LIPA,

1. due to any gross negligence or willful misconduct by the Manager during the term of the Agreement in carrying out its obligations thereunder,
2. due to any violation of or failure of compliance with Applicable Law by the Manager (except as provided below) which materially and adversely affects
 - a. the condition or operations of the T&D System,
 - b. the financial condition of LIPA,

c. the performance or ability of the Manager to perform its obligations under the Agreement, or

d. the cost of providing electric service to the customers of the T&D System, provided, however, that Manager will not be responsible and liable to LIPA under the provisions of the Agreement described in this clause (b) with respect to any violation of, failure of compliance with, or liability under, Environmental Laws (as defined in the LIPA/LILCO Merger Agreement) for which LIPA or the Manager may be strictly liable provided that Manager acted in a manner consistent with Prudent Utility Practice. Notwithstanding the foregoing, Manager will in all events be liable for any fine or penalty arising by reason of any violation of or failure of compliance with Applicable Law for acts or omissions of the Manager not consistent with Prudent Utility Practice,

3. due to any criminal violation of Applicable Law by the Manager,

4. due to an event which gives rise to a cost incurred with respect to Capital Improvements that is incurred by reason of actions or omissions of the Manager not consistent with Prudent Utility Practice, or

5. due to any claim that (a) the Manager's use of any Manager Owned Property or Manager Licensed intellectual property in connection with the performance of its services under the Agreement or (b) LIPA's use of any Manager Owned Property, Manager Licensed IP, or LIPA Owned Property created or developed by the Manager or Manager's Related Parties and not provided by or on behalf of LIPA or LIPA's Related Parties, in each case in accordance with the Agreement, infringes or otherwise violates Intellectual Property Rights or other proprietary rights of any third party.

Default, Termination For Cause And Dispute Resolution

Remedies for Breach. Subject to the provisions of the Agreement described below under the heading "Non-Binding Mediation; Arbitration," in the event that either party breaches any other obligation under the Agreement or any representation made by either party under the Agreement is untrue in any material respect, the other party will have the right to take any action at law or in equity it may have to enforce the payment of any damages or the performance of such other obligation under the Agreement and such right to recover damages or to be reimbursed as provided therein will ordinarily constitute an adequate remedy for any breach of such other obligation or any material untruth in any such representation. Either party may enforce by an action for specific performance the other party's obligations under the Agreement in the event a material breach thereof has occurred and is continuing. Neither party will have the right to terminate the Agreement for cause except after an Event of Default determined in accordance with the provisions of the Agreement has occurred.

Events of Default by the Manager

1. ***Events of Default Not Requiring Cure Opportunity for Termination.*** Each of the following will constitute an Event of Default on the part of the Manager for which LIPA may terminate the Agreement without any requirement of cure opportunity:

a. ***Change of Control.*** Change of Control of the Manager or the Guarantor.

b. ***Bankruptcy.*** Certain voluntary or involuntary events relating to bankruptcy affecting the Manager or the Guarantor.

c. *Credit Enhancement.* Failure of the Manager to supply, maintain, renew, extend or replace the credit enhancement required under the Agreement (see “General—Credit Enhancement in Certain Circumstances” below).

d. *Letter of Credit Draw.* Failure of the Manager to supplement, replace or cause to be reinstated the letter of credit as described in the Agreement (see “General—Credit Enhancement in Certain Circumstances” below) within 30 days following draws equal to, in the aggregate, 50% of the face value thereof.

e. *Performance Metrics.* Failure of the Manager to meet the minimum Performance Metrics for either (i) customer satisfaction for three (3) consecutive Contract Years, or (ii) SAIDI for two (2) out of three (3) consecutive Contract Years; provided, however, that such Event of Default by the Manager will be excused to the extent of a Force Majeure event, strike, work stoppage or other labor dispute with respect to the Manager’s work force that prevents or delays the Manager’s performance of such metric.

2. *Events of Default Requiring Cure Opportunity for Termination.* Each of the following shall constitute an Event of Default on the part of the Manager for which LIPA may terminate the Agreement upon compliance with the notice and cure provisions set forth below:

a. *Failure to Pay or Credit.* Failure of the Manager to pay or credit undisputed amounts owed to LIPA under the Agreement within 90 days following the applicable due date.

b. *Failure to Comply with Agreement or Guaranty.* The failure or refusal of the Manager to perform any material obligation under the Agreement, or the failure of the Guarantor to comply with any of its material obligations under the Guaranty unless such failure or refusal is excused by a Force Majeure or LIPA Fault; except that no such failure or refusal in clause (a) or (b) will constitute, an Event of Default giving LIPA the right to terminate the Agreement for cause unless LIPA has given prior written notice to the Manager or the Guarantor and the Manager or the Guarantor, as applicable, has neither challenged in an appropriate forum LIPA’s conclusion nor corrected or diligently taken steps to correct such default within a reasonable period of time, but not more than 60 days, from receipt of the notice (but if the Manager or the Guarantor shall have diligently taken steps to correct such default within a reasonable period of time, the same shall not constitute an Event of Default for as long as the Manager or the Guarantor cures such default within 270 days from its receipt of such notice).

Events of Default by LIPA. Each of the following shall constitute an Event of Default on the part of LIPA for which the Manager may terminate the Agreement upon compliance with the notice and cure provisions set forth below:

1. *Failure to Pay.* The failure of LIPA to pay undisputed amounts owed to the Manager under the Agreement within 90 days following the due date for such payment.

2. *Failure to Comply with Agreement.* The failure or refusal by LIPA to perform any material obligation under the Agreement unless such failure or refusal is excused by a Force Majeure or Manager Fault; except that no such failure or refusal will constitute an Event of Default giving the Manager the right to terminate the Agreement for cause unless the Manager has given prior written notice to LIPA and LIPA has neither challenged in an appropriate forum the Manager’s conclusion nor corrected or diligently taken steps to correct such default within a reasonable period of time, but not more than 60 days, from the date of the notice (but if LIPA shall have diligently taken steps to correct such default within a reasonable period of time, the same shall

not constitute an Event of Default for as long as LIPA corrects such default within 270 days from its receipt of such notice).

3. *Change of Control.* A change of control of LIPA or the Authority which results in ownership control of LIPA or the Authority by other than a state public benefit corporation, authority, political subdivision or other instrumentality of the State or any political subdivision thereof.

Procedure for Termination for Cause. If any party has a right of termination for cause, the right may be exercised by giving a notice of termination for cause to the party in default at least two years prior to (or, in the case of a bankruptcy or insolvency default, a Change of Control or an Event of Default specified in clause (e) above under the heading "Default, Termination For Cause And Dispute Resolution—Events of Default by the Manager," simultaneously with, or, in the case of an Event of Default as discussed in clause (c) and (d) above under the heading "Default, Termination For Cause And Dispute Resolution—Events of Default by the Manager," six months) the date of termination specified in such notice (the "Termination Date").

Non-Binding Mediation; Arbitration

The Agreement provides that any dispute arising out of or relating to the Agreement will be resolved in accordance with the negotiation, mediation and arbitration procedures for the resolution of such disputes established by the Agreement, which shall constitute the sole and exclusive procedures for the resolution of such disputes.

Provisional Relief

Either party may, without prejudice to any negotiation, mediation, or arbitration procedures, proceed in the NY State Supreme Court, Nassau County, to obtain provisional judicial relief if, in such party's sole discretion, such action is necessary to avoid imminent irreparable harm, to provide uninterrupted electrical and other services, or to preserve the status quo pending the conclusion of such negotiation, mediation or arbitration.

LIPA Emergency Powers. The Agreement provides that if the Manager, due to a Force Majeure event or any other reason whatsoever, fails to provide any Operation and Maintenance Services and Construction Work contemplated by the Agreement and LIPA or any Governmental Body finds that such failure endangers or menaces the public health, safety or welfare, then LIPA will have the right, upon notice to the Manager, during the period of such emergency, to take possession of and use any or all of the Operating Assets necessary to transmit and distribute Power and Energy which the Manager would otherwise be obligated to transmit and distribute. The Manager will fully cooperate with LIPA to effect such a temporary transfer of possession of the Operating Assets for LIPA's use of the same.

Term

Term of Agreement. The Agreement will continue in effect until December 31, 2013, unless earlier terminated in accordance with its terms.

Selection of Future Managers. LIPA may conduct a procurement for T&D System management services to be provided following the expiration or earlier termination of the Agreement. The Manager will have the right or be ineligible to submit a bid in such procurement on the same basis as other bidders unless the Agreement is terminated due to an Event of Default of the Manager. The Manager is obligated to cooperate with LIPA during such procurement process.

Miscellaneous Provisions

Affiliate. Pursuant to the Agreement, the Manager has agreed to remain an Affiliate of the Guarantor.

Credit Enhancement in Certain Circumstances. The Agreement provides that if the Guarantor's credit rating declines below investment grade, then the Manager will provide credit enhancement of its obligations under the Agreement in the form of either (i) an unconditional guarantee of all of GENCO's obligations under the Power Supply Agreement, the Manager's obligations under the Management Services Agreement, and the Energy Manager's obligations under the Energy Management Agreement, provided by a corporation or financial institution whose long-term senior debt is or would be rated investment grade, or (ii) an irrevocable letter of credit in form and substance satisfactory to LIPA securing GENCO's obligations under the Agreement, the Manager's obligations under the Management Services Agreement, and the Energy Manager's obligations under the Energy Management Agreement, in a face amount of \$60,000,000 provided by a financial institution whose long-term senior debt is rated investment grade. The amount of such letter of credit will be reduced by \$30,000,000 if the Energy Management Agreement has theretofore been or is thereafter terminated and by \$4,000,000 if the Power Supply Agreement has theretofore been or is thereafter terminated, such obligation to continue until the expiration or termination of the Agreement, the Power Supply Agreement and the Energy Management Agreement.

Force Majeure Generally. Except as otherwise specifically provided in the Agreement, neither LIPA nor the Manager will be liable to the other for any failure or delay in performance of any obligation under the Agreement, including any obligations with respect to the Performance Metrics, to the extent due to the occurrence of a Force Majeure event.

Indemnification. The Agreement provides that the Manager, to the extent permitted by law, will protect, indemnify and hold harmless LIPA and its respective representatives, trustees, directors, officers, employees and subcontractors (as applicable in the circumstances) (the "LIPA Indemnified Parties") from and against (and pay the full amount of) any Loss-and-Expense and will defend LIPA Indemnified Parties in any suit, including appeals, for personal injury to, or death of, any person; or loss or damage to property arising out of any matter for which the Manager is responsible under the caption "Allocation of Risk of Certain Costs and Liabilities" in the Agreement and LIPA, to the extent permitted by law, will protect, indemnify and hold harmless the Manager Indemnified Parties from and against (and pay the full amount of) any Loss-and-Expense, and will defend the Manager Indemnified Parties in any suit, including appeals, for personal injury to, or death of, any person, or loss or damage to property arising out of (i) any matter for which LIPA is responsible under the caption "Allocation of Risk of Certain Costs and Liabilities" in the Agreement and (ii) any claim that (a) LIPA's use of any LIPA Owned Property or any LIPA Licensed IP, (b) the Manager's use of any LIPA Owned Property provided by or on behalf of LIPA or LIPA's Related Parties or LIPA Licensed IP in accordance with the Agreement, or (c) the Manager's use of certain LIPA trademarks in accordance with the Agreement, infringes or otherwise violates Intellectual Property Rights or other proprietary rights of any third party. The foregoing indemnifications are subject to certain exceptions, including the negligence or other wrongful conduct of any indemnified party and any Force Majeure event.

Assignment and Transfer.

General. The Agreement may be assigned by either party only with the prior written consent of the other party, except that without the consent of the other party (1) LIPA may make such assignments, create such security interests in its rights thereunder and pledge such monies receivable thereunder as may be required in connection with issuance of revenue bonds; (2) LIPA may assign its rights, obligations and interests thereunder, or transfer such rights and obligations by operation of law, to any other governmental entity or to a subsidiary of LIPA provided that the successor entity gives reasonable assurances to the Manager that it will be able to fulfill LIPA's obligations thereunder; and (3) the Manager may assign its rights, obligations and interests thereunder to the Guarantor or any Affiliate thereof except that the Manager may not, without the consent of LIPA, make any assignment or other transfer to any person of its rights and obligations under the Agreement unless the Guaranty is and remains in full force and effect and unless the Guarantor or a majority-owned direct or indirect subsidiary of the Guarantor will have control of and responsibility for the Operation and Maintenance Services and any Construction Work.

T&D System Sale or Transfer. During the term of the Agreement, LIPA may, without the Manager's consent, sell, assign or transfer in whole or in part the T&D System to a federal, state or municipal governmental entity; provided, however, that any such sale, assignment or transfer will be subject to the Manager's rights under the Agreement. LIPA may, during the term of the Agreement, also sell, assign or transfer the T&D System to a private entity, in which event LIPA will have the right to terminate (upon not less than 6 months prior written notice to the Manager) the Agreement effective upon the closing of such sale, assignment or transfer (the "Early Termination Date"); provided, however, that on the Early Termination Date, LIPA pays to the Manager (1) a termination fee of (x) \$28,000,000 if the Early Termination Date occurs on or before December 31, 2009, and (y) \$20,000,000 if the Early Termination Date occurs after December 31, 2009, and (2) the Manager's reasonable and actual transition costs related to activities directed by LIPA or the new T&D System owner. In addition, with respect to contracts in the Manager's name with a term extending for 3 years or more beyond the Early Termination Date that are not assigned (without material cost) to LIPA or the new T&D System owner, on the Early Termination Date LIPA will pay to the Manager its actual and reasonable cost to terminate such contracts up to \$2,000,000 in the aggregate.

Appendix B

SUMMARY OF CERTAIN PROVISIONS OF THE POWER SUPPLY AGREEMENT

The following is a brief summary of certain provisions of the Power Supply Agreement. The summary does not purport to be complete or definitive and is qualified in its entirety by reference to the Power Supply Agreement, a copy of which is on file with the Trustee.

General

The Power Supply Agreement sets forth the terms and conditions for the sale and delivery of electric capacity and energy by BL Holding Corp. and its subsidiaries (“GENCO”) to LIPA.

Power Supply

Delivery of Power. The Agreement provides that during the term of the Agreement GENCO shall sell and deliver to LIPA, and LIPA shall purchase and accept delivery from GENCO of, (i) all the capacity from the GENCO Generating Facilities, and (ii) all the energy that GENCO produces from the GENCO Generating Facilities, in accordance with the Agreement, that LIPA requests to meet the electricity requirements of its retail and wholesale electricity customers (regardless of whether located inside or outside the Service Area). The Agreement also provides that GENCO will provide the various Ancillary Services as required by LIPA, and LIPA shall pay for any associated costs not otherwise compensated by LIPA.

Sale or Assignment of Generating Units. The Agreement provides that GENCO shall not sell or otherwise assign any interest in any of its generating units (as set forth in an appendix to the Agreement) except for (i) liens securing bona fide debt or other encumbrances incurred in the ordinary course of business, (ii) capital leases, or (iii) sales or assignments made with LIPA’s prior written consent, which consent shall be deemed to have been given in respect of certain easements specified in the Agreement.

Transmission Requirements. The Agreement provides that LIPA is responsible for all transmission reinforcements required in conformance with Prudent Utility Practice for any new generation, including any new interconnections and other T&D System requirements regardless of their location, sufficient to maintain the delivery of electricity from the GENCO Generating Facilities onto the T&D System. The additional costs charged to GENCO for such transmission reinforcements will not be greater than if such costs were allocated to all of the LIPA Electricity Customers and transmission service customers on an average system basis.

Purchase Price and Payment

The Agreement provides that during the term of the Agreement LIPA will pay to GENCO monthly an amount equal to the aggregate of the following components:

- (i) a capacity charge to compensate GENCO for its fixed costs of generating electricity from the GENCO Generating Facilities,
- (ii) a variable charge based on the variable operation and maintenance costs as established by the Agreement, multiplied by the actual megawatt-hour (“MWh”) of operation of the GENCO Generating Facilities,
- (iii) a charge for any costs incurred by GENCO in providing certain Ancillary Services to LIPA, if any such services are required by LIPA which are not otherwise compensated by the charges described in items (i) and (ii) above,

(iv) a charge for non-variable related expenses net of insurance proceeds, that cannot be planned for with any certainty and are outside the control of GENCO, and

(v) certain other miscellaneous charges as specified in the Agreement.

Budgets

Pursuant to the Agreement, GENCO and LIPA have agreed to an initial five-year plan which provides details on the fixed and variable costs of operating the GENCO Generating Facilities. The budget establishes the monthly capacity charge and the monthly variable charge for the first year of the five-year period, which forms the basis for adjustment for subsequent years in such period in accordance with the terms of the Agreement.

The Agreement provides that prior to the commencement of each successive five-year period during the term of the Agreement, GENCO shall prepare and submit to LIPA for review and approval a proposed five-year budget plan. If GENCO and LIPA are unable to reach agreement concerning the budget plan, those portions that are in dispute shall be resolved in a proceeding before the FERC.

The Agreement also provides that GENCO shall annually prepare and submit to LIPA a rolling Five Year Capital Improvement Budget for incremental capital expenditures and associated rate adjustments for LIPA's review and approval.

Capacity Ramp Down Option

The Agreement provides that, commencing in the seventh year of the Agreement, LIPA may determine to reduce the amount of capacity purchased from GENCO. In any such an event, LIPA shall immediately reimburse GENCO for the capacity charges in the amount set forth in the Agreement that would have been recovered from LIPA over the remaining portion of the original term of the Agreement. The Agreement provides that such reduction may not be greater than 1500 MW.

Term and Termination

Term. The Agreement commenced on May 28, 1998 for an initial term of fifteen (15) years. The Agreement provides that it shall terminate upon the purchase of the GENCO Generating Facilities by LIPA as provided for under the Generation Purchase Right Agreement attached to the LIPA/LILCO Merger Agreement.

Termination for Cause by GENCO. The Agreement provides that GENCO shall have the right to terminate the Agreement for cause if one of the following events shall have occurred:

(1) *Failure to Pay.* The failure of LIPA to pay undisputed amounts owed to GENCO under the Agreement within 90 days of such amounts having become due.

(2) *Failure to Comply with Agreement.* The failure or refusal by LIPA substantially to perform any material obligation under the Agreement unless such failure or refusal is excused by force majeure (as defined in the Agreement), except that the Agreement further provides that no such failure or refusal to pay or perform as referenced in these clauses (1) and (2) shall constitute an Event of Default giving GENCO the right to terminate the Agreement for cause unless GENCO has given prior written notice to LIPA stating that a specified failure or refusal to perform exists and LIPA has neither challenged in an appropriate forum GENCO's conclusion nor corrected or diligently taken steps to correct such default within a reasonable period of time, but not more than 60 days, from the date of the notice (but if LIPA shall have diligently taken

steps to correct such default within a reasonable period of time, the same shall not constitute an Event of Default for as long as LIPA is continuing to take such steps to correct such default).

Termination For Cause by LIPA. The Agreement provides that LIPA shall have the right to terminate the Agreement for cause after one of the following Events of Default as determined in accordance with the provisions of the Agreement shall have occurred:

(1) *Events of Default Not Requiring Cure Opportunity for Termination.* Each of the following shall constitute an Event of Default on the part of GENCO for which LIPA may terminate the Agreement without any requirement of cure opportunity:

(a) *Change of Control of GENCO.* Change of Control of GENCO or the Guarantor has occurred; provided, however, that the combination effectuated under the LIPA/LILCO Merger Agreement shall not constitute a Change of Control of GENCO for purposes of this provision.

(b) *Bankruptcy.* Certain voluntary or involuntary events relating to bankruptcy affecting GENCO or the Guarantor.

(c) *Credit Enhancement.* Failure of GENCO to supply, maintain, renew, extend or replace the credit enhancement required under the Agreement (see below, "Credit Enhancement in Certain Circumstances" below).

(d) *Letter of Credit Draw.* Failure of GENCO to supplement, replace or cause to be reinstated the letter of credit as described in the Agreement (see "Credit Enhancement in Certain Circumstances" below) within 30 days following draws equal to, in the aggregate, 50% of the face value thereof.

(2) *Events of Default Requiring Cure Opportunity for Termination.* Each of the following shall constitute an Event of Default on the part of GENCO for which LIPA may terminate the Agreement upon compliance with the notice and cure provisions of the Agreement described below:

(a) *Failure to Comply with Agreement.* The failure or refusal by GENCO to substantially perform any material obligation under the Agreement, except that no such failure or refusal shall constitute an Event of Default giving LIPA the right to terminate the Agreement for cause unless LIPA has given prior written notice to GENCO or the Guarantor, as applicable, stating that a specified failure or refusal to perform exists and GENCO or the Guarantor, as applicable, has neither challenged in an appropriate forum LIPA's conclusion nor corrected or diligently taken steps to correct such default within a reasonable period of time, but not more than 60 days, from receipt of the notice (but if GENCO or the Guarantor shall have diligently taken steps to correct such default within a reasonable period of time, the same shall not constitute an Event of Default for as long as GENCO or the Guarantor is continuing to take such steps to correct such default).

Procedure for Termination for Cause. If either GENCO or LIPA shall have a right of termination for cause in accordance with the provisions of the Agreement outlined above, the same may be exercised by notice of termination given to the party in default at least two years prior to (or, in the case of a bankruptcy or insolvency default or a Change of Control, simultaneously with or, in the case of an event of default described in clauses (1)(c) or (1)(d) above, six months) the date of termination specified in such notice.

Non-binding Mediation; Arbitration

The Agreement provides that any dispute arising out of or relating to the Agreement shall be resolved in accordance with the mediation and arbitration procedures for the resolution of such disputes established by the Agreement which shall constitute the sole and exclusive procedures for the resolution of such disputes.

Affiliate

Pursuant to the Agreement, GENCO has agreed to remain an Affiliate of the Guarantor.

Credit Enhancement in Certain Circumstances

The Agreement provides that if the Guarantor's credit rating declines below investment grade, then GENCO shall provide credit enhancement of its obligations under the Agreement at its sole cost and expense in the form of either (i) an unconditional guarantee of all of GENCO's obligations under the Agreement, the Manager's obligations under the Management Services Agreement, and the Energy Manager's obligations under the Energy Management Agreement, provided by a corporation or financial institution whose long-term senior debt is or would be rated investment grade, or (ii) an irrevocable letter of credit securing GENCO's obligations under the Agreement, the Manager's obligations under the Management Services Agreement, and the Energy Manager's obligations under the Energy Management Agreement, in a face amount of \$60,000,000 provided by a financial institution whose long-term senior debt is rated investment grade.

Allocation of Risk of Certain Costs and Liabilities

The Agreement contains provisions relating to the allocation of risks and liabilities that are substantially the same as the provisions of the Management Services Agreement described herein under the caption "Summary of Certain Provisions of the Management Services Agreement – Compensation and Budgets – Allocation of Risks of Certain Costs and Liabilities."

Appendix C

SUMMARY OF CERTAIN PROVISIONS OF THE ENERGY MANAGEMENT AGREEMENT

The following is a brief summary of the Energy Management Agreement. The summary does not purport to be complete or definitive and is qualified in its entirety by reference to the Energy Management Agreement, a copy of which is on file with the Trustee.

General

The Energy Management Agreement establishes the terms and conditions for the management by the KeySpan subsidiary party thereto (the “Energy Manager”) of fuel supplies used at the GENCO Generating Facilities to produce electric energy for delivery to LIPA, and for management and administration of the System Power Supply on behalf of LIPA in a manner consistent with policies established by LIPA.

Scope of Energy Management Services

As described in the Agreement, the Energy Manager is responsible for (a) fuel procurement, delivery, storage, and management for GENCO Generating Facilities to meet the energy generation requirements of the Electricity Customers, (b) the dispatch of all System Power Supply available to LIPA to meet total capacity and energy requirements of the Electricity Customers and Off-System Sales, (c) the purchase, on behalf of LIPA, of all capacity and energy to meet the needs of the Electricity Customers and (d) the sale, on behalf of LIPA, of Electricity owned by, or under contract to, LIPA which is not otherwise required to meet the needs of the Electricity Customers. The Agreement provides that all such responsibilities will be discharged in a manner consistent with Prudent Utility Practice, the System Policies and Procedures and New York State Public Service Commission policies and procedures pertaining to retail gas customer service. In discharging all such functions, the Energy Manager is obligated to use best efforts to obtain the least-cost fuel and least-cost capacity and energy for the benefit of the Electricity Customers.

The Energy Manager agrees to establish policies and procedures satisfactory to LIPA designed to assure that the Energy Manager’s responsibilities are performed without consideration of the ownership or economic return to the Energy Manager or its Affiliates, except for the incentive provisions of the Agreement (described below at “Fuel Management—Fuel Management Compensation—Fuel Purchase Performance Incentives/Disincentive Payments”), and comply with such policies and procedures.

The Agreement provides that in no event will the Energy Manager take title to Electricity being purchased or sold thereunder.

Fuel Management

Fuel Management Services. The Agreement provides that the Energy Manager will manage all aspects of the Fuel supply for the GENCO Generating Facilities, including determinations regarding the type of Fuel used for operating the GENCO Generating Facilities and the source of such Fuel supply taking into account the purchase of alternate sources of Electricity in lieu of Electricity from the GENCO Generating Facilities when economic. LIPA agrees to compensate the Energy Manager for such Fuel management services, including a Fuel Purchase Performance Incentive/ Disincentive Payment, in accordance with the terms of the Agreement (see “Fuel

Management—Fuel Purchase Performance Incentives/Disincentive Payments” below). The Energy Manager will not contract for additional firm assets specifically for use in the GENCO Generating Facilities unless LIPA and the Energy Manager agree to the contract.

Fuel Management Compensation. During the term of the Agreement, LIPA will make monthly payments to the Energy Manager consisting of an amount equal to the sum of: (i) the Monthly Fuel Management Fee, plus (ii) the Monthly Fuel Payment, plus or minus (iii) the Fuel Purchase Performance Incentive/Disincentive.

Fuel Management Fee. The Energy Manager will be paid an annual Fuel Management Fee in consideration for the Energy Manager’s performance of the Fuel Services contemplated in the Agreement. The Agreement provides that the cost-related component of the initial Fuel Management Fee, once established and approved by LIPA, will be indexed in the same manner as the Direct Cost Budget under the Management Services Agreement until the termination of the Management Services Agreement and thereafter will be subject to mutually agreeable adjustments. LIPA is obligated to pay the Fuel Management Fee to the Energy Manager in twelve equal monthly installments.

Monthly Fuel Payment. LIPA will, in accordance with the provisions discussed below at “Fuel Management—Payment,” pay the total monthly cost of all Fuel for use in the GENCO Generating Facilities that are under contract to LIPA pursuant to the Power Supply Agreement, including but not limited to any current or future fuel related taxes or other fuel related fees or costs reasonably incurred by the Energy Manager. This cost will be based upon (a) the actual variable cost of gas delivered to the delivery points for such fuel plus (i) any incremental Firm Gas Supply costs which are incurred based on use of Firm Gas Supplies in the operation of the GENCO Generating Facilities, (ii) any costs the Energy Manager incurs based on non-use of gas it has otherwise contracted to purchase for use in the operation of the GENCO Generating Facilities, and (iii) the Local Transportation Charge and (b) the delivered cost of oil for use in GENCO’s Generating Facilities.

Fuel Purchase Performance Incentives/Disincentive Payments. The Energy Manager will receive a Fuel Purchase Performance Incentive/Disincentive Payment, which will be calculated at the end of each month, with the results reflected in the following month’s invoice. The total Fuel Purchase Performance Incentive/Disincentive Payment will not exceed \$5.0 million on an annual basis.

Payment. The Energy Manager will submit monthly invoices to LIPA for the Monthly Fuel Management Fee and the Fuel Purchase Performance Incentive/Disincentive Payment by the tenth (10th) Business Day following the month of service, consistent with the provisions in this description of “Fuel Management.” Payment of all invoiced amounts will be due and payable by LIPA within fifteen (15) Business Days of LIPA receiving such invoices.

Minimization of Costs. In providing the Fuel, Energy Manager shall use best efforts to minimize Fuel costs for the GENCO Generating Facilities, such efforts being consistent with (i) all applicable insurance policies, (ii) all applicable prudent industry practices and standards, including Prudent Utility Practice, (iii) all applicable operating and contract constraints for Fuel delivery, (iv) Energy Manager’s collective bargaining agreements and (v) Applicable Law.

Off-System Sales

The Agreement provides that the Energy Manager will use best efforts to market to Off-System Sales customers, on LIPA’s behalf, Electricity from the System Power Supply that is not

otherwise needed by the Electricity Customers in a manner which will reduce the net cost of Electricity provided to the Electricity Customers. The Energy Manager will receive 33 percent of the revenue net of incremental costs from Off-System Sales of Electricity from the System Power Supply and LIPA will receive 67 percent of the revenue net of incremental costs from these Off-System Sales of Electricity from the System Power Supply. The incremental costs for such Off-System Sales will be based upon the incremental cost of energy for such Electricity sales including any other costs or charges (including applicable taxes) incurred to produce and deliver the Electricity and/or Ancillary Services for sale by the Energy Manager. The incremental costs associated with capacity sales will include the cost of replacement capacity incurred as a result of the sale, if any, and any other costs or charges related to the sale, including startup, no-load operation, transmission, and applicable taxes.

Notwithstanding any of the above, the Energy Manager will only attempt to sell excess Electricity to the extent that, in GENCO's judgment, such Electricity sales do not jeopardize any of GENCO's tax-exempt debt and to the extent that, in LIPA's judgment, such Electricity sales do not jeopardize the tax-exempt status of any of the Authority's debt. Each party will furnish the other an appropriately detailed description of the constraints imposed on such sales and will update such description from time to time to reflect any applicable changes in law or regulation.

System Power Supply Management

Lowest Cost Electricity. In connection with the purchase and management of the System Power Supply, on LIPA's behalf, the Energy Manager is obligated to use best efforts to provide the lowest cost Electricity to the T&D System and the Electricity Customers, given (i) the transmission and distribution limitations unique and/or external to the T&D System; (ii) the terms of the Existing Power Supply Agreements; (iii) availability of power through the New York Power Pool or its successor; (iv) regulatory and reliability council requirements, including, but not limited to system safety and reliability; and (v) System Policies and Procedures, including environmental policies contained therein.

Specific Energy Manager Responsibilities. In implementing its System Power Supply responsibilities, the Energy Manager will, subject to the transmission, contractual and reliability constraints referred to in the preceding paragraph:

- (i) schedule deliveries of and Dispatch energy from the System Power Supply;
- (ii) arrange for LIPA's purchase of Electricity to the extent the System Power Supply is insufficient to meet the requirements of the T&D System;
- (iii) continually monitor the market for LIPA's sale and purchase of wholesale Electricity and purchase Electricity, on LIPA's behalf, on the wholesale market to displace System Power Supply if such purchases, including the cost of transmission services to deliver such Electricity, will reduce total power supply costs;
- (iv) sell Electricity on LIPA's behalf from the System Power Supply that is surplus to the requirements of the T&D System whenever such sales, including consideration of any incremental cost of Transmission for delivery of such sales, are advantageous to LIPA;
- (v) arrange for such additional transmission services and capacity as will be necessary for the purchase or sale of Electricity by LIPA; and

(vi) with the prior written consent of LIPA, subcontract with power marketers or brokers, or similar entities, to assist in the acquisition of Electricity and the marketing and sale of excess Electricity.

All contracts for the purchase or sale of Electricity will be entered into by LIPA or by the Energy Manager as agent for LIPA. The Agreement provides that no contract for the purchase or sale of Electricity for a term in excess of three months will be entered into without the prior written consent of LIPA.

System Power Supply Management Compensation. Except as otherwise provided in the Agreement, the payments LIPA will make to the Energy Manager pursuant to the Agreement with respect to System Power Supply Services other than Off-System Sales will be calculated as set forth in the Agreement and as summarized below. During the term of the Agreement, LIPA will make monthly payments to the Energy Manager consisting of an amount equal to the sum of: (i) the System Power Supply Management Fee, plus or minus (ii) the System Power Supply Performance Incentive/Disincentive.

System Power Supply Management Fee. The Energy Manager will be paid an annual System Power Supply Management Fee, in consideration for the Energy Manager's performance of the System Power Supply management services contemplated in the Agreement. The amount of such System Power Supply Management Fee includes a fee of \$750,000 and an allowance for certain costs which, for 1998, has been established at \$868,000. Such allowance for costs will be indexed during the term of the Agreement in the same manner as the Direct Cost Budget under the Management Services Agreement. LIPA will pay the System Power Supply Management Fee to the Energy Manager in twelve equal monthly installments.

System Power Supply Performance Incentives/Disincentive. The Energy Manager will receive a System Power Supply Performance Incentive/Disincentive, calculated in accordance with the Agreement which will not exceed \$2 million on an annual basis.

Payment. The Energy Manager will submit monthly invoices to LIPA for the Monthly System Power Supply Management Fee and the System Power Supply Performance Incentive/Disincentive Payments and Off-System Sales compensation by the tenth (10th) Business Day following the month of service. Such invoices will show separately amounts payable with respect to Off System Sales and System Power Supply Management. Payment of all invoiced amounts will be due and payable by LIPA within fifteen (15) Business Days of LIPA receiving such invoices.

Records; Information

Account Records; Collection of Monies; Availability of Energy Manager

Account Records. The Energy Manager is obligated to maintain such records as LIPA reasonably requests setting forth in accurate and reasonable detail the information relating to the purchase and sale of Fuel and Electricity under the Agreement requested by LIPA.

Collection of Monies. The Energy Manager will use best efforts to collect on a timely basis (1) all amounts due LIPA for Off-System Sales, and (2) any other monies owed to LIPA in connection with System Power Supply and other matters within the purview of the Energy Manager. The Energy Manager will provide current and historical billing information concerning Fuel and System Power Supply to LIPA monthly in such form as reasonably requested by LIPA. All such monies collected by the Energy Manager or any Subcontractor thereto will be the property of

LIPA and will be deposited by the Energy Manager daily into such accounts and in the manner as LIPA may from time to time designate. The Energy Manager is unconditionally and absolutely obligated to pay or deposit such moneys as directed by LIPA.

Compliance with Applicable Law. The Energy Manager is obligated to perform all of its obligations under the Agreement in accordance with Applicable Law.

Information. The Agreement requires the Energy Manager to establish and maintain an information system to provide storage and real time retrieval for LIPA review and copying of operating data relating to (i) cost and quantities of Fuel Supply and Power Purchases, (ii) revenues from and quantities of Off-System Sales and (iii) the performance by the Energy Manager of its obligations under the Agreement, including, but not limited to, all information necessary to verify calculations made pursuant to the Agreement.

Books and Records. The Energy Manager will prepare and maintain proper, accurate and complete books, records and accounts regarding Fuel and System Power Supply to the extent necessary (1) to enable LIPA to prepare LIPA's financial statements in accordance with generally accepted accounting principles, (2) to verify data with respect to any operations or transactions in which LIPA has a financial or other material interest under the Agreement, (3) to prepare periodic performance reports and statements relating to purchase of Fuel and System Power Supply, which will be submitted by the Energy Manager to LIPA and (4) to enable LIPA to administer any fuel adjustment clause or similar provision applicable to Electricity sales. The Energy Manager will, upon notice and demand from LIPA, produce for examination and copying by representatives of LIPA, any documents showing all acts and transactions relating to the Agreement, any Subcontract or any transactions in which LIPA has or may have a financial or other material interest under the Agreement, and will produce such operation books and records for examination and copying in connection with the costs for which LIPA may be responsible under the Agreement.

Fiscal Affairs, Accounting and Record Keeping

General. The Energy Manager will maintain possession of equipment, materials and supplies, maps, plans and specifications, and Fuel and System Power Supply billing records during the term of the Agreement and will duly account to LIPA for such items.

Bank Deposits. All cash held by the Energy Manager for the account of LIPA and all cash collected by the Energy Manager for the account of LIPA after the LIPA/LILCO Merger Closing Date will be deposited on each Business Day in bank accounts in such bank or banks as LIPA may direct and upon such terms and conditions as may be specified by LIPA.

Bill Payments. The Energy Manager will timely pay all bills related to Fuel which are proper and appropriate and which it has authority to pay and will assure that, to the extent within the Energy Manager's control, no liens are filed against any portion of the assets or revenues of LIPA.

Allocation of Risk of Certain Costs and Liabilities

The Agreement contains provisions relating to the allocation of risks and liabilities that are substantially the same as the provisions of the Management Services Agreement described herein under the caption "Summary of Certain Provisions of the Management Services Agreement— Compensation and Budgets—Allocation of Risks of Certain Costs and Liabilities."

Term; Events of Default

Term. The term of the Agreement commenced on May 28, 1998 and, except as otherwise provided, will remain in full force and effect for an initial term of (i) fifteen (15) years from such date with respect to the Fuel Services and (ii) eight (8) years from such date with respect to System Power Supply Services. The Authority and KeySpan have entered into an agreement to extend the term of the System Power Supply Services until December 31, 2006 and thereafter on a month-to-month basis subject to termination by the Authority on sixty days notice, but in no event later than December 31, 2007.

Events of Default; Procedures for Termination

The Agreement contains provisions relating to Events of Default by the Energy Manager or LIPA and the procedures for termination that are substantially the same as the provisions of the Management Services Agreement that are described herein under the caption "Summary of Certain Provisions of the Management Services Agreement—Compensation and Budget—Events of Default by the Manager—Events of Default by LIPA" and "—Procedure for Termination for Cause."

LIPA Emergency Assumption of Fuel and System Power Supply Management Services. Should the Energy Manager, due to Uncontrollable Circumstances or any other reason whatsoever, fail, refuse or be unable to provide any or all Fuel and System Power Supply Services contemplated hereby and LIPA or any Governmental Body finds that such failure endangers or menaces the public health, safety or welfare, then, in any of those events and to the extent of such failure, LIPA will have the right, upon notice to the Energy Manager, during the period of such emergency, to perform the services which the Energy Manager would otherwise be obligated to perform under the Agreement. The Energy Manager agrees that in such event it will fully cooperate with LIPA to effect such a temporary assumption. The Energy Manager agrees that, in such event, LIPA may take and use any or all of the operating assets of the Energy Manager necessary for the above-mentioned purposes without paying the Energy Manager or any other person any additional charges or compensation whatsoever for such possession and use; provided, however, that if such emergency is due to Uncontrollable Circumstances, LIPA will reimburse the Energy Manager for its Cost-Substantiated costs incurred due to such a transfer of the operating assets.

Energy Manager's Reporting Requirements

Monthly Reports. The Energy Manager is obligated to provide LIPA and the Consulting Engineer with monthly reports no later than 20 days after the end of each month, including such data relating to the Fuel Services and System Power Supply Services as may reasonably be requested to be furnished by LIPA.

Annual Reports. The Energy Manager will furnish LIPA and, the Consulting Engineer, within 60 days after the end of each Contract Year, an Annual Settlement Statement together with annual summary of the statistical data provided in the monthly reports, certified by the Energy Manager, as well as such other data relating to the services provided under the Agreement as may be reasonably requested to be furnished by LIPA.

Fuel Consumption Reports. Fifteen (15) Business Days following the end of each month, Energy Manager is obligated to submit to LIPA a report summarizing the Fuel burned during that month and such other information as the parties may mutually agree.

Indemnification

The Agreement contains redemmnification provisions that are substantially the same as the indemnification provisions of the Management Services Agreement that are described herein under the caption “Summary of Certain Provisions of the Management Services Agreement—Miscellaneous Provisions—Indemnification.”

Miscellaneous Provisions

Insurance. The Agreement provides that Energy Manager shall maintain with financially responsible insurance companies insurance in such amounts and against such risks and losses as are customary for companies engaged in the business of providing services or undertaking activities similar to the Fuel Services and System Power Supply Services to be provided thereunder.

Assignment and Transfer. Agreement contains provisions relating to assignment and transfer that are substantially the same as the assignment and transfer provisions of the Management Services Agreement that are described herein under the caption “Summary of Certain Provisions of the Management Services Agreement—Miscellaneous Provisions—Assignment and Transfer.”

Non-Binding Mediation; Arbitration. The Agreement contains provisions relating to mediation and arbitration that are substantially the same as the mediation and arbitration provisions of the Management Services Agreement that are described herein under the caption “Summary of Certain Provisions of the Management Services Agreement—Compensation and Budget—Non-Binding Mediation; Arbitration.”

Affiliate. Pursuant to the Agreement, the Energy Manager has agreed to remain an Affiliate of the Guarantor.

Credit Enhancement in Certain Circumstances. The Agreement contains provisions relating to credit enhancement that are substantially the same as the credit enhancement provisions of the Management Services Agreement that are described herein under the caption “Summary of Certain Provisions of the Management Services Agreement—Miscellaneous Provisions—Credit Enhancement in Certain Circumstances.”

Hedging Policies. The Energy Manager agreed not engage in any hedging activities relating to the Fuel Services or System Power Supply Services without express approval from the Boards of Directors of the Energy Manager and its Parent and without notifying and consulting with LIPA at least 60 days prior to implementing such activities. The Agreement provides that in the event that approval for the use of hedging activities is implemented, the incentive/disincentive program will be reexamined by the parties to determine the appropriateness of the inclusion or exclusion of the related costs, gain or losses and appropriate mutually agreeable revisions thereto will be made.